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June 3, 20222

The Honorable Pat Toomey
Ranking Member
Committee on Banking, Housing, and Urban Affairs
U.S. Senate Office Building
534 Dirksen
Washington, D.C. 20510
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RE: JOBS Act 4.0 Deregulatory Package – Commenting Period

Dear Ranking Member Toomey,

Elizabeth L. Carter, Esq., LLC (ELCESQ, LLC), a crowdfunding securities law firm, appreciates the opportunity to provide comments on the JOBS Act 4.0 proposal. This proposal demonstrates the political will to provide small businesses with greater access to capital in order to promote local sustainability. The investment crowdfunding industry has grown rapidly since the original JOBS Act was passed in 2012. Millions of everyday people have become new investors and hundreds of small businesses and investment companies were able to raise millions of dollars - topping $1.1 billion in 2021.

Investment crowdfunding is by far one of the most democratic financial tools within the U.S. At ELCESQ, LLC, we aim to make the industry even more democratic by providing accessible legal services to small businesses, investment companies, nonprofits, and cooperatives owned and controlled by Black, Afro-Latinx, and other underrepresented entrepreneurs. However, despite our efforts and the efforts of many of our ecosystem partners, investment crowdfunding still remains elusive for many underrepresented business owners.

Primarily aimed at entrepreneurs seeking capital, the JOBS Act theoretically increases the ability of small businesses and startups to access capital and generate jobs through crowdfunding. Crowdfunding has several barriers to entry. These include transaction costs, disclosure

requirements, portal registration, and capital limitations. Due to the high costs of a crowdfunding issuance, the relatively low caps imposed on the amount of securities able to be issued, and the heavy restrictions on solicitation, the crowdfunding exemption will most likely be helpful only to a narrow set of issuers and investors. As such, any costs required to raise that capital are likely to be a huge deterrent. The cost of assembling and submitting all of the necessary disclosures for a crowdfunding issuance could be very high relative to the amounts raised.

While the JOBS was broadly designed to facilitate access to capital, it ultimately has competing priorities. The Act's crowdfunding provision is riddled with protections that make it inaccessible to historically underrepresented investors. As such, we believe the Jobs Act 4.0 can help make investment crowdfunding more equitable and democratic by enlisting the following changes:

Sec.204 (S.3939) Small Entrepreneurs' Empowerment and Development (SEED) Act of 2022

We support this proposal with the caveat that this new exemption will be unnecessary if the "accredited investor" requirement for any offering is eliminated as we propose below.

Sec.306 (S.3921 - Equal Opportunity for All Investors Act)

This proposal moves in the right direction in expanding the definition of accredited investors. However, we believe that the "accredited investor" designation should be removed altogether. The designation largely assumes that the very wealthy are better able to evaluate the merits and risks of investments than are the non-wealthy. This is only an assumption–one that is discriminatory and supports economic inequity.

Black Americans are among the most impacted by the "accredited investor" requirement. Historically, Black Americans have been prevented from accessing wealth, namely through past redlining and current gentrification efforts by real estate and real estate-related actors, including but not limited to, as realtors, the Federal Housing Administration (FHA), and local governments. By requiring a certain amount of accumulated wealth, the "accredited investor" designation systematically excludes Black investors and businesses from private markets and hampers the ability of Black businesses to raise capital. The effect is a continuation of racial and economic injustice.

Knowledge and experience, not wealth, are how investors can best protect themselves. Lawmakers seem to be slowly realizing this. For example, people with certain professional certifications, designations or credentials related to finance, business and investing are now

included as accredited investors.[1] However, these changes still exclude many people, partly because the professional qualifications require a certain amount of resources to attain.

Moreover, the Equal Opportunity for All Act's proposal to introduce a test that non-wealthy people can use to demonstrate financial and business sophistication is also insufficient. It is very difficult to avoid cultural bias when creating tests. Black Americans, in particular, have historically experienced difficulty with standardized tests which are usually designed with White test-takers in mind.

