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BACKGROUNDER

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Improving Entrepreneurs' Access to Capital: Vital for Economic Growth

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Abstract

Capital formation improves economic growth, boosts productivity, and increases real wages. So does entrepreneurship—which also fosters discovery and innovation. Entrepreneurs engage in the creative destruction of existing technologies, economic institutions, and business production or management techniques by replacing them with new and better ones. Entrepreneurs bear a high degree of uncertainty and are the source of much of the dynamism in the U.S. economy. New, start-up businesses account for most of the net job creation. Entrepreneurs innovate, providing consumers with new or better products. By providing other businesses with innovative, lower-cost production methods, entrepreneurship is one of the key factors in productivity improvement and real income growth. To promote prosperity, Congress and the Securities and Exchange Commission need to systematically reduce or eliminate state and federal regulatory barriers hindering entrepreneurs' access to capital. Due to the many regulatory provisions blocking entrepreneurs' access to capital, a large number of policy changes are warranted.

Capital formation improves economic growth, boosts productivity, and increases real wages.[1] So does entrepreneurship.[2] It also fosters discovery and innovation.[3] Entrepreneurs engage in the creative destruction of existing technologies, economic institutions, and business production or management techniques by replacing them with new and better ones.[4] Entrepreneurs bear a high degree of uncertainty and are the source of much of the dynamism in the U.S. economy.[5] New, start-up businesses account for most of the net job creation.[6] Entrepreneurs innovate, providing consumers with new or better products. By providing other businesses with

Key Points

- Capital formation and entrepreneurship improve economic growth, productivity, and real wages. Existing securities laws impede entrepreneurial capital formation.
- To promote prosperity, Congress and the Securities and Exchange Commission need to systematically reduce or eliminate state and federal regulatory barriers hindering entrepreneurs' access to capital.
- The regulatory environment needs to be improved for primary and secondary offerings by private and small public companies. Steps should also be taken to improve small firms' access to credit and to reduce the regulatory burden on small broker-dealers.
- Due to the many regulatory provisions blocking entrepreneurs' access to capital, a large number of policy changes are warranted.
- Entrepreneurs are central to the dynamism, creativity, and flexibility that enable market economies to grow, adapt successfully to changing circumstances, and create sustained prosperity.

This paper, in its entirety, can be found at **http://report.heritage.org/bg3182**

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innovative, lower-cost production methods, entrepreneurship is one of the key factors in productivity improvement and real income growth.[7] Entrepreneurs are central to the dynamism, creativity, and flexibility that enable market economies to grow, adapt successfully to changing circumstances, and create sustained prosperity.[8]

Securities Laws: Major Impediment to Entrepreneurial Capital Formation

The evidence indicates that entrepreneurship in the U.S. is in decline.[9] While there are many causes of that decline,[10] securities laws and regulations are major barriers to entrepreneurial success because they impede entrepreneurs' access to capital. Businesses that cannot raise capital cannot launch or grow.

Current securities laws and regulations:

- **Harm investors** by reducing the return on their investment and by limiting their investment choices;
- **Harm entrepreneurs** by impeding their ability to raise the capital needed to launch and to grow their enterprises;
- **Harm consumers** by reducing competition from new entrants to the marketplace, by preventing entrepreneurs from developing and bringing to market new and better products and services, and by preventing entrepreneurs from developing and bringing to market new and better production processes that will reduce costs;
- **Harm workers** by harming the firms that account for most of the net job creation and much of the dynamism in the economy; and
- **Harm taxpayers**, as the securities laws and regulations have a macro-economically significant adverse impact on economic growth and reduce the tax base, forcing tax rates to be higher than they would otherwise be.

At least five groups notably benefit from current securities laws and regulations. These groups usually support the current complex, expensive, and economically destructive system or support only minor incremental reforms:

- **Regulators** support complexity because it augments their budgets, salaries, and power and improves their employment opportunities upon leaving government;
- **Incumbent firms** benefit from reduced competition and, unlike entrepreneurial new entrants to the marketplace, they usually have the resources and expertise to comply with needlessly complex laws and regulations;
- **Large broker-dealers and other regulated financial professionals** benefit from reduced competition, from the barrier to entry caused by needlessly complex and expensive laws and regulations, and from legal provisions that de facto or de jure force issuers or investors to use broker-dealers;
- **The securities bar** has a strong interest in complexity because it generates large legal fees; and
- **The accounting profession** benefits from fees generated by securities laws that require internal control reporting and audits, and from needlessly complex financial accounting and laws that require the generation and reporting of information that is, at best, peripherally related to the needs of investors.

Securities regulation reform is needed to remove these obstacles to economic growth and prosperity.

How Entrepreneurs Raise Capital. Sometimes, an entrepreneur has sufficient capital to launch and grow his or her business from personal savings, including profits from previous entrepreneurial ventures and retained earnings.[11] Banks usually will not make unsecured loans to risky, start-up, or young firms. Thus, an entrepreneurial firm will often need capital from outside investors.[12] Other than friends or family, outside investors are typically described as "angel investors" or "venture capitalists."[13] Typically, angel investors are individuals who invest at the early "seed stage," while "venture capitalists" are firms or funds that make investments later in the firms' life cycle after "proof of concept." Firms seeking outside investors are often the most dynamic, high-growth companies.[14] The process of raising capital from investors is heavily regulated at both the state and federal level. State laws governing securities are known as blue sky laws.[15]

Which Securities Laws Matter to Entrepreneurs

The Securities Act of 1933[16] makes it generally illegal to sell securities unless the offering is registered with the Securities and Exchange Commission (SEC).[17] Making a registered offering (often called "going public") is a very expensive proposition and well beyond the means of most small and start-up companies. In addition, the costs of complying with continuing disclosure and other obligations of being a registered, public company are quite high.[18] The act, however, exempts various securities and transactions from this requirement. There are three longstanding exemptions and one new exemption from the requirement to register a securities offering with the SEC that, in principle, are of particular importance to entrepreneurs:

1. The "Intrastate Exemption." This exemption is important if the entrepreneur raises capital in only one state.[19] Some states have used this exemption to establish an intrastate crowdfunding exemption.[20] In the modern, mobile, interconnected U.S. economy, this exemption is of declining importance except to the smallest businesses.

2. The "Small-Issues Exemption." This exemption was meant to provide an exemption for small firms.[21] This exemption is implemented by Regulation A.[22] Although this exemption is important in principle, it has been, in practice, of virtually no value to small firms due to overregulation (primarily by state regulators). Until 2015 it was almost never used.[23] The 2012 Jumpstart Our Business Startups (JOBS) Act may change this. On April 20, 2015, the SEC adopted final rules[24] effective June 19, 2015, to implement Title IV of the JOBS Act.[25] The SEC's revisions to Regulation A, while a marked improvement over the previous version of Regulation A, are, nevertheless, cause for serious concern.[26] Given the rules that the SEC adopted, Tier 1 offerings will remain unattractive,[27] and Tier 2 offerings are unlikely to be as attractive as they should be.

3. The "Exemption for Private Offerings."[28] The primary means of implementing this exemption is Regulation D.[29] The SEC adopted Regulation D in 1982 during the Reagan Administration.[30] Although private offerings do not necessarily have to be in compliance with Regulation D, Regulation D provides a regulatory safe harbor such that if an issuer meets the requirements of Regulation D, the issuer will be treated as having made a private offering (often called a private placement). As discussed below, Regulation D investments are generally restricted to accredited investors, who are affluent individuals or institutions. The vast majority of Americans are effectively prohibited from investing in Regulation D securities.[31] Regulation D has become the most important means of raising capital in the United States, particularly for entrepreneurs.[32] According to SEC data, in 2014, registered (public) offerings accounted for \$1.35 trillion of new capital raised, compared to \$2.1 trillion raised in private offerings. Regulation D accounted for \$1.3 trillion (62 percent) of private offerings in 2014.[33]

The Three Rules of Regulation D. Rule 504[34] and Rule 505[35] were meant for use by small firms. Rule 504 allows firms to raise up to \$1 million annually.[36] Rule 505 allows firms to raise up to \$5 million annually.[37] In practice, 99 percent of capital raised using Regulation D is raised using Rule 506.[38] This is because Rule 506 offerings, in contrast to Rule 504 or Rule 505 offerings, are exempt from state blue sky registration and qualification requirements.[39] Issuers using Rule 506, therefore, do not have to bear the expense and endure the delay of dealing with as many as 52 regulators.[40] Thus, even though the federal regulatory burden is less under Rules 504 and 505 than under Rule 506, even small issuers use Rule 506 to avoid the burden of state blue sky laws. Overregulation by state regulators destroyed the usefulness of Rules 504 and 505, just as state blue sky laws effectively destroyed the usefulness of Regulation A.[41]

Under Rule 506, a company may raise an unlimited amount of money and sell securities to an unlimited number of "accredited investors," and up to 35 non-accredited but sophisticated investors. Under Regulation D, an "accredited investor" is, generally, either a financial institution or a natural person who has an income of more than \$200,000 (\$300,000 joint) or a residence-exclusive net worth of \$1 million or more.[42] Unlike under Rule 505, under Rule 506 all non-accredited investors, either alone or with a purchaser representative, must be "sophisticated." Rule 506 does not actually use the term "sophisticated."[43] "Sophisticated investor" is an almost universal shorthand for an investor who has "sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment"—the language actually used in Rule 506(b)(2)(ii). Given the ambiguity of this sophisticated investor definition and the fact that the price of failing to comply with Regulation D is that the entire offering may be treated as unlawful, the vast majority of issuers sell only to accredited investors. SEC data show that 90 percent of offerings involve only accredited investors and even those that are not exclusively composed of accredited investors are composed overwhelmingly of accredited investors.[44]

4. The "Crowdfunding Exemption" of the JOBS Act, discussed below, is the fourth exemption of importance to entrepreneurs.

Companies that issue securities that are not exempt or exceed various thresholds must register with the SEC. Registered companies (also called reporting or public companies) do not all have the same obligations. Companies with a public float of less than $75 million are deemed smaller reporting companies and have less onerous disclosure obligations and do not need to comply with the Sarbanes–Oxley Act Section 404(b) internal control reporting requirements.[45] Title I of the JOBS Act created a new concept of emerging growth companies (EGCs).[46] EGCs are excused for five years from complying with a number of onerous disclosure requirements and from Sarbanes–Oxley Act Section 404(b) internal control reporting requirements. Moreover, they may submit a confidential draft registration statement to the SEC for review.[47]

Securities Act section 4(a)(1) exempts "transactions by any person other than an issuer, underwriter, or dealer" from registration. Thus, the resale of restricted securities purchased by an investor in a private placement is permitted provided that certain requirements are adhered to so that the seller is not deemed an underwriter.[48] Rule 144[49] and Rule 144A[50] provide regulatory safe harbors. So-called section 4(a)(1-½)[51] is a body of case law (and practices and SEC guidance) that generally allows private resales, subject to restrictions, without the seller being deemed an underwriter, and therefore the seller is able to undertake such resales without registration.[52] A provision in the 2015 Fixing America's Surface Transportation (FAST) Act[53] provides a safe harbor meant to codify this exemption subject to a number of previously non-existent conditions.[54]

The Securities Exchange Act of 1934[55] established the SEC and sets forth the general rules governing securities exchanges and broker-dealers. It is often not possible as a practical matter for small public companies to be cost-effectively listed on national securities exchanges,[56] such as the New York Stock Exchange or NASDAQ.[57] Instead, they are more often traded on the over-the-counter (OTC) market. However, stocks traded off the national securities exchanges are subject to blue sky laws,[58] and secondary-market blue sky compliance is expensive and sometimes simply not possible.[59]

The Jumpstart Our Business Startups Act

The 2012 JOBS Act[60] was a bipartisan achievement of consequence.[61] It has improved the regulatory environment for entrepreneurial capital formation. The final SEC rules implementing the JOBS Act are, however, cause for serious concern and will limit its positive impact.[62]

The changes made by the JOBS Act fall into five categories. Those relating to:

1. Smaller public "emerging growth companies" (Title I);
2. General solicitation under Regulation D (Title II);
3. Crowdfunding (Title III);
4. An improved small-issues exemption (often called Regulation A+) (Title IV); and
5. Changes to the registration threshold allowing more companies to remain private (Titles V and VI).

