

Statement Regarding the Proposing Release on Crowdfunding

Commissioner Kara M. Stein

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I'd like to echo my fellow Commissioners in thanking the staff. The proposing release before us today reflects excellent and clearly cross-divisional work on an important and challenging topic, and I commend the staff for their careful drafting and exemplary professionalism. I would also like to provide special thanks to one of my counsels, Blair Petrillo, who has spent countless hours wading through these documents, offering insights, and thoughtfully advising me on a number of the complex issues raised by today's release.

With this proposal, the Commission is taking another step towards implementing the Jumpstart Our Business Startups Act, also known as the JOBS Act. We have the statutory obligations to implement both the JOBS Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act, and this proposal helps us to fulfill our duty. While the Commission has made immense progress, we still have several more important rulemakings to go. And, I urge the staff and my fellow Commissioners to continue to move forward with these rulemakings.

The proposal before us is a particularly challenging one for the Commission. Today, we are proposing an entirely new regime for the regulation of some types of securities offerings. The proposal before us seeks to strike a balance between our statutory duty to create a new regulatory regime for capital formation and our longstanding duty to protect investors.

As Senator Merkley, one of the drafters of the crowdfunding provisions in the JOBS Act, has stated: "[T]his law will make sure entrepreneurs can use online tools to find investors, and make sure investors can put their money into exciting projects without worrying about getting ripped off."

It is clear to me that the proposal before us seeks to make that vision a reality. But, in truth, we won't know if we achieve that reality until the rule is finalized and this new method of securities offering begins.

Crowdfunding has developed in recent years as a way to fund a variety of social, charitable, and for-profit projects. The basic concept is simple: it allows the wisdom of the crowd to identify, and reward with capital, good ideas. Different methods of crowdfunding have expanded rapidly over the last few years with the help of the internet and social sites that bring together individuals and the projects in need of financing. Some websites that facilitate crowdfunding specialize in certain industries, certain projects, or particular types of entrepreneurs. The projects are as diverse as the individuals providing the financing.

However, until the JOBS Act, federal securities laws have restricted this financing method from being used to offer securities or equity in a particular business venture. With the adoption of the JOBS Act, Congress directed the Commission to open up this new funding method for small and new businesses seeking to raise capital from ordinary investors.

Because this has not been done before, we know very little about the dynamics of how this financial innovation will work. We don't yet know the characteristics of who will invest. Or how much the median investor will invest in any particular company. Or what types of businesses are most likely to take advantage of it. Or what types of abuses are most likely to arise. We can make informed guesses, as the staff has done its best to do, but we still have a lot to learn.

A central challenge with effectively regulating and overseeing this new financial marketplace is that the main objective is to gain access to capital from retail investors, who are precisely the individuals who our securities laws are designed to

most protect. The statute takes great pains to protect these investors from unnecessary risks. Clearly, the rule implementing this new law needs to be equally careful.

I encourage comment on all aspects of the release so that we can evaluate a diverse range of views in formulating the final rule. However, I wanted to highlight three areas where I think guidance from commenters would be particularly helpful.

First, there is ambiguity in the statute about how much any single investor should be permitted to invest. There are essentially two tests: one based on the income of the investor, and another based on the net worth of the investor. However, it's not clear from the statute which test should apply and when. One approach is to separately look at both the investor's income and net worth, and allow the investor to invest up to the maximum amount allowed by the test permitting the greater investment amount. That is the approach taken in the proposed rule. The proposed rule also excludes from the calculation of net worth an individual's primary residence. No senior citizen living off of a modest, fixed income should be at risk of losing her home to a crowdfunding venture. But even with primary residences excluded from the calculation, I remain concerned that taking the "greater than" approach may expose seniors or others to risks and losses they cannot afford. Another approach could be to limit the investor to the lower investment amount dictated by either the annual income or net worth tests. The release requests comment on which approach is appropriate, and I look forward to hearing from commenters on all sides of this fundamental issue.

The second area I'd like to highlight is whether we should permit funding portals not based in the United States to register and operate in the United States. The release proposes to allow non-U.S. funding portals to register as long as they meet certain requirements, including the portal's ability to submit to an on-site examination. Given the complexities currently surrounding compliance and enforcement with respect to non-U.S. entities, I believe we need to hear from all parties on this issue and make certain, at a minimum, that all funding portals are fully within our examination and enforcement jurisdiction. I look forward to hearing commenters' perspectives on this aspect of the proposal.

Third, there is substantial discussion in the release with respect to an issuer's responsibility to keep complete and accurate records of its securityholders. I believe this is a critically important issue that could have far-reaching implications for the marketplace. A business simply must be able to track who its owners are. While I understand that requiring a registered transfer agent would increase the costs to an issuer, I would like to hear from commenters about possible third-party, cost-effective solutions to help crowdfunding issuers manage their recordkeeping responsibilities.

Today's proposal is just one step towards implementing this new crowdfunding regulatory regime. We should learn from the comment process. And we should continue to learn even after we finalize the rule, as the new regime comes into existence. We have performed bold experiments before. Sometimes they worked and sometimes they didn't.

In 1992, the Commission liberalized the restrictions imposed on small offerings under Rule 504. Unfortunately, this experiment failed in the face of pervasive fraud, and the Commission needed to reinstate some investor protections just a few years later. Much like that experiment two decades ago, the proposal before us today appears to offer great promise for providing capital to small businesses so that they can survive, and hopefully thrive. But it also may provide great risks to investors. Getting the balance right will likely take time and careful refinement. If we don't get it right, I fear that the promise of crowdfunding will be lost.

I support the staff's recommendation, and I look forward to learning more about how we may best finalize this rule through the public comment process.

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