We propose that the accredited investor designation be eliminated and that all investors instead be required to certify, represent, and warrant that they have sufficient knowledge and experience in financial and business matters that makes them sufficiently capable of evaluating the merits and risks of prospective investments. This knowledge and experience may be shown, although not required, through personal investments on the secondary market, "day trading," or even proof of mortgaging and/or purchasing a home residence, at any value, and at any income level. Alternatively, investors could certify that they have relied upon the advice of a professional advisor with regard to the prospective investment.

The decision to invest is a personal choice. If someone is willing to affirmatively state that they have the business and financial experience as well as sufficient knowledge to evaluate the merits and risks of an investment, or that they have received advice from a professional advisor regarding the investment, then they should be allowed to make the decision to invest and take responsibility for that decision in the absence of fraud. All that said, we believe that sufficient disclosure by issuers is essential for investor protection and to prevent disputes between investors and issuers. We propose that all private offerings require disclosure of material information to investors. As stated under "Disclosure Requirements" below, we propose that the SEC only require disclosures that provide valuable information to the market.

Disclosure Requirements

The Commission's disclosure regime rests on two assumptions: (1) Investors with sufficient access to information about an investment can make informed decisions, and (2) disclosure will deter fraud and other exploitative behaviors.

It would benefit companies, investors and the American economy if the SEC required only those disclosures that provided valuable information to the market. For example, risk factors educate potential investors on the risk of investing in a business.[2] Risk factors are a key component of a

[1] 17 CFR § 230.501(a)(10)
[2] *See*, Lexis practice advisor top 10 - fried frank Lexis Practice Advisor, https://www.friedfrank.com/siteFiles/Publications/LPA-Top%2010%20Tips-RISK%20FACTORS-final.pdf (last visited Jun 3, 2022)

company's offering documents, investors gain access to everything they need when an issuer provides material risk factors.[3] The lack of evidence that fraudulent offerings increased following the introduction of Title III of the JOBS Act demonstrates that the majority of the mandatory disclosures are unnecessary. We propose a review of the mandatory disclosure requirements by the SEC accompanied by a commitment to remove any requirements that do not prove effective at preventing fraudulent offerings, as well as requirement that all issuers provide investors with material risk factors.

II. Proposals for New Rules

This section concludes with a proposal for actions that the SEC should consider now for more informed policymaking in the future.

Advertising Rules

Apart from the high potential costs, another problem facing issuers are the heavy restrictions on solicitation. One of the big advantages of Regulation Crowdfunding is that it permits general solicitation and advertising.[4] However, advertising under Regulation Crowdfunding is currently hampered by rules that are difficult for issuers to understand and the purpose of which is unclear.

The most troubling rule is that issuers are not allowed to advertise "terms" alongside non-terms outside the intermediary's platform with limited exceptions.[5] The SEC seems to believe that there is a risk that investors will decide to invest in an offering based on a terms/non-terms off–platform advertisements instead of investing based on the issuer's disclosures on the platform.[6] We propose that Rule 204 of Regulation Crowdfunding be amended to allow advertisement of "terms" and non-terms together.

In addition to this, we propose that the SEC require (1) that all advertising and general solicitation outside of the Regulation Crowdfunding platform include, along with the link to the issuer's crowdfunding page on the platform, a disclaimer urging prospective investors to read all information the page provides, including the issuer's Form C, before making an investment decision and (2) that Rule 302(b) of Regulation Crowdfunding explicitly require the intermediary to include a prominent notice on each issuer's crowdfunding page cautioning prospective investors that, before deciding whether to invest, investors should review (a) all disclosures on the issuer crowdfunding page, along with the issuer's Form C, and (b) the investor education materials provided by the platform.

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[3] *See*, *Id*.
[4] *See* 17 CFR § 227.204
[5] 17 CFR § 227.204(b)
[6] *See* Crowdfunding, Release No. 33-9974 (Oct. 30, 2015) [80 FR 71387 (Nov. 16, 2015)] at page 140, *available at* https://www.sec.gov/rules/final/2015/33-9974.pdf.