Title I: Emerging Growth Companies. Title I of the JOBS Act—sometimes called the IPO on-ramp—created a new concept of EGCs.[63] Generally, a company qualifies as an EGC if it has total annual gross revenues of less than $1 billion during its most recently completed fiscal year and, as of December 8, 2011, had not sold common equity securities under a registration statement. For five years, EGCs are excused from complying with a number of onerous disclosure requirements and from Sarbanes–Oxley Act Section 404(b) internal control reporting requirements. Moreover, they may submit a confidential draft registration statement to the SEC for review[64] and communication with institutional accredited investors or qualified institutional buyers before or after the filing of the registration statement is permitted.[65]

Title II: General Solicitation and Title II Crowdfunding. Title II eliminated the prohibition against general solicitation or general advertising for Regulation D Rule 506 offerings, provided that all purchasers of the securities are accredited investors and that the issuer takes "reasonable steps to verify" that purchasers of the securities are accredited investors, using such methods as determined by the SEC.[66]

Title II also provided an exemption from broker-dealer registration for platforms that facilitate trading of Regulation D securities provided that the platforms meet certain requirements.[67] This provision is of limited value since the platforms are barred from taking any form of compensation in connection with the purchase or sale of securities via the platform.[68] Although platforms trading securities issued pursuant to Regulation D have grown rapidly since the passage of the JOBS Act, it is far from clear that this provision in the JOBS Act is the reason. Most are presumably relying on other exemptions (such as 4(a)(1-½) and the recently added Securities Act section 4(a)(7)).[69]

Title III: Crowdfunding. Title III establishes the framework for a new crowdfunding exemption. Issuers may offer up to $1 million in securities annually using this exemption. Investors may not invest in any Title III offering more than (1) the greater of $2,000 or 5 percent of the annual income or net worth of the investor if either the annual income or the net worth of the investor is less than $100,000,[70] or (2) 10 percent of the annual income or net worth of such investor if either the annual income or net worth of the investor is equal to or more than $100,000.[71] The total amount invested may not exceed $100,000.[72] The crowdfunding offering must be conducted through a broker-dealer or funding portal. Both the issuer and intermediary must comply with numerous requirements.

Title IV: Regulation A Plus. Title IV creates what has come to be known as Regulation A+. It added a new small-issues exemption under which issuers could raise up to $50 million in a public offering and sell unrestricted securities subject to such initial and continuing disclosure requirements as the SEC may determine.[73] The commission has issued a final rule that was effective June 19, 2015.[74] In that rule, the commission took the necessary and very positive step of pre-empting state blue sky registration and qualification requirements with respect to "Tier 2" Regulation A+ primary offerings.[75] It also conditionally exempted Regulation A companies from the requirements that they become a reporting company if they exceed the Securities Exchange Act section 12(g) holder-of-record threshold. Thus, Regulation A+ could become an important means of raising capital for larger small companies. However, the failure to pre-empt blue sky laws with respect to secondary sales of Regulation A+ Tier 2 securities and for all Tier 1 securities will substantially limit the usefulness of the exemption, particularly for smaller firms. Tier 1 is substantially similar to the old Regulation A and can be expected to prove as unpopular as the previous Regulation A.

Allowing More Firms to Remain Private or Quasi-Public. Titles V and VI increased the number of holders of record a firm can have before being required to register under section 12(g) of the Securities Exchange Act from 500 persons to 2,000 persons, or 500 non-accredited investors.[76] Title V also excluded from the count securities held by persons who received the securities pursuant to an employee compensation plan.[77]

Reform Needed to Reduce Regulatory Burden on Entrepreneurial Capital Formation

The list of securities-law provisions that impede small and start-up firms' ability to access the capital they need to launch and grow is long. Hence, the list of proposed reforms is accordingly long. The discussion of each item below is necessarily brief.

Regulation D Reform. In order to improve entrepreneurs' access to capital, Congress should:

- **Repair Regulation D by pre-empting blue sky registration and qualification requirements for Regulation D Rule 505 offerings** (originally meant for smaller firms).[78] This can be accomplished by defining Rule 505 securities as covered securities, or by defining "qualified purchaser" to include all purchasers of Rule 505 securities, or both.

- **Establish a statutory definition of "accredited investor" that maintains the existing thresholds.**[79] Regulation D is the most important means of entrepreneurial capital formation today. Congress should prevent the SEC from reducing the number of Americans who have the opportunity to invest in private companies.[80]

- **Stop the promulgation of Regulation D amendments proposed in July 2013.**[81] These proposed rules would substantially increase the regulatory burden on smaller companies seeking to use Regulation D, and have no appreciable positive impact.[82] They would require filing three forms instead of one, and would impose a variety of other burdensome requirements.[83]

- **Change the definition of "accredited investor" for purposes of Regulation D to include persons who have met specific statutory bright-line tests** that determine whether an investor has the "knowledge and experience in financial and business matters" to be "capable of evaluating the merits and risks of the prospective investment." In practice, sophisticated investors without high incomes or net worth are unable to invest in the companies with the most profit potential. People that fall in this category are disproportionately young. It also means that young entrepreneurs seeking to raise capital from their non-wealthy peers find it more difficult to raise capital. For example, Congress could provide that someone is an accredited investor for purposes of Regulation D who has (1) passed a test demonstrating the requisite knowledge, such as the General Securities Representative Examination (Series 7), the Securities Analysis Examination (Series 86), or the Uniform Investment Adviser Law Examination (Series 65),[84] or a newly created accredited investor exam; (2) met relevant educational requirements, such as an advanced degree in finance, accounting, business, or entrepreneurship; or (3) acquired relevant professional certification, accreditation, or licensure, such as being a certified public accountant, chartered financial analyst, certified financial planner, or registered investment advisor.[85]

- **Specify that the receipt by an issuer of a self-certification of accredited investor status constitutes taking "reasonable steps to verify that purchasers of the securities are accredited investors"** for purposes of the JOBS Act. Most people would probably be surprised to know that until September 23, 2013, it was illegal for an inventor or entrepreneur to place an advertisement in the newspaper or online seeking rich investors to back their idea. Title II of the JOBS Act changed that by permitting "general solicitation" in Rule 506 offerings, provided that issuers "take reasonable steps to verify that purchasers of securities sold" in the offering are all accredited investors.[86] This is one of the most important reforms made by the legislation. Small businesses can seek affluent investors using the Internet or otherwise without having a pre-existing relationship or going through broker-dealers. The SEC promulgated rules implementing these provisions, albeit more than a year after the legal deadline.[87] This provision (called Rule 506(c) after the relevant section in the regulation) is giving rise to new opportunities to raise capital. Some are now using the Internet or traditional media to seek accredited investors.

The rules implementing Title II of the JOBS Act, however, are too onerous.[88] They impose costs on issuers and investors, and raise privacy concerns that make investors reluctant to invest in Rule 506(c) offerings. The traditional and almost universal current practice in Regulation D offerings not involving general solicitation is to use investor-suitability questionnaires combined with investor self-certification to establish accredited investor status. Congress did not intend to dramatically undermine the laudable policy goals of the JOBS Act by changing this current long-standing practice with respect to verifying accredited investor status.[89]

The final rule creates a safe harbor that inevitably, in practice, will become the rule that "reasonable steps to verify" means obtaining tax returns or comprehensive financial data proving net worth. Many investors will be reluctant to provide such sensitive information to issuers with whom they have no relationship, as the price of making an investment and, given the potential liability, accountants, lawyers, and broker-dealers are unlikely to make certifications except perhaps for very large, lucrative clients.

Self-certification should continue to be allowed for all Rule 506 offerings, and obtaining an investor self-certification should be deemed to constitute taking "reasonable steps to verify that purchasers of the securities are accredited investors," as required by the JOBS Act. Should policymakers choose not to adopt this approach, it would be possible to remove many of the problems associated with the new SEC rule while still addressing unease that traditional self-certification is inadequate by requiring investors to make their self-certifications under penalty of perjury. This would make investors less willing to lie on their certifications to issuers.

Crowdfunding Reforms. The story of the investment crowdfunding exemption is an object lesson in how a simple, constructive idea can be twisted by the Washington legislative process into a complex morass. Representative Patrick McHenry (R–NC) introduced his Entrepreneur Access to Capital Act on September 14, 2011.[90] It was a mere three pages; less than one page, if the actual legislative language were pasted into a Word document. It would have allowed issuers to raise up to $5 million, and limited investors to making investments of the lesser of $10,000 or 10 percent of their annual income.[91] The exemption would have been self-effectuating, requiring no action by the SEC in order to be legally operative. The bill that was reported out of Committee and ultimately passed by the House was 14 pages long.[92] By the time the Senate was done with it, it had grown to 26 pages.[93] Many of the additions were authorizations for the SEC to promulgate rules or requirements that it do so. The bill was incorporated into the JOBS Act as Title III of the act. The PDF of the October 23, 2013, proposed crowdfunding rule is 585 pages (although double spaced) and sought public comments on well over 300 issues raised by the proposed rule.[94] The PDF of the final rule was 685 pages long.[95] This is far from the simple, straight-forward means of raising capital for small businesses laid out in Representative McHenry's original bill.[96]

University of Florida law professor Stuart Cohn put it this way:

> Is there any regulatory burden left unchecked by this supposedly favorable-to-small-business legislation? If so, Congress put icing on the cake by authorizing the SEC to make such other requirements as the Commission prescribes for the protection of investors.... Opportunity knocked, but what began as a relatively straightforward approach to assist small business capital-formation ended with a regulatory scheme laden with limitations, restrictions, obligations, transaction costs and innumerable liability concerns.[97]

The primary advantages of crowdfunding are that it enables small firms to access small investments from the broader public (that is, from non-accredited investors), and that resale of the stock will not be restricted after one year.[98] In addition, crowdfunding shareholders are excluded from the count for purposes of the section 12(g) limitation relating to when a company must become a reporting company[99] and crowdfunding securities are treated as covered securities (that is, blue sky registration and qualification laws are pre-empted for crowdfunding offerings).[100] If, however, the regulatory costs associated with crowdfunding are too high, issuers will either use other means to raise capital or be unable to raise capital at all. Moreover, ordinary investors will be denied the opportunity to make these investments. This is no idle possibility. The history of the small-issues exemption (Regulation A), and Regulation D Rule 504 and Rule 505, demonstrates that overregulation can destroy the usefulness of an exemption.[101]

Given the structure of the underlying statute and the proposed rule, there is strong reason to doubt whether Title III crowdfunding will achieve the promise of the original idea.[102] Following are core solutions to some of the Title III problems that Congress should undertake:

- **Increase the amount that can be raised using Title III to $5 million.** In order for crowdfunding to be an attractive option for all but the very smallest start-ups, the amount that can be raised using Title III should be increased.[103]

- **Make it clear that funding portals are not liable for the misstatements of issuers.** The SEC final rule treats funding portals as issuers, turning the funding portals into insurers of issuers against fraud by issuers that use their funding portal. This dramatically increases the risk that funding portals face and makes funding portals a much less viable alternative to a broker-dealer. Funding portals are intermediaries not issuers. Funding portals should only be liable for fraud or misrepresentation if they participated in the fraud or were negligent in discharging their due diligence obligations.[104]

- **Repeal the requirement that crowdfunding issuers raising $500,000 or more provide audited financial statements.**[105] Except for start-up firms with no operating history, audits are expensive. There are many other exemptions, usually used by much larger firms, which do not have this requirement.

