Testimony of
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We live in the age of the 3D printer but the way in which we fund that technology is stuck in 1933. That may be about to change and so may the entrepreneurial landscape.

1. Introduction

Chairman Tester, Ranking Member Johanns and distinguished members of the subcommittee, thank you for holding this hearing on the status of the JOBS Act in relation to Title III, Crowdfunding. My name is Sherwood Neiss. I am a Principal at Crowdfund Capital Advisors, LLC (CCA). CCA works with Governments, multilateral organizations, investors and entrepreneurs on creating crowdfunding ecosystems. I am also an entrepreneur and one of the co-creators of the Startup Exemption, the framework used by Congress to create Title III. I was honored to be with my partners Jason Best and Zak Cassady-Dorion at the White House on April 5, 2012 as President Obama signed our idea into law. This law allows entrepreneurs to use their social networks and regulated websites to raise capital for their endeavors from people who believe in them. It addresses the funding void faced by startups and small businesses and, if implemented according to the intent of the law, may result in much needed economic growth, innovation, and jobs.

At a period of time when there are such polarized interests in Washington, DC, I continually point to the fact that when it comes to jobs, everyone here agrees, more are better. Washington understood this when the House voted in favor of our bill 407-17 and the Senate passed it, as part of the JOBS Act, 73-26. We can now include the Securities and Exchange Commission in that rank. On October 23, 2013 they voted unanimously, 5-0 in favor of the proposed rules related to Title III. This represents a huge step forward as this vote included skeptics among the Commissioners.

Jason and I worked hard as co-founders of the Crowdfund Intermediary Regulatory Advocates (CFIRA) and the Crowdfunding Professional Association (CFPA) to pull the industry together behind two unified voices to make sure the SEC had as much guidance to craft rules that followed the intent and spirit of the legislation. We think, while not perfect, the proposed rules go far to strike a fair balance. The intent of the legislation was to take what currently exists and efficiently operates in the crowdfunding space and layer on securities regulation in a way that provides oversight without undue burden. We believe there is still work to be done on the 'undue burden' part. In the end, we believe Washington understands that technology is something to get in front of and not behind and if we do it right we can help fund our nation's innovators and job creators.

2. The Challenging Entrepreneurial Environment

There is plenty of research that indicates the important role that startups and small businesses play in an economy. For one, they are the breeding ground for new ideas. Such innovation used to cost a lot but is rapidly decreasing. According to Don Tapscott, author of Wikinomics, "readily available resources such as open source software, cloud computing, and the rise of the virtual office infrastructure has driven the cost to launch an Internet venture down from $5 million in 1997 to less than $500,000 today." The decreased startup costs allow for more market entrants,

which can lead to greater innovation. This innovation can spur the M&A market as larger companies who often find it challenging to innovate, buy these smaller companies.

These young companies can also be job creators. As noted in a Kauffman Foundation study, 65% of net new jobs come from startups and small businesses. These jobs can address a problem that persists not only in the USA but globally, youth unemployment. As we note in our World Bank report *Crowdfunding's Potential for the Developing World,* startups and small businesses may have the greatest potential to fill this void. From a personal experience, I co-founded and acted as Chief Financial Officer of a company called FLAVORx. We flavored medicine so children were more compliant. We sold our system to pharmacies and grew it from one pharmacy to over 40,000. To help us grow we hired along the way. Prior to selling the company in 2007, we had up to 50 direct employees and over 100 indirect (contractors, subcontractors, etc) employees. The average age of our staff was 27, which falls right in line with the youth unemployment gap. Companies like ours played an important role in hiring youth.

But you cannot have businesses nor jobs without capital or properly functioning capital markets. The capital crunch was exacerbated with the Global Financial Crisis (GFC) in 2008. Prior to the GFC startups and small businesses had similar choices for access to capital; savings, home equity, friends and family, bank credit, bank loans, Angels or Venture Capital (VC). With the collapse of the financial markets this funding dried up. The banks stopped lending. Interest rates rose and limits were cut on credit cards such that credit card financing was no longer an option. Home equity values dropped and HELOCs shrunk or disappeared as a funding option. And Venture Capital saw more opportunity upstream and shifted their focus on bigger deals as the Investment Banks braced. The net result was a negative impact on startups and small business financing that is still struggling to recover.

It was at this time that we showed up in Washington with a solution to the funding void called the Startup Exemption. It was a 10-point framework to use the principles of crowdfunding – raising many small amounts of money from a large group of people via the Internet and merge it with startup and small business financing.

3. Title III – Crowdfunding Framework

What ended up being signed into law was strikingly similar to the Startup Exemption even though it went through several iterations in Congress. The net result is an exemption from registration with the SEC provided that rules and procedures are followed. To this effect, the SEC released on October 25, 2013 a 585-page report detailing the proposed rules for Title III.