Financial Statements

It is unclear why audited financial statements should ever be needed under Regulation Crowdfunding. Reviewed financial statements provide limited assurance to investors that a company's financial statements are not materially misstated.[7] Furthermore, issuers should not be required to disclose to investors any financial information that is not material.

Moreover, as the SEC has acknowledged,[8] the expense of an audit imposes a heavy burden on startup companies. Despite the SEC's knowledge of this issue, they have failed to address it sufficiently. Instead, the SEC requires audited financial statements when the issuer is raising more than $535,000 and has previously raised money under Regulation Crowdfunding. The implicit assumption is that after an initial Regulation Crowdfunding offer, an issuer would be able to afford audited financial statements.[9] This is likely untrue in many cases.

In 2020, the average crowdfunding issuer raised $275,000.[10] The platform may take 6% of that or more.[11] Plus, many startups who raise through Regulation Crowdfunding are not well-resourced as many have never raised capital, broke even or begun operations. These startups are crowdfunding for the purpose of obtaining very early stage business capital called "seed financing" and financial audits would make up a large portion of this need, typically costing $10,000 or more.[12] This is especially true for a company whose only resources are what it raised in its initial crowdfunding round.

Beyond being costly, audits take a considerable amount of time–often delaying a company's capital raise and preventing their business from moving forward. In many cases, the cost and the time involved in an audit can impede an issuer from launching a Regulation Crowdfunding raise at all. Given that audits are burdensome to the point of preventing issuers from raising capital, and given that reviewed financials can provide all the same material information that audited financials can without overburdening the issuer, we propose that the requirement that issuers provide audited financials be eliminated.

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[7] *See* ARC-90, Review of Financial Statements, SSARS No. 25, American Institute of Certified Public Accountants, *available at* https://us.aicpa.org/content/dam/aicpa/research/standards/compilationreview/downloadabledocuments/ar-c-00090.pdf

[8] *See supra* note 4, at page 109 and page 98

[9] *See supra* note 4

[10] 2020 US Equity Crowdfunding Stats – Year in Review, Crowdwise, Jan 3, 2021, https://crowdwise.org/funding-portals/2020-us-equity-crowdfunding-stats-year-in-review/

[11]See Report to the Commission, Regulation Crowdfunding, June 18, 2019, page 47, *available at* https://www.sec.gov/files/regulation-crowdfunding-2019_0.pdf

[12] *See* Cameron Keng, How Much Do Financial Audits Cost? At Least $10,000 Dollars, Forbes, May 31, 2018; https://www.forbes.com/sites/cameronkeng/2018/05/31/how-much-do-financial-audits-cost-at-least-10000-dollars/?sh=747cfcca4262; *see also* What is an independent audit?, National Council of Nonprofits, accessed on June 2, 2022, https://www.councilofnonprofits.org/nonprofit-audit-guide/what-is-independent-audit

Eliminate the Need for Investors to Reconfirm to Improve Small Business Capital Raising

Currently, investors of Regulation Crowdfunding are required to reconfirm their investment should the Issuer make a material amendment to its Form C.[13] During this situation, the regulated crowdfunding portal is required to send a notice to investors that the Issuer has made a material change and that they have five (5) business days to reconfirm their investor, or else their investment will be canceled and monies returned.[14] These notices are required to be sent via email or other electronic correspondence.[15]

Although the stated reason for this reconfirmation is to protect investors by giving them more time to consider the material change, it creates a significant risk to the issuer and does little to protect investors' investment. This is due to the nature of online capital raising. Many of the notices are oftentimes sent to email spam folders or are otherwise overlooked by the investor. In reality, many of these investors would actually reconfirm their investment if they were to actually receive the notice or were given more time to check their messages so that they may reconfirm in time. Instead, these investors lose their investment opportunity and the issuer loses a great percentage of committed capital.