- **Repeal restrictions on curation by funding portals.**[106] Funding portals are prohibited from offering "investment advice or recommendations."[107] Moreover, funding portals are required to "take such measures to reduce the risk of fraud with respect to such transactions, as established by the Commission, by rule."[108] How, exactly, the portals are to reduce the risk of fraud and limit their own liability without adopting a position on the merit or lack thereof of any potential offerings is a congressionally created mystery that the SEC attempts to solve in its final rule.[109]

  Assuming that policymakers want to retain the prohibition on personalized "investment advice," a potential solution to the existing statutory cross purposes would be to allow funding portals to provide "impersonal investment advice" as defined in Advisers Act Rule 203A,[110] to wit, "investment advisory services provided by means of written material or oral statements that do not purport to meet the objectives or needs of specific individuals or accounts." Applying the distinction between "impersonal" and "personalized" investment advice in the funding portal context would permit responsible curation where a funding portal chose to exclude certain offerings from its platform but did not suggest specific investments. Congress should either repeal the restriction on providing investment advice entirely or explicitly permit "impersonal investment advice." It should also be clear that a portal may bar an issuer from its platform if the portal deems an offering to be of inadequate quality without fear of liability to issuers or investors, and that this would not constitute providing prohibited investment advice.

- **Substantially reduce the complex initial and ongoing mandatory disclosure requirements on crowdfunding issuers.** The disclosure requirements in the final rule are voluminous. There are 25 specific disclosure requirements—(a) through (y)—most of which have multipart requirements.[111] The statute is less demanding with 12 specific requirements.[112] Companies that raise money via crowdfunding have significant ongoing-disclosure requirements as well. In furtherance of the one-sentence statutory continuing reporting requirement,[113] the final rule requires continuing reporting with respect to 12 multipart matters.[114] The bottom line is that these requirements are nearly as burdensome as those found in Regulation A and constitute a large fraction of the burden imposed on smaller reporting companies. Crowdfunding companies are the smallest issuers, and it is inappropriate to impose this level of burden on the smallest companies. A better-scaled disclosure regime is needed.

- **Clarify that funding portals are not subject to the anti-money laundering, "Know Your Customer" and associated Bank Secrecy Act requirements.**[115] Funding portals do not handle customer funds; the JOBS Act prohibits them from doing so.[116] The banks and broker-dealers that do handle customer funds must comply with these rules. Requiring funding portals to also do so is duplicative and unnecessary. The Treasury's Financial Crimes Enforcement Network (FinCEN) has proposed rules that would require funding portals to comply with these rules.[117] The Financial Industry Regulatory Authority (FINRA) and the SEC both originally proposed requiring funding portals to comply with the anti-money-laundering rules but did not include the requirement in their final rules.[118]

Overall, Congress may want to simply start over using Representative McHenry's original bill as the template.

Reform Regulation A. Congress should take a number of steps to make the small-issue exemption a better means for small firms to raise capital:

- **Pre-empt state blue sky registration and qualification requirements for all primary Regulation A offerings** (as it has done for Rule 506 and crowdfunding offerings).[119] State antifraud laws should remain fully operative.

- **Codify the exemption from the section 12(g) holder-of-record limitations for Regulation A securities** (as was necessarily done for crowdfunding).

- **Specify a limited scaled disclosure regime for Regulation A offerings.**[120] In particular, Tier 1 Regulation A offerings must have reasonable requirements for offering statements and periodic disclosure. These provisions should be self-effectuating without having to wait for the promulgation of SEC regulations. The current Tier 2 requirements, which are the "price" of blue sky exemption for primary offerings, are similar to the burden imposed on smaller reporting companies and not feasible for most companies raising only a few million dollars.

- **Make clear that investor limitations restricting the amount that investors may invest in Regulation A offerings (added by the SEC in its proposed and final rule) to no more than 10 percent of income or net worth are not permitted.** This rule, while not objectively unreasonable for most people, is unreasonable for certain entrepreneurs and, more important, it establishes the precedent of the SEC regulating the content of investor-portfolio composition.

- **Pre-empt blue sky laws with respect to secondary sales of Regulation A securities (along with securities of reporting companies trading on OTC markets).** This will make these securities more liquid and attractive, helping investors to achieve a higher price at a lower cost and helping issuers raise capital, since these securities will be more attractive to investors.[121]

Statutory Private Placement Micro Issues Safe Harbor. Section 4(a)(2) of the Securities Act exempts "transactions by an issuer not involving any public offering." There is no definition of a public offering or, conversely, of what is not a public offering (that is, a private placement) in the Securities Act or, for that matter, in the securities regulations. Thus, in principle, a few guys forming a small little business (such as a local restaurant) who are a little too public in seeking investors (for example, telling a local reporter about their plans when they run into him at the local high school football game, or standing up at the local Rotary Club meeting seeking partners) can run afoul of the securities laws.[122]

Nevertheless, in this hyper-litigious country, and given the potentially catastrophic impact that unjust enforcement of the law would entail, it is appropriate to create a bright-line safe harbor for very small offerings. If you are raising a small amount of money from a few people most of whom you know already, you should not have to hire a securities lawyer, do a private placement offering memorandum, and file a Form D or otherwise risk being pursued by federal or state regulators, or more likely, being successfully sued by disgruntled investors if the business fails or does not have the hoped for returns.

Congress should amend the Securities Act to create a safe harbor so that any offering (within a 12-month period),

1. to people with whom the issuer (or its officers, directors, or 10 percent or more shareholders) has a substantial pre-existing relationship;

2. involving 35 or fewer other persons; or

3. of less than $500,000,

is deemed not to involve a public offering for purposes of section 4(a)(2).[123] The anti-fraud provisions of federal and state laws would remain fully applicable.

Finders, Business Brokers, and Small Broker-Dealers

A finder is a person who is paid to assist small businesses to find capital by making introductions to investors, either as an ancillary activity to some other business (such as the practice of law, public accounting, or insurance brokerage), as a Main Street business colleague, or as an acquaintance or friend or family member of the business owner.[124] Finders are sometimes called private placement brokers.[125] They are typically paid a small percentage of the amount of capital they helped the business owner to raise. Business brokers (also called M&A brokers)[126] help entrepreneurs to sell or acquire businesses for a fee. They are typically paid a percentage of the sales price of the businesses. Neither finders nor business brokers should be treated the same for regulatory purposes as a Wall Street investment bank.[127]

Congress should create a statutory exemption needed for small-business finders who are not "engaged in the business" of "effecting transactions in securities for the account of others"[128] or of "buying and selling securities."[129] As an integral component of that exemption, it is necessary to create a bright-line "small finder" safe harbor such that small finders are deemed not to be engaged in the business of being a securities broker or dealer. Such a bright-line safe harbor would eliminate much of the regulatory uncertainty associated with the use of finders.

Specifically, an exemption should be created for finders from the Section 15 registration requirement providing a safe harbor such that a finder is deemed not to be engaged in the business of effecting transactions in securities for the account of others if the finder meets one or more of the following criteria:

1. The finder does not receive finder's fees exceeding $300,000 in any year,
2. The finder does not assist an issuer in raising more than $10 million in any year,
3. The finder does not assist any combination of issuers in raising more than $20 million in any year, or
4. The finder does not assist any combination of issuers with respect to more than 15 transactions in any year.

For those "larger" finders (those who do not meet the above criteria), which really are holding themselves out as in the business of being a "private placement broker," something more akin to the American Bar Association proposal to have finder registration and limited regulation of private placement brokers may make sense.[130] Some states have pursued this approach, but so long as the SEC holds to its current position, these licensing regimes will be of limited utility (except in the case of intrastate offerings).[131]

It would be reasonable to prohibit finders from engaging in certain activities to be eligible for this exemption on the grounds that such activities would constitute crossing the line to effecting transactions in securities or providing investment advice (thus triggered investment advisory registration requirements). Among those activities that would be proscribed would be:

1. Holding investor funds or securities,
2. Recommending the purchase of specific securities,[132] and
3. Participating materially in negotiations between the issuer and investors.

Small Broker-Dealers. Congress should amend the law to pre-empt state regulation of broker-dealers except with respect to sales practices and fraud. Small broker-dealers are an important part of the small-firm capital-formation process, particularly for those firms seeking to move beyond the friends-and-family stage of raising capital. Requiring small broker-dealers to comply with 51 state securities laws[133] governing broker-dealers raises their costs and is a barrier to entry that reduces competition. It places large broker-dealers at a competitive advantage. All broker-dealers are already regulated by the SEC and FINRA.

Other Reforms

S Corporations. In 2012, 4.2 million S corporations with 9.2 million shareholders filed tax returns.[134] Almost all of these businesses are small businesses. S corporations are subject to three restrictions. They may not have (1) more than one class of stock; (2) non-resident alien shareholders; or (3) more than 100 shareholders.[135] The third restriction limiting the total number of shareholders to no more than 100 is extremely problematic for S corporations that hope to take advantage of either Regulation A+ or crowdfunding. Both of these exemptions contemplate issuers raising relatively small amounts of capital from a large number of investors. An S corporation will be unable, as a practical matter, to make use of these exemptions to raise capital without endangering its pass-through tax status.[136]

Congress should amend the Internal Revenue Code so that Title III crowdfunding and Regulation A investors are disregarded for purposes of determining whether an S corporation has more than 100 shareholders.[137]

Secondary-Markets Reform. When an equity or debt interest in a company is issued or sold by that company, it is called a primary securities offering. A secondary securities offering is when an investor who owns a security sells it to another investor, and a secondary securities market is a market where investors trade securities among themselves. Stock exchanges are the leading example of secondary markets. However, a secondary market exists in securities not listed on stock exchanges.

Robust secondary markets are important because their existence facilitates primary securities offerings, because they enhance investor returns, and because they foster a more efficient allocation of scarce capital. The secondary market for large public companies is robust; the secondary market for smaller firms is much less so. The primary reason for this is the U.S. regulatory regime, particularly blue sky laws.

U.S. law should allow the development of venture exchanges[138] similar to the Canadian TSX Venture Exchange[139] and the United Kingdom's Alternative Investment Market,[140] so that a robust secondary market for the securities of smaller companies can develop. The most important step that can improve U.S. secondary markets is to reduce the burdens imposed by blue sky laws. In some cases, it is simply impossible to achieve blue sky compliance.[141] This means that companies not traded on a national securities exchange,[142] and therefore not having their securities treated as covered securities exempt from blue sky compliance, have serious regulatory difficulties in secondary markets. In order to improve small-firm secondary markets, Congress should:

- **Amend section 18(b) of the Securities Act to treat all securities as covered securities that (1) are traded on established securities markets and (2) have continuing reporting obligations** as (a) a registered company; (b) pursuant to Regulation A; or (c) pursuant to regulation crowdfunding. An established securities market should be defined to include those on electronic markets such as an SEC-designated alternative trading system (ATS).[143] This would probably be sufficient to allow venture exchanges to develop in the United States without having to adopt an alternative, separate regulatory framework for venture exchanges.

