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Statement of the Shadow Financial Regulatory Committee on

Two Cheers for the JOBS Act

May 7, 2012

On April 5, 2012, the President signed into law the Jumpstart Our Business Startups (JOBS) Act, which passed by a large bipartisan majority in the Congress. The Act is designed to facilitate the equity funding of new companies. Recent research has documented that from 1980 through the 2008-09 recession new companies have been main drivers of job creation in the United States.

The Act has several provisions. First, it relaxes a series of restrictions on the raising of investment capital for “emerging growth companies” (EGCs), or public companies in the first five years after their initial public offering (IPO), as long as their revenues are under \$1 billion (popularly referred to as the “IPO on-ramp”). Among the most important of these liberalizations are the reduction from three to two in the number of years of audited financial statements required in IPO filings with the SEC; permitting a draft IPO prospectus to be submitted to the SEC for confidential review prior to filing publicly; repealing the “quiet period” and advertising and general solicitation bans; and exempting EGCs from the costly “internal controls” auditing requirement of Section 404 of the Sarbanes-Oxley Act.

Second, the Act raises the cap on “Regulation A” offerings from \$5 million to \$50 million, making it easier for small companies to raise debt or equity capital without the expense of SEC registration. Importantly, investors are protected in such offerings through Securities Act civil liability for false or misleading statements or omissions in offering documents or related oral communications, and by a requirement that issuers file audited financial statements with the SEC annually.

Third, the Act lifts from 500 to 2,000 the number of record shareholders at which point privately-held companies must register their stock and “go public.” Notably, this change also applies to banks and bank holding companies, which may enable smaller banks, in particular, to issue much needed additional stock without having to register with the SEC under the Securities Exchange Act of 1934.

Finally, perhaps the most publicized and controversial element of the Act is the exemption from SEC registration requirements for certain “crowd funding” transactions. Crowd funding refers to the equity and debt financing of new and/or small companies through small individual investments, generally enabled by the Internet. To qualify for the exemption, issuers may not raise more than \$1 million in this way during any 12-month period, including allowing non-accredited investors to make substantial investments according to a formula. In addition, the Act requires issuers seeking money through crowd funding to do so on third-party platforms (such as those now in place on such websites as Kickstarter and announced for Facebook) that register with the SEC.

The Chairman of the SEC and other opponents have criticized the Act for generally weakening protections for investors. The Shadow Financial Regulatory Committee supports the Act. It believes the objections generally are not well grounded or offset by the above listed benefits of the Act. In fact, as the foregoing summary notes, the Act has a number of provisions designed to protect investors, including civil liability for false or misleading statements, requirements for audited financial statements, and limits on investments, in the case of crowd funding, in particular. As a whole, the Act restores some balance to the laws and regulations relating to the raising of capital for new and growing businesses, which have become significant burdens for small companies raising small amounts of equity. At the same time, it does not touch existing protections for investors and current anti-fraud statutes.

The provisions relating to crowd funding will not go into effect until the SEC issues implementing rules, which the Act requires within 270 days after its enactment. The Committee encourages the SEC not only to comply with this deadline, but to beat it, without erecting roadblocks to crowd funding. The SEC should keep in mind the experience of eBay, which, when it was launched, evoked widespread concerns that sellers would use the site to perpetrate fraud on ill-informed or defenseless buyers. That has not turned out to be the case because eBay developed ways of both rating the trustworthiness of sellers and ridding the site of those sellers that abused it. That experience points to the economic incentives to ensure that such markets are reputable and safe. The Committee sees no reason why the experience with third-party platforms that host issuers seeking investments from “the crowd” would be materially different. Because some limited participation by non-accredited investors would be permitted in private offerings, which has concerned some commentators, the SEC should monitor these for abuses from a suitability perspective.

Additionally, because crowd funding is an experiment and because fraud problems may surface, the Committee encourages Congress either to hold hearings annually to examine the experience with this particular provision of the Act (and perhaps its other provisions), or ask the Government Accountability Office to deliver a report annually on this subject. Furthermore, the uncertain impacts of some of the new procedures and the challenges in implementing the law point to the potential importance of undertaking cost-benefit analysis of these issues in the future. The SEC has an opportunity to design the upcoming rules and transition paths to facilitate the production of information for such future cost-benefit analyses of these provisions.