In light of this, we propose that Regulation Crowdfunding investors be required to "opt-out" rather than reconfirm their investments when an issuer files a material amendment to its Form C. This way, investors are still protected. They will still have the same amount of time to consider the material change while also being able to make an active decision to cancel its investment. Meanwhile, the issuer can be sure that most, if not all, of its investment commitments are secure, and that as a result, its business is sufficiently funded.

Role of Funding Portals As Advisors to Issuers

Currently, the Regulation Crowdfunding rules allow funding portals to "[a]dvise an issuer about the structure or content of the issuer's offering."[16] Such advice "include[s] advice about the types of securities the issuer can offer [and] the terms of those securities."[17] There are three problems with allowing portals to provide such advice.

First, portals are not legal counsel to issuers. Yet, advice on what securities to offer, the terms of those securities, and how to structure an offering is legal advice. In fact, it is the core of what securities attorneys provide to clients. Second, because portals provide some legal advice, issuers

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[13] *See* Rule 304(c) of the U.S. Securities Act Section 4A(a)(7).
[14] *See Id.*
[15] *See* Rule 302(a)(2) of Regulation Crowdfunding.
[16] 17 CFR § 227.402(b)(5)
[17] *Supra* note 4, at page 290

often believe that they are receiving sufficient counsel when, not being attorneys or assuming the responsibilities of attorneys, portals are not advising issuers completely. Last, portals cannot advise on what securities an issuer should offer or how the issuer's offering should be structured without having a potential or actual conflict of interest.

Portals make money based on how much the issuer raises. They have an interest in trying to ensure that the issuer raises the most capital possible, whether or not the security offered or the structure of the offering is good for the company in the long term. For example, a portal might push an issuer to offer equity because it is best for it despite all of the downsides that this security type could have for many companies, especially if not particularly structured in a way that is unique to the companies themselves.

Offering securities is a major undertaking and commitment for many companies, whether it is done through crowdfunding or a registered public offering. The choice of security offered can have a major financial impact and significant legal consequences for the company. Moreover, investments involve relationships, sometimes long-term ones, that the issuer will have to maintain and as such, issuers should be able to control their own offering and investments without undue influence from a crowdfunding portal.

Securities law is highly regulated and multifaceted. Issuers should not be led to believe that they can safely navigate its nuances without guidance from experienced and dedicated attorneys. Due to the foregoing, we propose that the rules be revised to prohibit portals from providing legal advice on the terms or structure of an offering.

Three Day Attorney Review Period

As stated and in line with the statutory prohibition against regulated crowdfunding portals from soliciting and providing investment advice and recommendation to issuers,[18] these portals should also be prohibited from providing legal advice to issuers. In light of this, we propose a new rule that would require regulated crowdfunding portals to conspicuously place the following disclaimer on both their websites and listing/onboarding agreements with issuers:

"[NAME] IS A REGULATED CROWDFUNDING PORTAL AND IS PROHIBITED BY THE U.S. SECURITIES ACT OF 1933 AND THE U.S. SECURITIES EXCHANGE COMMISSION FROM PROVIDING INVESTMENT AND LEGAL ADVICE TO ISSUERS. THIS LISTING OR ONBOARDING AGREEMENT IS A LEGALLY BINDING CONTRACT THAT WILL BECOME FINAL WITHIN THREE (3) BUSINESS DAYS. DURING THIS PERIOD ISSUERS MAY CHOOSE TO CONSULT AN ATTORNEY WHO CAN REVIEW, CANCEL, OR OTHERWISE MODIFY THE CONTRACT."

[18] *See* U.S. Securities Exchange Act Section 3(a)(80)

This disclaimer requirement has the effect of ensuring the integrity and legal compliance of crowdfunding offers as issuers will be encouraged to hire their own legal counsel that is competent, unbiased and non-conflicted so that they may offer securities that are in line with their own particular business interest and purpose while providing investors with a variety of options for investment. This is especially true where the filing of the Form C is not required to be reviewed or qualified by the SEC prior to the filing.

Yours truly,

Elizabeth L. Carter, Esq.
Managing Attorney