

Testimony on the Implementation of Title II of the JOBS Act
by
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U.S. Securities and Exchange Commission

before the
Subcommittee on Oversight and Investigations
Committee on Financial Services
U.S. House of Representatives

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Chairman McHenry, Ranking Member Green, and Members of the Subcommittee:

I appreciate the opportunity to testify today regarding the implementation of Title II of the Jumpstart Our Business Startups Act (JOBS Act or the Act) by the Commission and its staff.¹ Implementing the JOBS Act, including Title II, is one of the Commission's top priorities.

Title II requires the Commission to revise the Rule 506 safe harbor of Regulation D² from registration to allow general solicitation or general advertising for offers and sales of securities made under Rule 506, provided that all purchasers of securities are accredited investors.³ The rules the Commission adopts pursuant to Title II must require issuers to take

¹ This testimony is my own and does not necessarily reflect the views of the U.S. Securities and Exchange Commission, my fellow Commissioners, or the Commission staff.

² 17 CFR 230.506. Rule 506 of Regulation D under the Securities Act is a non-exclusive safe harbor under Section 4(a)(2) (formerly Section 4(2)) of the Securities Act, which exempts transactions by an issuer "not involving any public offering" from the registration requirements of Section 5 of the Securities Act. Under Rule 506, an issuer may offer and sell securities, without any limitation on the offering amount, to an unlimited number of "accredited investors," as defined in Rule 501(a) of Regulation D, and to no more than 35 non-accredited investors who meet certain "sophistication" requirements. The availability of the existing safe harbor is subject to a number of requirements and is conditioned on the issuer, or any person acting on its behalf, not offering or selling securities through any form of "general solicitation or general advertising."

³ Title II also amends Section 4 of the Securities Act to provide a narrow exemption from the requirement to register with the Commission as a broker-dealer in connection with certain limited activities related to Regulation D offerings. In February 2013, the Commission's Division of Trading and Markets posted on the Commission's website answers to frequently asked questions about these provisions, including confirmation that the exemption does not require the Commission to issue or adopt any rules. *See* <http://www.sec.gov/divisions/marketreg/exemption-broker-dealer-registration-jobs-act-faq.htm>.

“reasonable steps to verify that purchasers of the securities are accredited investors, using such methods as determined by the Commission.” The Commission also is required to revise Securities Act Rule 144A⁴ to provide that securities sold under this rule may be offered to persons other than qualified institutional buyers, including by means of general solicitation or general advertising, provided that the securities are sold only to persons reasonably believed to be qualified institutional buyers.

The Title II rulemaking was required to be completed within 90 days of enactment of the JOBS Act. Prior to enactment, a rulewriting team was formed consisting of staff from across the Commission, including economists from the Division of Risk, Strategy, and Financial Innovation. In August 2012, the Commission issued for public comment proposed rules to implement Title II.⁵ Under the proposed rules, companies issuing securities in an offering conducted under Rule 506 of Regulation D would be permitted to use general solicitation or general advertising to offer securities, provided that the issuer takes reasonable steps to verify that the purchasers of the securities are accredited investors. The Proposing Release explains that, in determining the reasonableness of the steps that an issuer has taken to verify that a purchaser is an accredited investor, issuers should consider the facts and circumstances of the transaction, such as the type of purchaser and the type of accredited investor that the purchaser

⁴ 17 CFR 230.144A. Rule 144A is a non-exclusive safe harbor exemption from the registration requirements of the Securities Act for resales of certain “restricted securities” to qualified institutional buyers. Although Rule 144A does not include an express prohibition against general solicitation or general advertising, offers of securities under Rule 144A currently must be limited to qualified institutional buyers, which has the same practical effect. A qualified institutional buyer is defined in Rule 144A and includes specified institutions that, in the aggregate, own and invest on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with such institutions. Banks and other specified financial institutions also must have a net worth of at least \$25 million. A registered broker-dealer is a qualified institutional buyer if it, in the aggregate, owns and invests on a discretionary basis at least \$10 million in securities of issuers that are not affiliated with the broker-dealer.