- **Establish an alternative regulatory regime for venture exchanges** that would treat venture exchanges as national securities exchanges for purposes of blue sky pre-emption, but more like ATSs for regulatory purposes.[144] The Main Street Growth Act[145] would create venture exchanges along these lines.

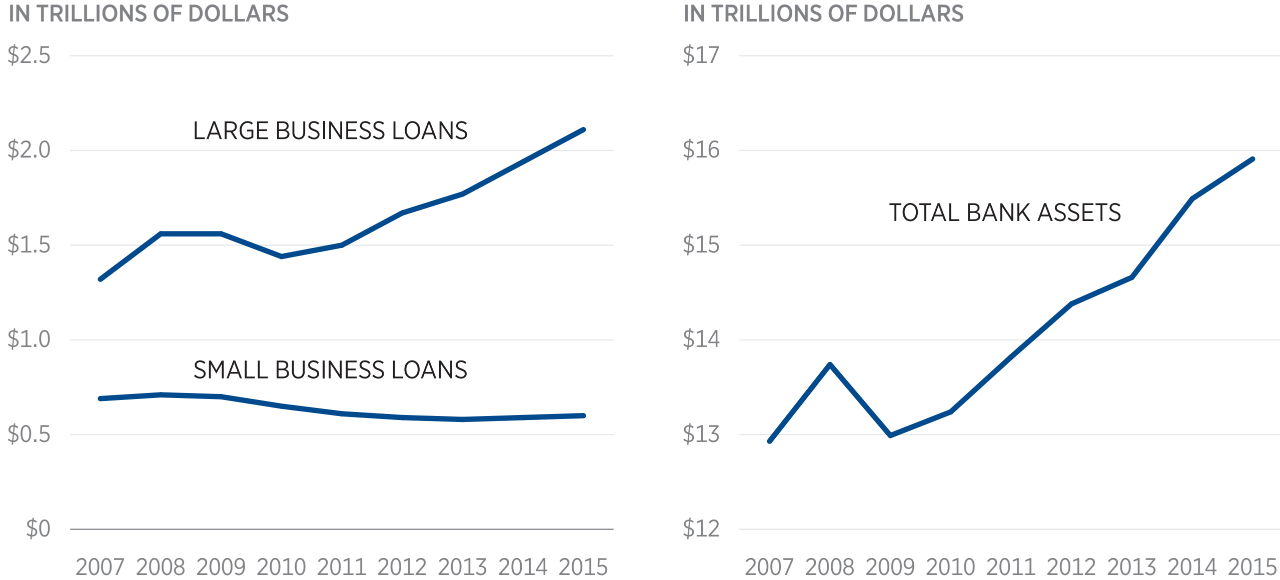
Reducing Regulatory Burdens on Small Public Companies. Requiring public companies to disclose information that is material to investment decisions has positive economic effects and protects investors.[146] Excessive disclosure mandates, however, have two adverse effects. First, the costs imposed impede capital formation and have a disproportionate negative impact on small and start-up companies. This, in turn, harms economic growth and job creation. Second, once disclosure documents reach a certain length, they obfuscate rather than inform.[147]

The SEC has estimated that "the average cost of achieving initial regulatory compliance for an initial public offering is $2.5 million, followed by an ongoing compliance cost, once public, of $1.5 million per year."[148] This is probably an underestimate. Costs of this magnitude make going public uneconomic for most smaller firms. Public company compliance costs have grown sufficiently high that many smaller firms are "going private."[149] Sarbanes–Oxley (2002),[150] Dodd–Frank (2010),[151] and other legislation and regulatory actions have contributed to these costs. Moreover, U.S. initial public offering (IPO) costs are considerably higher than those abroad.[152] Although the number of IPOs and amounts raised have recovered somewhat recently due to the strong stock market and the IPO On-Ramp provisions of the JOBS Act,[153] the number of U.S. IPOs remains considerably lower than in the 1980s and 1990s, and the amount raised is lower than in the 1990s—despite the fact that the economy is six times larger than 1980 and two and a quarter times larger than 1995.[154]

For small and medium-sized firms seeking to raise capital, these costs make access to the public capital markets prohibitively expensive. Obviously, $2.5 million imposes a hefty 10 percent deadweight cost even on a $25 million offering. But the continuing costs—$1.5 million annually on average according to the SEC—are more problematic. A company with shareholders' equity of $10 million with a healthy return on equity of 20 percent will earn $2 million. Net of public company regulatory costs, however, that company will earn only $500,000 and have a return on equity that is an anemic 5 percent. In effect, there is a $1.5 million annual toll charge for being a public company. This makes going public out of the question until companies reach a sufficient size that compliance costs can be borne without having a dramatic negative impact on their earnings. Reducing this toll charge would make the public market available for more companies and enable them to grow more rapidly. Another way of looking at this is to capitalize the $1.5 million annual cost. Using a discount rate of 10 percent, this additional $1.5 million cost is the equivalent of erasing $15 million from shareholders' equity.[155] This kind of shareholders' equity erasure cannot be justified by the

CHART 1

Overview of Bank Lending



NOTE: Total Bank Assets include total assets at all FDIC-insured savings institutions and all FDIC-insured commercial banks. Small Business Loans include all commerical and industrial loans plus Nonfarm Nonresidential loans less than $1 million; Large Business Loans include all C&I plus Nonfarm Nonresidential loans greater than $1 million.
SOURCE: Federal Deposit Insurance Corporation, "Bank Data & Statistics," https://www.fdic.gov/bank/statistical/ (accessed December 20, 2016).

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higher price-earnings ratio that a public company commands until expected risk-adjusted earnings are quite high.

In short, ever-increasing regulatory barriers have cut small and medium-sized companies off from the public capital markets. This needs to change.

Currently, smaller reporting companies (generally those with a public float of less than $75 million)[156] and emerging growth companies[157] have lower regulatory burdens than larger and older reporting companies. In order to improve capital access for smaller reporting companies, Congress should:

- **Increase the smaller-reporting-company threshold to $300 million, and conform the accelerated filer definition.**[158] This would, among other things, eliminate the internal control reporting and assessment requirements of Sarbanes–Oxley section 404(b) for companies with market capitalizations of $300 million or less.[159]

- **Make all emerging growth company advantages permanent for smaller reporting companies.**[160]

- **Provide a statutory, coherent, and reasonable scaled disclosure regime for smaller reporting companies.**[161]

Improving Access to Borrowing

A Federal Reserve Bank of Cleveland study has found that while large business loans have increased to record levels in the recovery, small business lending has declined.[162] A Small Business Administration study had similar findings.[163]

The question is why.[164] If, as some argue, it is because regulators (especially bank examiners) have without justification deemed small-business loans to be riskier assets and therefore banks struggling to meet capital requirements have become less willing to lend to small firms, it is a phenomenon caused by regulators.[165] Regulators generally deny this.[166] Community bankers often claim this.[167] If the cause of the problem is regulators, a congressional response is appropriate, although it is not yet clear what the response should be.

If, as others argue, the decline in small-business lending is simply a function of small businesses seeing their balance sheets weaken during the recession compared to larger firms, and become less credit worthy, or, alternatively, that small businesses have been demanding less credit because they have fewer business opportunities, it is a market phenomenon and a specific congressional response is unnecessary.[168] The solution would be for Congress to enact general pro-growth policies to improve overall economic performance.[169] The decline of community banks relative to large money center banks caused by the marked increase in bank regulation is another possible factor.[170] The facts matter. However, the facts of the matter remain very unclear. Of course, it may well be that there are multiple reasons for the decline.

Congress should instruct the Government Accountability Office to investigate the cause of the decline in small-business lending. Congress should repeal the arbitrary limit on credit union small-business lending. Section 107A of the Federal Credit Union Act[171] imposes a limit on credit union business lending (which is almost exclusively small-business lending). The limit is equal to 1.75 times the Section 216 net worth requirement of 7 percent. Thus, no more than 12.25 percent of loans can go to small businesses. As there is no reason to believe that small-business loans involve any more risk than consumer loans, this is an unwarranted restriction from a safety and soundness perspective. It is an artificial impediment to small-business lending by credit unions.[172]

Peer-to-peer (P2P) lending represents a way of making financial intermediation for consumer and small-business loans much more efficient to the benefit of consumers, small-business owners, and small lenders.[173] There is a very strong need to cut down the regulatory weeds and allow the potential efficiencies of Internet lending and borrowing to take place.

The key substantive, non-legal point here is that a loan is a loan, not a security.[174] Whether that loan is from a bank, a credit union, a non-bank lender, or an individual via a P2P lending portal should not matter. Under the current regulatory regime and SEC practice, loans to small businesses by banks, credit unions, finance companies, or individuals not using a P2P lending platform are almost always treated as exempt from registration requirements. Loans via P2P lending platforms are not. This fundamentally irrational disparity in treatment creates a major regulatory impediment to both consumer and small-business lending using P2P lending platforms, harming both small-business and consumer borrowers, as well as investors seeking a better return. It also protects banks from competition from non-bank financial intermediation and protects the two incumbent consumer P2P lending platforms from competition from new entrants.[175]

There are three means of eliminating, or reducing, the regulatory impediments to P2P lending generally, and P2P small-business lending, in particular.

- **Congress should exempt P2P lending from the federal and state securities laws.** The House-passed version of the Dodd–Frank legislation adopted a version of this approach.[176] It exempted "[a]ny consumer loan, and any note representing a whole or fractional interest in any such loan, funded or sold through a person-to-person lending platform," and defined a consumer loan as a "loan made to a natural person, the proceeds of which are intended primarily for personal, family, educational, household, or business use."[177] Such an exemption should also include loans to small businesses. This approach is the preferred approach. To the extent that Congress wishes to have a regulator overseeing this market, it could assign that task to one of the bank regulators,[178] whose primary role would be anti-fraud enforcement.

- **Congress should amend Title III of the JOBS Act to create a category of crowdfunding security called a "crowdfunding debt security" or "peer to peer debt security"**[179] whereby the issuer offering securities pursuant to Securities Act section 4(a)(6)—the crowdfunding exemption—would be exempt from much of the continuing disclosure requirements. Continuing disclosure requirements may be appropriate with respect to an equity investment, but are entirely inappropriate for debt securities.[180] Valuing equity securities requires making a judgment about expected future returns. Ergo, significant disclosure is appropriate. Moreover, some form of equity security will exist so long as the company exists. In the case of a loan, disclosure related to future earnings prospects is much less appropriate. The question is simply whether the loan is being repaid and, of course, once it is repaid, there is no need for continued disclosure. The exemption should include single-purpose entities whose sole purpose is to allow investors to invest in an entity that holds the debt securities of a single issuer. This approach, which should be adopted in addition to the first approach, might give some vitality to lending via Title III crowdfunding platforms. The statutory peer-to-peer debt security exemption should be self-effectuating and not rely on the SEC to issue rules to become effective.

- **Congress could adopt an alternative regulatory regime for P2P lending.** Such an approach has already been proposed.[181] It would require some regulatory agency (usually the Consumer Financial Protection Bureau is suggested) to promulgate rules, create a division to regulate P2P lending, and, undoubtedly, bureaucratize the entire field. This is the least attractive approach.

