



NASAA

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July 28, 2015

The Honorable Jeb Hensarling  
Chairman  
House Committee on Financial Services  
Washington, D.C. 20515

The Honorable Maxine Waters  
Ranking Member  
House Committee on Financial Services  
Washington, D.C. 20515

Re: July 28, 2015 Full Committee Markup of H.R. 1839, “The Reforming Access for Investments in Startup Enterprises Act of 2015,” and the Amendment in the Nature of a Substitute expected to be offered by Mr. McHenry and Ms. Waters.

Dear Chairman Hensarling and Ranking Member Waters:

On behalf of the North American Securities Administrators Association (“NASAA”),<sup>1</sup> I write to offer comments on an amendment that is expected to be offered during today’s Committee markup of H.R. 1839, the “Reforming Access for Investments in Startup Enterprises Act of 2015.” As introduced, H.R. 1839 would add a new transactional exemption in Section 4 of the Securities Act of 1933 (“Securities Act”) for secondary market sales to accredited investors by persons other than the issuer. The bill would also preempt state authority to review and/or exempt those secondary sales under state law.

On April 29, 2015, NASAA submitted a Written Statement expressing significant concerns about H.R. 1839 when the bill was the subject of a hearing in the Subcommittee on Capital Markets and Government Sponsored Enterprises.<sup>2</sup> Specifically, NASAA noted that the bill could create significant risks to investors due to its lack of information or disclosure requirements, allowance of general solicitation and advertising by selling security holders, insufficient verification standards and undefined platforms, and preclusion of state securities regulators’ ability to take action until after a fraud or unethical conduct has occurred. NASAA urged the Subcommittee to improve the bill by incorporating into the legislation key features of resale exemptions that presently exist under state law, including substantially stronger investor protections and information standards, and requirements that sellers and purchasers utilize a regulated entity (i.e., a registered broker-dealer) to facilitate the transaction.

NASAA is pleased that the Amendment in the Nature of Substitute (“Substitute Amendment”) that is expected to be offered today by Ranking Member Waters and Congressman McHenry would make a number of important improvements to H.R. 1839, including several key changes that NASAA requested

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<sup>1</sup> The oldest international organization devoted to investor protection, the North American Securities Administrators, Inc. was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

<sup>2</sup> See: Written Statement of William Beatty, President of the North American Securities Administrators Association, Inc., and Washington Securities Division Director before the House Subcommittee on Capital Markets and Government Sponsored Enterprises at a hearing entitled “Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens.” United States House of Representatives. (April 29, 2015)

in our comments on the bill in April. Specifically, the Substitute Amendment would prohibit general solicitation and advertising, remove references to an undefined platform, and require that sellers in all instances make available to a prospective purchaser certain information obtained from the issuer, including basic information about the issuer, its officers and directors and a statement about its business and the products and services it offers.<sup>3</sup> The Substitute Amendment also mandates financial statement disclosures (e.g., balance sheet and profit and loss statements), prepared in accordance with general accepted accounting principles (“GAAP”) or, for a foreign private issuer, GAAP or International Financial Reporting Standards. The Substitute Amendment would further improve H.R. 1839 by requiring that a seller who is a control person provide a statement about their affiliation, and certify that they have no reasonable grounds to believe that the issuer is in violation of the securities laws or regulations. Finally, the Substitute Amendment would prohibit the use of the exemption by bad actors, require that the issuer be actively engaged in business, prohibit any transaction constituting part of an unsold allotment by a broker or dealer acting as an underwriter, and impose an outstanding class requirement of 90 days.

While NASAA is pleased by the significant improvements that would be made to H.R. 1839 by the Substitute Amendment, we note that the Amendment fails to address other investor protection considerations, and urge Congress to further improve the legislation prior to its enactment. Specifically, NASAA strongly recommends that Congress include in the bill a requirement that the prospective purchaser receive a copy of a private placement memorandum or other offering document that the seller received at the time of the seller’s purchase of the securities, and that the seller provide any material information or updates about the issuer or the securities that the seller has received or has knowledge of since the date of the seller’s purchase of the securities.<sup>4</sup> Such disclosures are relevant and reasonable. A selling security holder should provide subsequent purchasers with information necessary to fulfill their obligation under the antifraud provisions of the securities laws that all material facts be disclosed.<sup>5</sup> Further, if the seller has received material information or communications from the issuer about its business operations or financial condition since the date of their initial purchase and receipt of an offering document, that information should be provided to a prospective purchaser. Additionally, the term “control person” should be defined under the exemption, and audited financial statements should be provided to the extent they are available.

Finally, NASAA notes that because this legislation would treat transactions under the exemption as a “covered security,” the exemption established by H.R. 1839 would preempt state review or an applicable state resale exemption. As with Regulation D, Rule 506 offerings, state regulators will only be able to take action after a fraud or unethical conduct has occurred, and in almost all such instances investor funds are unrecoverable. NASAA does not support preemption of state authority, and we note that the currently available manual resale exemption does not include any state filing requirement.

As NASAA observed in our April 29 Written Statement, exemptions from securities registration should be based on the principal that securities registration is not necessary either because of available and effective alternative oversight to ensure quality control, a pre-existing relationship between the company and potential investors, or because minimum financial investor thresholds help ensure that potential purchasers are capable of evaluating a private securities offering and do not need the full protection of securities registration. While the Substitute Amendment would significantly improve H.R.

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<sup>3</sup> Information required to be provided to a prospective purchaser must also include the title and class of the security, its par or stated value, and the total amount of securities outstanding, as well as identification of the name of any transfer agent or person responsible for transferring the securities, and any registered intermediary used to facilitate the transaction.

<sup>4</sup> The private placement memorandum includes information such as the terms of the security itself and the rights of security holders, the capital structure of the company, risk factors, compensation of executive management and any affiliate transactions and controls in place to address conflicts of interest.

<sup>5</sup> These requirements are important because traditional sources of information about the issuer such as a 10-K or 10-Q are unavailable securities of non-public companies.

1839, the bill would be further improved by additional disclosures and investor protections. NASAA looks forward to working with Congress to address these outstanding issues prior to the bill's enactment.

Thank you for your consideration of NASAA's views. State securities regulators look forward to working with this Committee and Congress on this legislation. Should you have any questions, please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read "William Beatty". The signature is fluid and cursive, with the first name "William" and the last name "Beatty" clearly distinguishable.

William Beatty  
NASAA President  
Washington Securities Administrator