⁵ Securities Act Release No. 33-9354 (Proposing Release), 77 Fed. Reg. 54464 (August 29, 2012), *available at* <http://www.sec.gov/rules/proposed/2012/33-9354.pdf>.

claims to be, the amount and type of information that the issuer has about the purchaser, and the nature of the offering. The proposed rules would preserve the existing portions of Rule 506 as a separate exemption so that companies conducting Rule 506 offerings without the use of general solicitation or general advertising would not be subject to the new verification requirement.

The Commission also proposed that securities sold pursuant to Rule 144A could be offered to persons other than qualified institutional buyers, including by means of general solicitation or general advertising, provided that the securities are sold only to persons whom the seller and any person acting on behalf of the seller reasonably believe are qualified institutional buyers.

Prior to issuing the Proposing Release, to aid the rulemaking process and to increase the opportunity for public comment, the Commission permitted interested parties to submit comments regarding this provision of the JOBS Act.⁶ These pre-proposing release commenters expressed a variety of views on how the Commission should implement Title II, in particular, how the rules relating to the requirement to verify accredited investor status should be implemented. Some focused on the capital formation benefits they believed the rulemaking could provide, highlighting the enhanced ability of accredited investors and qualified institutional buyers to learn about, and participate in, offerings made under the revised rules.⁷

Others asserted that permitting general solicitation without additional safeguards would create serious investor protection concerns, with some commenting on other areas that they believed should be considered as part of this rulemaking. For example, several recommended

⁶ See <http://www.sec.gov/spotlight/jobactcomments.shtml>. The Commission received more than 65 comment letters regarding Title II prior to issuing its rule proposal. See <http://www.sec.gov/comments/job-title-ii/job-title-ii.shtml>.

⁷ See, e.g., letter from Federal Regulation of Securities Committee, Business Law Section of the American Bar Association (April 30, 2012).

that the Commission amend the definition of “accredited investor” as it relates to natural persons. Others recommended that the Commission amend the Form D filing requirement, including conditioning the availability of the revised Rule 506 on the filing of a Form D, requiring the Form D to be filed in advance of any general solicitation, or adding to the information requirements of Form D. In addition, some commenters suggested that the Commission propose rules governing the content and manner of advertising and solicitations used in offerings conducted under the revised rule.⁸

In the Proposing Release, the Commission proposed only those rule and form amendments that a majority of the Commission members believed were necessary to implement the mandate in Title II. The Proposing Release did not propose other amendments to Regulation D, Form D, or the definition of “accredited investor,” such as those suggested in pre-proposing release comment letters. The Commission requested that commenters address the Commission’s specific proposed approach to implementing Title II. The Proposing Release did not request comment on other potential rule changes, nor did it address any such recommendations as potential reasonable alternatives to the approach in the proposed rule.⁹

Prior to the issuance of the rule proposal, a number of commenters expressed concerns about the possibility that the Commission might proceed to a final rule without allowing the

⁸ See, e.g., letters from Investment Company Institute (May 21, 2012); AFL-CIO, Americans for Financial Reform, Consumer Federation of America, Consumer Action, and Fund Democracy (May 24, 2012); Massachusetts Securities Division (July 2, 2012); North American Securities Administrators Association (July 3, 2012); Ohio Division of Securities (July 3, 2012).

⁹ Commissioner Luis Aguilar dissented from the Commission’s action, stating his view that the Proposing Release presented a framework that was not balanced and did not consider the alternatives suggested by pre-proposing release commenters. See Commissioner Luis A. Aguilar, Statement at SEC Open Meeting, August 29, 2012, available at <https://www.sec.gov/news/speech/2012/spch082912laa.htm>.

public an opportunity to comment on a specific Commission proposal.¹⁰ The Administrative Procedure Act, which governs all Commission rulemakings, requires such a notice and comment process, with certain narrow exceptions.¹¹

The comment period for the proposal ended in October 2012. Following the proposal, commenters have submitted more than 220 letters.¹² Those letters have generated meaningful discussion regarding the issues and been very useful in our consideration of how to implement Title II.