Conclusion

Capital formation and entrepreneurship improve economic growth, productivity, and real wages. Existing securities laws impede entrepreneurial capital formation. To promote prosperity, Congress and the SEC need to systematically reduce or eliminate state and federal regulatory barriers hindering entrepreneurs' access to capital. The regulatory environment needs to be improved for primary and secondary offerings by private and small public companies. This *Backgrounder* outlines a series of specific steps that should be taken to improve entrepreneurial capital formation.

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Endnotes

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28. Section 4(a)(2) of the Securities Act exempts “transactions by an issuer not involving any public offering,” 15 U.S. Code § 77d(a)(2). Prior to the JOBS Act, the exemption was in §4(2). This exemption is typically called the “private placement” or “private offering” exemption. There is no definition in the statute or, for that matter, in the securities regulations, of a “public offering” or, conversely, of what is not a public offering. Investors and their attorneys must rely on various court cases, SEC interpretive releases, SEC concept releases, SEC policy statements, SEC staff interpretations, SEC staff legal bulletins, and SEC “no action” letters to make judgments about what will be deemed a public offering. The leading Supreme Court case interpreting this statutory provision is *SEC v. Ralston Purina Co.* 346 U.S. 119 (1953). In that 1953 case, the court held that “the applicability of §4(1) [now §4(a)(2)] should turn on whether the particular class of persons affected needs the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction ‘not involving any public offering.’” This “fend for themselves” formulation is highly suspect in that, whether or not an offering is “public” is analytically unrelated to whether or not the investors in the offering can “fend for themselves.” For example, an offering to one utterly unsophisticated person wholly incapable of fending for himself with whom there is a substantial pre-existing relationship is not public in any meaningful sense. (For instance, when the CEO’s never-employed son who was a poetry major in college is the sole offeree.) Conversely, an offering limited to those demonstrably able to “fend for themselves” (by whatever measure) conducted on national television and with whom there was no pre-existing relationship is certainly public in the ordinary sense of the term (and the authors of the Securities Act of 1933 undoubtedly intended for it to be treated as such).
29. 17 C.F.R. §230.500 et seq. See also Securities and Exchange Commission, “Regulation D–Rules 504, 505 and 506,” http://www.sec.gov/info/smallbus/qasbsec.htm#regd (accessed November 7, 2016).
30. “Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers of Sales” (Release No. 33-6389), *Federal Register*, No. 47 (March 16, 1982), p. 11251. Regulation D is found at 17 C.F.R. §230.500 through §230.508. See “Revision of Certain Exemptions from the Registration Provisions of the Securities Act of 1993 for Transactions Involving Limited Offers of Sales” (Release No. 33-6339), *Federal Register*, No. 46 (August 18, 1981), p. 41791, for the original proposed rule.
31. Using Survey of Consumer Finances data, the SEC staff has estimated that only about 7 percent to 9 percent of households qualify as accredited investors: U.S. Securities and Exchange Commission, “Report on the Review of the Definition of ‘Accredited Investor,’” December 18, 2015, pp. 100–101, https://www.sec.gov/corpfin/reportspubs/special-studies/review-definition-of-accredited-investor-12-18-2015.pdf (accessed October 25, 2016). See also Rachita Gullapalli, “Accredited Investor Pool,” SEC Forum on Small Business Capital Formation, November 20, 2014, https://www.sec.gov/info/smallbus/sbforum112014-gullapalli.pdf (accessed October 25, 2016), and U.S. Government Accountability Office, “Securities and Exchange Commission: Alternative Criteria for Qualifying as an Accredited Investor Should Be Considered,” GAO-13-640, July 2013, http://www.gao.gov/assets/660/655963.pdf (accessed October 25, 2016).
32. David R. Burton, “Don’t Crush the Ability of Entrepreneurs and Small Businesses to Raise Capital,” Heritage Foundation *Backgrounder* No. 2874, February 5, 2014, http://www.heritage.org/research/reports/2014/02/dont-crush-the-ability-of-entrepreneurs-and-small-businesses-to-raise-capital.
33. Scott Bauguess, Rachita Gullapalli, and Vladimir Ivanov, “Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009–2014,” Securities and Exchange Commission, October 2015, https://www.sec.gov/dera/staff-papers/white-papers/unregistered-offering10-2015.pdf (accessed October 25, 2016).
34. 17 C.F.R. §230.504. See also Securities and Exchange Commission, “Rule 504 of Regulation D,” http://www.sec.gov/answers/rule504.htm (accessed October 25, 2016).
35. 17 C.F.R. §230.505. See also Securities and Exchange Commission, “Rule 505 of Regulation D,” http://www.sec.gov/answers/rule505.htm (accessed October 25, 2016).
36. Rule 504 offerings are exempt from the additional disclosure requirements for sales to non-accredited investors. See Rule 504(b)(1). General solicitation is permitted only in certain specified circumstances.
37. Rule 505 allows up to 35 non-accredited investors, but investments by non-accredited investors trigger additional disclosure requirements under Rule 502(b).
38. Vladimir Ivanov and Scott Bauguess, “Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009–2012,” U.S. Securities and Exchange Commission, Division of Economic and Risk Analysis, July 2013, p. 7; Rutheford B. Campbell Jr., “The Wreck of Regulation D: The Unintended (and Bad) Outcomes for the SEC’s Crown Jewel Exemptions,” *The Business Lawyer*, Vol. 66 (2011), pp. 919–942, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1971200 (accessed October 25, 2016).
39. This has been true since the passage of the National Securities Markets Improvement Act (NSMIA) of 1996, which amended section 18 of the Securities Act (15 U.S. Code 77r) to exempt from state securities regulation any “covered security.” 15 U.S. Code 77r(b)(4)(E) provides that a “security is a covered security with respect to a transaction that is exempt from registration under this subchapter pursuant to…commission rules or regulations issued under section 77d(2) of this title, except that this subparagraph does not prohibit a State from imposing notice filing requirements that are substantially similar to those required by rule or regulation under section 77d(2) of this title that are in effect on September 1, 1996.” Section 77d(2) is a reference to Section 4(2) of the Securities Act (now Section 4(a)(2)), to wit, transactions by an issuer not involving any public offering. Only Rule 506 of Regulation D relied on this provision. See “Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers of Sales,” *Federal Register*, Vol. 47 (March 16, 1982), p. 11251. Rule 505 and Rule 504 rely instead on section 3(b) of the Securities Act. See 17 C.F.R. 230.504(a) and 17 C.F.R. 230.505(a). Accordingly, Rule 504 and Rule 505 offerings are not treated as covered securities by the SEC or the state regulators.
40. Fifty states, the District of Columbia, and the SEC.

41. David R. Burton, "Don't Crush the Ability of Entrepreneurs and Small Businesses to Raise Capital," Heritage Foundation *Backgrounder* No. 2874, February 5, 2014, http://www.heritage.org/research/reports/2014/02/dont-crush-the-ability-of-entrepreneurs-and-small-businesses-to-raise-capital; Campbell Jr., "The Wreck of Regulation D"; and U.S. Government Accountability Office, "Securities and Exchange Commission: Alternative Criteria for Qualifying as an Accredited Investor Should Be Considered."
42. The statutory basis for the use of an accredited investor in Regulation D is §2(a)(15) of the Securities Act, 15 U.S. Code §77b(a)(2). 17 C.F.R. §230.501(a) defines "accredited investor" for purposes of Regulation D.
43. However, 17 C.F.R. §230.501(a)(7) (Definitions) does use the term "sophisticated person" in reference to Rule 506(b)(2)(ii).
44. Ivanov and Bauguess, "Capital Raising in the U.S.," p. 15.
45. 17 C.F.R. 240.12b-2, and 17 C.F.R. 229.10 (Item 10(f)(1)).
46. Section 2(a)(19) of the Securities Act of 1933 (15 USC 77b(a)(19)).
47. Section 6(e) of the Securities Act of 1933 (15 U.S. Code 77f(e)).
48. Robert B. Robbins, "Offers, Sales and Resales of Securities Under Section 4[a](1-1/2) and Rule 144A," ALI CLE Course of Study, March 14–16, 2013, http://www.pillsburylaw.com/siteFiles/Publications/RobbinsSalesandResalesunder4112andRule144A2013.pdf (accessed October 19, 2016), and Rutheford B. Campbell Jr., "Resales of Securities Under the Securities Act of 1933," *Washington & Lee Law Review*, Vol. 52, No. 4 (1995), pp. 1333–1384, http://scholarlycommons.law.wlu.edu/wlulr/vol52/iss4/6 (accessed October 19, 2016).
49. Legal Information Institute, "17 CFR 230.144–Persons Deemed Not to Be Engaged in a Distribution and Therefore Not Underwriters," and U.S. Securities and Exchange Commission, "Rule 144: Selling Restricted and Control Securities," http://www.sec.gov/investor/pubs/rule144.htm (accessed October 19, 2016).
50. 17 C.F.R. 230.144A, "Private Resales of Securities to Institutions," and Securities and Exchange Commission, "Securities Act Rules: Section 138. Rule 144A—Private Resales of Securities to Institutions," http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm (accessed October 25, 2016).
51. Section 4(1-½) prior to the JOBS Act renumbering of Section 4.
52. See.*Ackerberg v. Johnson, Jr.*, 892 F.2d 1328 (8th Cir. 1989), and Robert B. Robbins, "Offers, Sales and Resales of Securities Under Section 4[a] (1-1/2) and Rule 144A," Pillsbury ALI CLE Course of Study, Regulation D Offerings and Private Placements, March 14–16, 2013, http://www.pillsburylaw.com/siteFiles/Publications/RobbinsSalesandResalesunder4112andRule144A2013.pdf (accessed October 26,2 016). For an early discussion, see "The Section '4(1 ½)' Phenomenon: Private Resales of Restricted Securities," *The Business Lawyer*, Vol. 34, No. 4 (1979), pp. 1961–1978.
53. Fixing America's Surface Transportation Act, Title LXXVI, section 76001, Public Law No. 114–94, creates a new exemption at Securities Act Section 4(a)(7).
54. These requirements include a long list of information requirements, bad actor disqualifications, and limits on what types of firms are eligible.
55. The Securities Exchange Act of 1934, Public Law 73–291, 48 Stat. 881. 15 U.S. Code §78a et seq. U.S. Securities and Exchange Commission, "Securities Exchange Act of 1934: As amended through P.L. No. 112-158, August 10, 2012," https://www.sec.gov/about/laws/sea34.pdf (accessed October 14, 2016).
56. For a list of exchanges, see Securities and Exchange Commission, see "Fast Answers: Exchanges," http://www.sec.gov/divisions/marketreg/mrexchanges.shtml (accessed October 26, 2016). There are currently 18 exchanges.
57. See Section 6 of the Securities Exchange Act and, for instance, the NASDAQ listing standards, https://listingcenter.nasdaqomx.com/assets/initialguide.pdf (accessed November 7, 2016).
58. Section 18(b) of the Securities Act of 1933.
59. Remarks by R. Cromwell Coulson, president and CEO of OTC Markets Group, Inc., at the 33rd Annual Securities and Exchange Commission Government-Business Forum on Small Business Capital Formation, record of proceedings, November 2, 2014, p. 63, http://www.sec.gov/info/smallbus/sbforum112014-final-transcript.pdf (accessed October 26, 2016).
60. Jumpstart Our Business Startups Act, Public Law 112–106, April 5, 2012, http://www.gpo.gov/fdsys/pkg/PLAW-112publ106/pdf/PLAW-112publ106.pdf (accessed October 26, 2016).
61. H.R. 3606 (112th Cong.) passed the House with overwhelming support, 390 to 23: Final Vote Results for Roll Call 110, H.R. 3606, Recorded Vote, March 8, 2012, http://clerk.house.gov/evs/2012/roll110.xml (accessed October 26, 2016), and passed the Senate by a wide margin, 73 to 26: U.S. Senate Roll Call Votes 112th Congress–2nd Session, H.R. 3606, March 22, 2012, http://www.senate.gov/legislative/LIS/roll_call_lists/roll_call_vote_cfm.cfm?congress=112&session=2&vote=00055 (accessed October 26, 2016). For general information, see Securities and Exchange Commission, "Jumpstart Our Business Startups (JOBS) Act," https://www.sec.gov/spotlight/jobs-act.shtml (accessed October 26, 2016).
62. They are (1) the final rule implementing Regulation A+; (2) the final rule implementing Title III crowdfunding; (3) the final rule implementing the Title II general solicitation provisions and the proposed Regulation D amendments; and (4) the final rule implementing Titles V and VI. See also Rutheford B. Campbell Jr., "The New Regulation of Small Business Capital Formation: The Impact–If Any–of the Jobs Act," April 30, 2014, *Kentucky Law Journal*, Vol. 102, No. 4 (2014), http://uknowledge.uky.edu/cgi/viewcontent.cgi?article=1483&context=law_facpub (accessed December 9, 2016), and David R. Burton, "Proposals to Enhance Capital Formation for Small and Emerging Growth Companies," testimony before the Capital

Markets and Government Sponsored Enterprises Subcommittee, Committee on Financial Services, U.S. House of Representatives, April 11, 2014, http://www.heritage.org/research/testimony/2014/04/capital-formation-for-small-and-emerging-growth-companies.

63. Securities Act, Section 2(a)(19) [15 U.S. Code 77b(a)(19)].
64. Securities Act, Section 6(e) [15 U.S. Code 77f(e)].
65. Securities Act, Section 5(d) [15 U.S. Code 77e(d)].
66. Securities Act, Section 4(b) [15 U.S. Code 77d(b)]; JOBS Act section 201(a)(1); and Final Rule, "Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings," *Federal Register*, Vol. 78, No. 142 (July 24, 2013), p. 44771, http://www.gpo.gov/fdsys/pkg/FR-2013-07-24/pdf/2013-16883.pdf (accessed October 26, 2016). See also comment letter of David R. Burton regarding "Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings," to SEC Secretary Elizabeth M. Murphy, October 5, 2012, http://www.sec.gov/comments/s7-07-12/s70712-118.pdf (accessed October 26, 2016).
67. Securities Act, Section 4(b) [15 U.S. Code 77d(b)], and JOBS Act, Section 201(c).
68. Securities and Exchange Commission, "Jumpstart Our Business Startups Act: Frequently Asked Questions About the Exemption from Broker-Dealer Registration in Title II of the JOBS Act," February 5, 2013, https://www.sec.gov/divisions/marketreg/exemption-broker-dealer-registration-jobs-act-faq.htm (accessed November 3, 2016).
69. Title LXXVI, Section 76001 of the Fixing America's Surface Transportation Act, Public Law 114–94, December 4, 2015, creates a new exemption at Securities Act, Section 4(a)(7).
70. Securities Act, Section 4(a)(6)(B)(i).
71. Securities Act, Section 4(a)(6)(B)(ii).
72. Ibid.
73. JOBS Act, Section 401.
74. Final Rule, "Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A)," *Federal Register*, Vol. 80, No. 75, April 20, 2015, pp. 21806–21925, http://www.gpo.gov/fdsys/pkg/FR-2015-04-20/pdf/2015-07305.pdf (accessed November 3, 2016), and Proposed Rule, "Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act," *Federal Register*, Vol. 79, No. 15, January 23, 2014, p. 3926, http://www.gpo.gov/fdsys/pkg/FR-2014-01-23/pdf/2013-30508.pdf (accessed November 3, 2016).
75. Under the final rule, Tier 1 offerings may not exceed $20,000,000, including not more than $6,000,000 offered by affiliates of the issuer. Tier 2 offerings may offer up to $50,000,000 annually but are subject to greater disclosure requirements.
76. JOBS Act, Section 501.
77. JOBS Act, Sections 502 and 503.
78. Pre-empting blue sky laws for Rule 504 offerings would require some modifications to Rule 504, since Rule 504(b)(1) by its terms contemplates state registration in certain cases.
79. For a more detailed discussion, see David R. Burton, "Don't Crush the Ability of Entrepreneurs and Small Businesses to Raise Capital," Heritage Foundation *Backgrounder* No. 2874, February 5, 2014, http://www.heritage.org/research/reports/2014/02/dont-crush-the-ability-of-entrepreneurs-and-small-businesses-to-raise-capital.
80. The House-passed Fair Investment Opportunities for Professional Experts Act of 2016 (H.R. 2187, 114th Congress), with a margin of 347 to 8, would statutorily set the accredited investor thresholds at current levels and index them for inflation prospectively.
81. The House-passed Accelerating Access to Capital Act of 2016 (H.R. 2357, 114 Congress) included the Private Placement Improvement Act, which would prevent promulgation of the proposed rules. Securities and Exchange Commission, "Proposed Rule: Amendments to Regulation D, Form D and Rule 156," *Federal Register*, Vol. 78, No. 142 (July 24, 2013), pp. 44806–44855, and Securities and Exchange Commission, "Proposed Rule: Amendments to Regulation D, Form D and Rule 156; Re-Opening of Comment Period," *Federal Register*, Vol. 78, No. 192 (October 3, 2013), p. 61222, http://www.sec.gov/rules/proposed/2013/33-9416.pdf (accessed October 19, 2016).
82. Comments from David R. Burton to SEC Secretary Elizabeth M. Murphy, November 4, 2013, http://www.sec.gov/comments/s7-06-13/s70613-462.pdf (accessed November 3, 2016).
83. However, filing a simple closing Form D indicating the amount actually raised is justified by the need for improved information about this critical market.
84. FINRA, "Series 7 Exam–General Securities Representative Examination (GS)," http://www.finra.org/industry/compliance/registration/qualificationsexams/qualifications/p011051 (accessed November 3, 2016).
85. The House passed the Fair Investment Opportunities for Professional Experts Act (H.R. 2187, 114th Cong.), which would treat registered investment advisers and "brokers" (presumably registered representatives) as accredited. It would also allow the SEC to develop rules for who qualifies as a sophisticated investor.
86. 17 C.F.R. § 230.506(c).
87. Pursuant to Section 201 of the JOBS Act, the deadline was 90 days after the April 5, 2012, JOBS Act date of enactment (that is, July 4, 2012). Final Rules, "Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings," *Federal*

Register, Vol. 78, No. 142 (July 24, 2013), pp. 44771–44805, http://www.gpo.gov/fdsys/pkg/FR-2013-07-24/pdf/2013-16883.pdf (accessed November 3, 2016).

88. David R. Burton, Comments on Proposed Rule "Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings," October 5, 2012, http://www.sec.gov/comments/s7-07-12/s70712-118.pdf (accessed November 3, 2016). For a discussion of some of the issues, notably blue sky issues relating to offerings involving general solicitation, see William K. Sjostrom Jr., "Direct Private Placements," *Kentucky Law Journal*, Vol. 102, No. 4, pp. 947–969 (2013–2014), http://law-apache.uky.edu/wordpress/wp-content/uploads/2014/07/12-Sjostrom.pdf (accessed November 3, 2016).
89. For an extended discussion of the legislative history, see David R. Burton, comments on Proposed Rule "Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings," letter to SEC Secretary Elizabeth Murphy, October 5, 2012 http://www.sec.gov/comments/s7-07-12/s70712-118.pdf (accessed October 18, 2016).
90. H.R. 2930, 112th Cong., http://www.gpo.gov/fdsys/pkg/BILLS-112hr2930ih/pdf/BILLS-112hr2930ih.pdf (accessed October 25, 2016).
91. It also excluded crowdfunding investors from the holders of record count, pre-empted blue sky laws, and entitled issuers to rely on investor self-certification for income level.
92. H.R. 2930, 112th Cong.
93. Senate Amendment to Title III of H.R. 3606, http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606eas/pdf/BILLS-112hr3606eas.pdf (accessed November 3, 2016).
94. There were 284 requests for comment, but many of them are multipart requests. Securities and Exchange Commission, "Proposed Rules: Crowdfunding," October 23, 2013, http://www.sec.gov/rules/proposed/2013/33-9470.pdf (accessed November 3, 2016). See also Proposed Rule, "Crowdfunding," *Federal Register*, Vol. 78, No. 214 (November 5, 2013), p. 66428. Further references to the "Crowdfunding" proposed rules are to the *Federal Register* version.
95. Securities and Exchange Commission, Final Rule, "Crowdfunding," *Federal Register*, Vol. 80, No. 220 (November 16, 2015), https://www.sec.gov/rules/final/2015/33-9974.pdf (accessed December 9, 2016).
96. For a different perspective, see Joan MacLeod Heminway, "How Congress Killed Investment Crowdfunding: A Tale of Political Pressure, Hasty Decisions, and Inexpert Judgments that Begs for a Happy Ending," *Kentucky Law Journal*, Vol. 102, No. 4 (2013–2014), pp. 865–889, http://law-apache.uky.edu/wordpress/wp-content/uploads/2014/07/9-Heminway.pdf (accessed November 3, 2016). (Heminway argues that the crowdfunding statute is deeply flawed and that the SEC would do a better job than Congress.) The statute is, of course, deeply flawed but her analysis assumes that the SEC would *ever* do anything about crowdfunding in the absence of a congressional mandate. Given its history of inaction with respect to facilitating entrepreneurial capital formation, this is unlikely.
97. Stuart R. Cohn, "The New Crowdfunding Registration Exemption: Good Idea, Bad Execution," *Florida Law Review*, Vol. 64, No. 5 (October 2012), pp. 1143 and 1145, http://scholarship.law.ufl.edu/cgi/viewcontent.cgi?article=1032&context=flr (accessed October 19, 2016).
98. Securities Act, Section 4A(e).
99. Securities Exchange Act, Section 12(g)(6).
100. Securities Act, Section 18(b)(4)(C).
101. U.S. Government Accountability Office, "Factors that May Affect Trends in Regulation A Offerings," GAO-12-839, July 2012, and Rutheford B. Campbell Jr., "The Wreck of Regulation D: The Unintended (and Bad) Outcomes for the SEC's Crown Jewel Exemptions," *The Business Lawyer*, Vol. 66 (August 2011), pp. 919–942, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1971200 (accessed November 3, 2016).
102. See, for instance, Stuart R. Cohn, "The New Crowdfunding Registration Exemption: Good Idea, Bad Execution," *Florida Law Review*, Vol. 64, No. 5 (2012), pp. 1433–1446, http://scholarship.law.ufl.edu/cgi/viewcontent.cgi?article=1032&context=flr (accessed November 3, 2016); Samuel Guzik, "SEC's Proposed Crowdfunding Regulations: Six Deadly Sins," *Crowdfund Insider*, January 9, 2014, http://www.crowdfundinsider.com/2014/01/29734-secs-proposed-crowdfunding-regulations-six-deadly-sins/ (accessed November 3, 2016); David R. Burton, comments to SEC Secretary Elizabeth M. Murphy on "Crowdfunding," February 3, 2014, http://www.sec.gov/comments/s7-09-13/s70913-192.pdf (accessed November 3, 2016); Rutheford B. Campbell Jr., comments to SEC Secretary Elizabeth M. Murphy on "Crowdfunding," February 14, 2014, http://www.sec.gov/comments/s7-09-13/s70913-278.pdf (accessed November 3, 2016); and Heminway, "How Congress Killed Investment Crowdfunding."
103. Section 2 of the original version of the Fix Crowdfunding Act (H.R. 4855, 114th Cong.) would do this.
104. Section 3 of the original version of the Fix Crowdfunding Act (H.R. 4855, 114th Cong.) would do this.
105. Securities Act, Section 4A(b)(1)(D)(iii).
106. Securities Exchange Act, Section 3(a)(80)(A).
107. For a discussion of issues surrounding the provision of investment advice, see Securities and Exchange Commission, "Study on Investment Advisers and Broker-Dealers," January 2011, http://www.sec.gov/news/studies/2011/913studyfinal.pdf (accessed November 3, 2016).
108. Securities Act, Section 4A(a)(5).
109. See 17 C.F.R. §227.402 as adopted in Final Rule, "Crowdfunding," *Federal Register*, Vol. 80, No. 220 (November 16, 2015), pp. 71387–71680, https://www.gpo.gov/fdsys/pkg/FR-2015-11-16/pdf/2015-28220.pdf (accessed November 3, 2016).
110. 17 C.F.R. 275.203A-3 (a)(3)(ii).