Commenters on the proposal were sharply divided in their views. Sixty-one commenters, including the majority of professional and trade associations/organizations, law firms and legal associations that submitted letters, expressed general support for the proposal, with many stating generally that the elimination of the prohibition on general solicitation or general advertising would facilitate capital formation.¹³ In addition, several supporters recommended that the proposed framework for verifying accredited investor status be supplemented in the final rule by including a non-exclusive list of specific verification methods that could be relied upon by issuers seeking greater certainty that they are satisfying the verification requirement.¹⁴ Eighty-

¹⁰ See, e.g., letters from the Investment Company Institute (August 17, 2012); Fund Democracy, Consumer Federation of America, Americans for Financial Reform and Lynn E. Turner (August 16, 2012); Council of Institutional Investors (August 16, 2012); and North American Securities Administrators Association (August 15, 2012).

¹¹ See 5 U.S.C. 553.

¹² See <http://www.sec.gov/comments/s7-07-12/s70712.shtml>. Commissioners and the staff also have participated in numerous meetings with a wide variety of interested individuals and groups regarding the rulemaking. The comment file relating to Title II provides information about the meetings in which the Commissioners and the staff participated. See <http://www.sec.gov/comments/jobs-title-ii/jobs-title-ii.shtml>.

¹³ See, e.g., letters from the Federal Regulation of Securities Committee, Business Law Section of the American Bar Association (October 5, 2012); Angel Capital Association (September 27, 2012); Center for Capital Markets Competitiveness of the U.S. Chamber of Commerce (October 5, 2012); and Securities Industry and Financial Markets Association (October 5, 2012).

¹⁴ See, e.g., letters from Angel Capital Association (September 27, 2012); Biotechnology Industry Organization (October 5, 2012); and Managed Funds Association (September 28, 2012).

one commenters expressed general opposition to the Commission's proposal, including the Investor Advisory Committee formed by the Commission as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act,¹⁵ all of the investor organizations, and all but one of the federal and state officials who submitted letters. Some of these commenters stated that the proposed rules, if adopted, would result in an increase in fraudulent securities offerings, with a number recommending that the Commission consider additional safeguards, such as those recommended in certain pre-proposing release comment letters.¹⁶ Currently, staff in the Divisions of Corporation Finance and Risk, Strategy, and Financial Innovation are developing recommendations for the Commission's consideration as to how best to move forward with implementation of Title II.

In conclusion, the Commission and the staff continue to work on implementing Title II of the JOBS Act. Although our work on this important provision is still ongoing, the Commission needs to complete this rulemaking promptly and it is a priority for the agency.

Thank you again for inviting me to appear before you today. I would be pleased to answer any questions you may have.

¹⁵ The Investor Advisory Committee was established in April 2012 pursuant to Section 911 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) to advise the Commission on regulatory priorities, the regulation of securities products, trading strategies, fee structures, the effectiveness of disclosure, and on initiatives to protect investor interests and to promote investor confidence and the integrity of the securities marketplace. Members of the Investor Advisory Committee were nominated by all five of the sitting Commissioners at the time of its formation and represent a wide variety of interests, including senior citizens and other individual investors, mutual funds, pension funds and state securities regulators. The Dodd-Frank Act authorizes the Investor Advisory Committee to submit findings and recommendations for review and consideration by the Commission. *See* Recommendations of the Investor Advisory Committee Regarding SEC Rulemaking to Lift the Ban on General Solicitation and Advertising in Rule 506 Offerings: Efficiently Balancing Investor Protection, available at <http://www.sec.gov/spotlight/investor-advisory-committee-2012/iac-general-solicitation-advertising-recommendations.pdf>.

¹⁶ *See, e.g.*, letters from AARP (October 5, 2012); Council of Institutional Investors (September 27, 2012); Consumer Federation of America (October 3, 2012); Investment Company Institute (October 5, 2012); Massachusetts Securities Division (September 20, 2012); and North American Securities Administrators Association (October 3, 2012).