111. Securities and Exchange Commission, Final Rule, "Crowdfunding," *Federal Register*, §227.201.
112. Securities Act, Section 4A(b)(1).
113. Securities Act, Section 4A(b)(4).
114. Securities and Exchange Commission, Final Rule, "Crowdfunding," *Federal Register*, §227.202.
115. For a more detailed discussion of Bank Secrecy Act and anti-money laundering rules, see David R. Burton and Norbert J. Michel, "Financial Privacy in a Free Society," Heritage Foundation *Backgrounder* No. 3157, September 23, 2016, http://www.heritage.org/research/reports/2016/09/financial-privacy-in-a-free-society.
116. Securities Exchange Act, Section 3(a)(80)(D).
117. Proposed Rule, "Amendments to the Definition of Broker or Dealer in Securities," *Federal Register*, Vol. 81, No. 64 (April 4, 2016), pp. 19086–19094.
118. Regulatory Notice 13-34, "FINRA Requests Comment on Proposed Funding Portal Rules and Related Forms," October 2013, and Proposed Rules, "Crowdfunding," *Federal Register*, Vol. 78, No. 214 (November 5, 2013), p. 66428, Release Nos. 33-9470 and 34-70741, File No. S7-09-13.
119. The SEC has, by rule, pre-empted blue sky registration and qualification requirements for Regulation A Tier 2 primary offerings.
120. David R. Burton, "Securities Disclosure Reform," in Norbert J. Michel, ed., *Prosperity Unleashed: Smarter Financial Regulation*, The Heritage Foundation, forthcoming.
121. David R. Burton, "Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens: Venture Exchanges," testimony before the Capital Markets and Government Sponsored Enterprises Subcommittee, Committee on Financial Services, U.S. House of Representatives, May 13, 2015, http://www.heritage.org/research/testimony/2015/legislative-proposals-to-enhance-capital-formation-and-reduce-regulatory-burdens-venture-exchanges (accessed December 8, 2016).
122. Assuming they do not have a substantial pre-existing relationship with everyone in the room. Now, if they comply with the investor verification procedures and make a compliant Rule 506(c) offering (by selling only to accredited investors), they could save their situation. The odds are, however, they will not even have heard of Rule 506 and not have the vaguest idea that their actions would be a violation of the securities laws.
123. The original version of the Micro Offering Safe Harbor Act (H.R. 4850, 114th Cong.) would accomplish this objective by creating a separate exemption. The version reported out of committee and passed by the House (as Title II of the Accelerating Access to Capital Act of 2016 (H.R. 2357)) is much narrower and imposes various conditions on the exemption.
124. For a good, recent analysis, see Gregory C. Yadley, "Notable by Their Absence: Finders and Other Financial Intermediaries in Small Business Capital Formation," presentation to the U.S. Securities and Exchange Commission Advisory Committee on Small and Emerging Businesses, June 3, 2015, http://www.sec.gov/info/smallbus/acsec/finders-and-other-financial-intermediaries-yadley.pdf (accessed November 3, 2016).
125. Particularly by those familiar with the work and proposals of the American Bar Association Task Force on Private Placement Broker-Dealers. See the American Bar Association, "Report and Recommendations of the Task Force on Private Placement Broker-Dealers," June 20, 2005, http://www.sec.gov/info/smallbus/2009gbforum/abareport062005.pdf (accessed November 3, 2016).
126. For "merger and acquisition broker."
127. David R. Burton, "Don't Overregulate Business Brokers," Heritage Foundation *Backgrounder* No. 2883, February 19, 2014, http://www.heritage.org/research/reports/2014/02/dont-overregulate-business-brokers. See also the Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2015 (H.R. 686, 114th Cong.).
128. Securities Exchange Act, Section 3(a)(4) [definition of broker].
129. Securities Exchange Act, Section 3(a)(5) [definition of dealer].
130. American Bar Association, "Report and Recommendations of the Task Force on Private Placement Broker-Dealers."
131. Michigan Department of Licensing and Regulatory Affairs, "Finders & Solicitors," http://www.michigan.gov/lara/0,4601,7-154-35299_61343_32915_59945_60133-269112--,00.html (accessed November 3, 2016), and Texas State Securities Board, "Dealer & Adviser Registration," http://www.ssb.state.tx.us/Dealer_And_Investment_Adviser_Registration/Frequently_Asked_Questions.php#oneC (accessed November 3, 2016).
132. Analogous to personalized investment advice provisions in Advisers Act Rule 203A, 17 C.F.R. 275.203A-3 (a)(3)(ii).
133. 50 states and the District of Columbia.
134. IRS Statistics of Income, "Table 1--S Corporations: Total Receipts and Deductions, Portfolio Income, Rental Income, and Total Net Income, by Major Industry, Tax Year 2012," http://www.irs.gov/file_source/pub/irs-soi/12co01s.xls (accessed November 3, 2016).
135. 26 U.S. Code §1361 et seq.
136. Alternatively, they could convert to an LLC by merging the S corporation with an LLC, with the LLC as the surviving entity. This involves costs and other issues.
137. H.R. 4831, 114th Cong. would achieve this objective.
138. These are often called SME exchanges, or alternative investment markets in the European or academic literature. SME stands for small and medium-sized enterprises. See Securities and Exchange Commission, "Remarks at FIA Futures and Options Expo," speech by Commissioner

Daniel M. Gallagher, November 6, 2013, https://www.sec.gov/News/Speech/Detail/Speech/1370540289361#.VIsXvXt4zYg (accessed November 3, 2016) ("Through well-designed venture exchanges governed by scaled, sensible regulation, small companies would be provided with a proper runway for them to grow while at the same time providing investors with the material disclosures they need to make informed decisions."); Securities and Exchange Commission, "Whatever Happened to Promoting Small Business Capital Formation?" speech by Commissioner Daniel M. Gallagher, September 17, 2014, https://www.sec.gov/News/Speech/Detail/Speech/1370542976550#.VInvAHt4zYg (accessed November 3, 2016) ("I've called for the creation of 'Venture Exchanges': national exchanges, with trading and listing rules tailored for smaller companies, including those engaging in issuances under Regulation A. Shares traded on these exchanges would be exempt from state blue sky registration. The exchanges themselves would be exempted from the Commission's national market structure and unlisted trading privileges rules, so as to concentrate liquidity in these venues. This should in turn bring market makers and analysts to these exchanges and their issuers, thereby recreating some of the ecosystem supportive of small companies that has been lost over the years."); and Securities and Exchange Commission Advisory Committee on Small and Emerging Companies, "Recommendation Regarding Separate U.S. Equity Market for Securities of Small and Emerging Companies," February 1, 2013, https://www.sec.gov/info/smallbus/acsec/acsec-recommendation-032113-emerg-co-ltr.pdf (accessed November 3, 2016) ("The Commission should facilitate and encourage the creation of a separate U.S. equity market or markets that would facilitate trading by accredited investors in the securities of small and emerging companies, and such small and emerging companies would be subject to a regulatory regime strict enough to protect such investors but flexible enough to accommodate innovation and growth by such companies.")

139. News release, "TSX Venture Exchange Celebrates its 15th Anniversary," TMX, November 28, 2014, http://www.tmx.com/newsroom/press-releases?id=228&year=2014&month=11 (accessed November 3, 2016).

140. London Stock Exchange, "AIM," http://www.londonstockexchange.com/companies-and-advisors/aim/aim/aim.htm (accessed November 3, 2016). AIM is a multilateral trading facility (MTF) as defined under the Markets in Financial Instruments Directive (MiFID) 2004, EUR-Lex access to European Union Law, Title I, Article 4, "Definitions," Section 15, http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32004L0039 (accessed November 3, 2016). An MTF is the EU analog to the U.S. alternative trading system (ATS).

141. Remarks of R. Cromwell Coulson, President and CEO, OTC Markets Group, at 33rd Annual Securities and Exchange Commission Government-Business Forum on Small Business Capital Formation, November 2, 2014, p. 63, http://www.sec.gov/info/smallbus/sbforum112014-final-transcript.pdf (accessed November 3, 2016) ("The other 10 percent, it's impossible. You cannot become blue sky, whether you are Roche's ADR [American depository receipt], you are an SEC-reporting company, you're a billion-and-a-half-dollar community bank holding company. You cannot become blue sky in the United States in every jurisdiction.")

142. See Securities Exchange Act, Section 6.

143. Regulation ATS, 17 CR § 242.300 et seq., and Securities and Exchange Commission, "Alternative Trading Systems with Form ATS on File with the SEC as of June 1, 2015" [approximately 90], http://www.sec.gov/foia/ats/atslist0615.pdf (accessed November 3, 2016).

144. David R. Burton, "Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens: Venture Exchanges," testimony before the Capital Markets and Government Sponsored Enterprises Subcommittee, Committee on Financial Services, U.S. House of Representatives, May 13, 2015, http://www.heritage.org/research/testimony/2015/legislative-proposals-to-enhance-capital-formation-and-reduce-regulatory-burdens-venture-exchanges.

145. H.R. 4638, 114th Cong.

146. Burton, "Securities Disclosure Reform."

147. David R. Burton, "Reducing the Burden on Small Public Companies Would Promote Innovation, Job Creation, and Economic Growth," Heritage Foundation *Backgrounder* No. 2924, June 20, 2014, http://www.heritage.org/research/reports/2014/06/reducing-the-burden-on-small-public-companies-would-promote-innovation-job-creation-and-economic-growth.

148. Proposed Rules, "Crowdfunding," *Federal Register*, Vol. 78, No. 214 (November 5, 2013), p. 66509 (col. 2).

149. See, for instance, Committee on Capital Markets Regulation, "Interim Report," November 30, 2006, http://www.capmktsreg.org/2006/11/30/interim-report/ (accessed November 3, 2016); Ehud Kamar, Pinar Karaca-Mandic, and Eric Talley, "Going-Private Decisions and the Sarbanes–Oxley Act of 2002: A Cross-Country Analysis," Kauffman–RAND Institute for Entrepreneurship Public Policy, February 2008, http://www.rand.org/content/dam/rand/pubs/working_papers/2008/RAND_WR300-2.pdf (accessed November 3, 2016); and Robert P. Bartlett III, "Going Private But Staying Public: Reexamining the Effect of Sarbanes–Oxley on Firms' Going-Private Decisions," *University of Chicago Law Review*, Vol. 76, No. 7 (2009), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1088830 (accessed November 3, 2016).

150. The Sarbanes–Oxley Act of 2002, Public Law 107–204 (July 30, 2002).

151. The Dodd–Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203 (July 21, 2010).

152. See, for instance, Michele Meoli et al., "The Cost of Going Public: A European Perspective," *International Journal of Economics and Management Engineering*, Vol. 2, No. 2 (May 2012).

153. The IPO On-Ramp as enacted is Title I of the JOBS Act, Public Law 112–106 (April 5, 2012), which generally delays application of some of the most onerous provisions governing public companies for five years for companies that meet the definition of an "emerging growth company." For IPO data, see Jay R. Ritter, "IPO Data," Warrington College of Business, http://bear.warrington.ufl.edu/ritter/ipodata.htm (accessed November 3, 2016). See also Burton, "Reducing the Burden on Small Public Companies Would Promote Innovation, Job Creation, and Economic Growth."

154. Gross domestic product was $2.9 trillion in 1980, $7.7 trillion in 1995, and $17.4 trillion in 2014. Bureau of Economic Analysis, "National Data," http://www.bea.gov/iTable/iTable.cfm?ReqID=9&step=1#reqid=9&step=3&isuri=1&904=2014&903=5&906=a&905=1980&910=x&911=0 (accessed November 3, 2016).
155. The present discounted value of $1.5 million annually with a 10 percent discount rate is $15 million.
156. 17 CFR 240.12b-2.
157. See discussion previously under "The Jumpstart Our Business Startups Act: Title I: Emerging Growth Companies."
158. In general, an accelerated filer is an issuer with an aggregate worldwide common equity market value of $75 million or more, but less than $700 million that is not a smaller reporting company. An accelerated filer must file its 10-Qs within 40 days of the close of the quarter and its 10-Ks within 75 days of the close of the year. See 17 C.F.R. 240.12b-2(1).
159. Jiamin Wang, "Sarbanes–Oxley Section 404 Places Disproportionate Burden on Smaller Public Companies," The Heritage Foundation Center for Data Analysis, August 2008, http://www.heritage.org/~/media/CDA/CDA_features/SOXCDAedited3.ashx, and Charles River Associates, and Charles River Associates, "Sarbanes-Oxley Section 404 Costs and Remediation of Deficiencies: Estimates from a Sample of Fortune 1000 Companies," April 2005, https://www.sec.gov/spotlight/soxcomp/soxcomp-all-attach.pdf (accessed November 3, 2016).
160. Among those would be:
    - Exemption from the requirement in Securities Exchange Act section 14A(a) to conduct shareholder advisory votes on executive compensation (for exemption, see Securities Exchange Act section 14A(e)(2));
    - Exemption from the requirement in Securities Exchange Act section 14A(b) to provide disclosure about and conduct shareholder advisory votes on golden parachute compensation (for exemption, see Securities Exchange Act section 14A(e)(2));
    - Exemption from the requirement in section 953(b) of the Dodd–Frank Wall Street Reform and Consumer Protection Act, as implemented by the Commission in Item 402 of Regulation S-K (17 C.F.R. §229.402), to provide disclosure of the ratio of the median annual total compensation of all employees (except the CEO) of the registrant to the annual total compensation of the chief executive officer (for exemption, see JOBS Act section 102(a)(3));
    - Exemption from the requirement in Securities Exchange Act section 14(i) to provide disclosure of the relationship between executive compensation and issuer financial performance (for exemption, see Securities Exchange Act section 14A(i));
    - Exemption from compliance with new or revised financial accounting standards until those standards apply to private companies (for exemption, see Securities Exchange Act section 13(a)); and
    - Exemption from the Sarbanes–Oxley section 404(b) internal control reporting requirements (for exemption, see JOBS Act section 103).
161. A discussion of how to do this is included in David R. Burton, "Securities Disclosure Reform," Heritage Foundation *Backgrounder* No. 3178, February 13, 2017, http://www.heritage.org/government-regulation/report/securities-disclosure-reform.
162. Ann Marie Wiersch, "Good News and Bad News on Small Business Lending in 2014," Federal Reserve Bank of Cleveland, January 5, 2015, https://www.clevelandfed.org/en/newsroom-and-events/publications/community-development-briefs/db-20150105-good-news-bad-news-small-bus-lending.aspx (accessed October 25, 2016).
163. Victoria Williams, "Small Business Lending in the United States, 2012," U.S. Small Business Administration, Office of Advocacy, July 2013, https://www.sba.gov/sites/default/files/files/sbl_12study.pdf (accessed October 25, 2016).
164. For an analysis, see Ann Marie Wiersch and Scott Shane, "Why Small Business Lending Isn't What It Used to Be," Federal Reserve Bank of Cleveland, August 14, 2013, https://www.clevelandfed.org/newsroom-and-events/publications/economic-commentary/2013-economic-commentaries/ec-201310-why-small-business-lending-isnt-what-it-used-to-be.aspx (accessed November 3, 2016). See also Karen Gordon Mills and Brayden McCarthy, "The State of Small Business Lending: Credit Access During the Recovery and How Technology May Change the Game," Harvard Business School *Working Paper* No. 15-004, July 22, 2014, http://www.hbs.edu/faculty/Publication%20Files/15-004_09b1bf8b-eb2a-4e63-9c4e-0374f770856f.pdf (accessed November 3, 2016).
165. See, for instance, Alan Fisher, "Small Business Access to Credit—The Little Engine that Could: If Banks Helped," California Reinvestment Coalition, December 2013, http://calreinvest.org/system/resources/W1siZiIsIjIwMTMvMTIvMjMvMTdfMTNfNTJfOTQzX0NSQ19TbWFsbF9CdXNpbmVzc19SZXBvcnRfMjAxMy5wZGYiXV0/CRC%20Small%20Business%20Report%202013.pdf (accessed November 3, 2016), and Candace A. Franks, "Right-Sizing Bank Regulation to Preserve Our Unique System," *Talk Business & Politics*, May 6, 2015, http://talkbusiness.net/2015/05/right-sizing-bank-regulation-to-preserve-our-unique-system/ (accessed November 3, 2016).
166. See, for instance, Federal Deposit Insurance Corporation, "Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers," February 12, 2010, https://www.fdic.gov/news/news/press/2010/pr10029a.pdf (accessed November 3, 2016).
167. William Loving, testimony on behalf of the Independent Community Bankers of America, Committee on Small Business and Entrepreneurship, U.S. Senate, June 8, 2010, pp. 3–4, https://www.icba.org/files/ICBASites/PDFs/test060810.pdf (accessed November 3, 2016).
168. Mills and McCarthy, "The State of Small Business Lending."
169. David R. Burton, "Building an Opportunity Economy: The State of Small Business and Entrepreneurship," testimony before the Committee on Small Business, U.S. House of Representatives, March 4, 2015, http://smbiz.house.gov/uploadedfiles/3-4-2015_final_burton_tesimony_final.pdf (accessed November 3, 2016).

170. Marshall Lux and Robert Greene, "The State and Fate of Community Banking," Harvard Kennedy School, February 9, 2015, http://www.hks.harvard.edu/content/download/74695/1687293/version/1/file/Final_State_and_Fate_Lux_Greene.pdf (accessed November 3, 2016). See also Mills and McCarthy, "The State of Small Business Lending."

171. 12 U.S. Code 1757a.

172. Concerns that Internal Revenue Code section 501(c)(14) affords an unfair advantage to credit unions is reasonable. Unfair competition by tax-exempt organizations against businesses is commonplace. But that Internal Revenue Code provision has a long history and whatever advantage is accorded to credit unions is equally applicable to *any* loan made by credit unions, so it does not logically justify a provision affirmatively discriminating against small businesses. Banks compete against credit unions in the consumer-lending or home-loan markets, which is where most of their lending currently takes place. For more on this issue, see John A. Tatom, "Competitive Advantage: A Study of the Federal Tax Exemption for Credit Unions," Tax Foundation, February 28, 2005, http://www.taxfoundation.org/sites/taxfoundation.org/files/docs/8ccda96dc9aa7b1b47ca2f9f2632c796.pdf (accessed November 3, 2016); U.S. Department of the Treasury, "Comparing Credit Unions with Other Depository Institutions," January 2001; and Donald J. Melvin, *The Federal Income Tax Exemption of Credit Unions: A Historical, Competitive, and Legal Analysis* (Washington, DC: Defense Credit Union Council, 1981).

173. Mills and McCarthy, "The State of Small Business Lending."

174. For a discussion of some of the legal issues involved in drawing lines between loans (or notes or investment contracts) and securities (bonds or debentures), see Andrew Verstein, "The Misregulation of Person-to-Person Lending, *University of California–Davis Law Review*, Vol. 45, No. 2 (2011), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1823763 (accessed November 3, 2016); Elisabeth de Fontenay, "Do the Securities Laws Matter? The Rise of the Leveraged Loan Market," *Journal of Corporation Law*, Vol. 39 (2014), pp. 725–768, http://scholarship.law.duke.edu/faculty_scholarship/3258/ (accessed November 7, 2016). See Securities Act, Section 3 for a veritable laundry list of exemptions for securities involving banks. See *Reves v. Ernst & Young*, 494 U.S. 56 (1990) for the Supreme Court's adoption and application of the highly amorphous four-part "family resemblance" test, drawing the distinction between notes that are and are not securities.

175. The P2P lending firms Lending Club and Prosper have now learned how to deal with the current SEC requirements and have reached sufficient size that the regulatory costs can be managed.

176. The provision provided "primary" jurisdiction to the CFPB. It did not explicitly pre-empt blue sky laws. Any pre-emption of state blue sky laws should not pre-empt state antifraud provisions.

177. Section 4315 of H.R. 4173, 111th Cong. (House-passed version), http://www.gpo.gov/fdsys/pkg/BILLS-111hr4173eh/pdf/BILLS-111hr4173eh.pdf (accessed October 25, 2016).

178. This is probably unnecessary, since such fraud would be a violation of countless existing laws, including state blue sky laws, state consumer-protection laws, state banking laws, and the common law of fraud.

179. A debt security would be defined "as any contract that (1) provides for the repayment of the principal amount over a definite period together with interest and (2) provides no payments to the holder other than principal payments, interest payments and penalties for late payments."

180. "Peer-to-peer debt security" issuers should be exempt from Securities Act:
    - Section 4A(b)(1)(D)(ii)-(iii);
    - Section 4A(b)(1)(G);
    - Section 4A(b)(1)(H);
    - Section 4A(b)(4); and
    - Section 4A(b)(5).

181. See, for example, Eric C. Chaffee and Geoffrey C. Rapp, "Regulating Online Peer-to-Peer Lending in the Aftermath of Dodd–Frank: In Search of an Evolving Regulatory Regime for an Evolving Industry," *Washington and Lee Law Review*, Vol. 69, No. 2 (2012), pp. 485–533, http://scholarlycommons.law.wlu.edu/wlulr/vol69/iss2/4/ (accessed October 25, 2016), and Verstein, "The Misregulation of Person-to-Person Lending."