Under "Regulation Crowdfunding" an entrepreneur otherwise known as an issuer can raise up to $1 million per year on websites (also known as intermediaries, platform or portals) that are registered with the SEC and overseen by FINRA.

Issuers and those holding more than 20% equity in the business must submit to a fraud/background check to weed out any bad actors. Issuers must upload disclosures to the SEC and the intermediaries that include the following:

- the name, legal status, physical address and website address of the issuer;
- the names of the directors and officers (and any persons occupying a similar status or performing a similar function), and each person holding more than 20 percent of the shares of the issuer;
- a description of the business of the issuer and the anticipated business plan of the issuer;
- a description of the financial condition of the issuer;
- a description of the stated purpose and intended use of the proceeds of the offering sought by the issuer with respect to the target offering amount;
- the target offering amount, the deadline to reach the target offering amount and regular updates regarding the progress of the issuer in meeting the target offering amount;
- the price to the public of the securities or the method for determining the price; and
- a description of the ownership and capital structure of the issuer.

The disclosures, as well as other identifying information about the issuer, including in many cases a video about the entrepreneur(s) and the company will appear on the website as a campaign.

Once uploaded, issuers can use their social networks to reach out to a community of individuals they have an established relationship with to learn more about the investment by pointing them to the crowdfunding website. While most solicitations are expected to happen online, issuers are allowed to use other means of solicitation (in-store placards, newspapers, etc) provided that the notice point the potential investor to the crowdfunding website. The intent of this is to make sure that all investment activity take place on websites that are registered and overseen by the SEC and FINRA and prevent unscrupulous actors from claiming to crowdfund when they are not.

Investors who come to the site must register and take an education series and certify they understand the risk. The proposed rules include education on:

- the process for the offer, purchase and issuance of securities through the intermediary;
- the risks associated with investing in crowdfunded securities;
- the types of securities that may be offered on the intermediary's platform and the risks associated with each type of security, including the risk of having limited voting power as a result of dilution;

- the restrictions on the resale of crowdfunded securities offered and sold in reliance on this exemption;
- the types of information that an issuer is required to provide in annual reports, the frequency of the delivery of that information, and the possibility that the issuer's obligation to file annual reports may terminate in the future;
- the limitations on the amounts investors may invest, as set forth in the legislation;
- the circumstances in which the issuer may cancel an investment commitment;
- the limitations on an investor's right to cancel an investment commitment;
- the need for the investor to consider whether investing in a security offered and sold in reliance on this exemption is appropriate for him or her; and
- that following completion of an offering, there may or may not be any ongoing relationship between the issuer and intermediary.

Investors could make commitments provided they are limited to the greater of

- $2,000 or 5 percent of annual income or net worth, if annual income or net worth of the investor is less than $100,000; and
- 10 percent of annual income or net worth (not to exceed an amount sold of $100,000), if annual income or net worth of the investor is $100,000 or more (these amounts are to be adjusted for inflation at least every five years);

Issuers must hit 100% of their funding target within the deadline to reach the target-offering amount or the money is returned from escrow to the investors. Investors would have the ability to communicate with issuers on the intermediary and ask questions.

Intermediaries are defined as either funding portals or broker-dealers. Funding portals are a new entity created by Title III and regulated by FINRA. Funding portals were created to act in the limited capacity that current crowdfunding websites do. In order to create funding portals, it was necessary to determine activities they cannot perform. These include:

- offer investment advice or recommendations;
- solicit purchases, sales or offers to buy the securities offered or displayed on its platform or portal;
- compensate employees, agents or other person for such solicitation or based on the sale of securities displayed or referenced on its platform or portal;
- hold, manage, possess or otherwise handle investor funds or securities; or
- engage in such other activities as the Commission, by rule, determines appropriate

The intent of this was to create a "broker-dealer light" regulatory scheme for funding portals that do not perform the wide array of activities (including promoting and selling) and hence the costs and compliance of a broker-dealer. It would allow these intermediaries to list crowdfund opportunities and allow the

crowd to do the diligence, vetting and funding very much like what currently happens on donation and perks-based crowdfunding websites.

4. Addressing Pumping, Dumping and Fraud

The legislation effectively addresses earlier attempts at easing regulations to stimulate capital formation. It deters the "pumping" of securities by disallowing compensation tied to the success of an offering unless this duty is performed by an individual who is registered as a broker-dealer, expressly disclosed to investors and regulated as a broker-dealer activity. It deters the "dumping" of securities by requiring them to be held for a 1-year period. It deters potential scam artists from entering the market by performing background checks, mandating disclosures, forcing the transactions to take place on regulated intermediaries, and requires issuers to hit 100% of their funding target or no money is exchanged.

When speaking at an event in Scottsdale, Arizona I had the opportunity to talk with a skeptical FBI Securities fraud agent about the JOBS Act and crowdfunding. He has spent the better part of 20 year trying to find and hold accountable securities fraud scam artists. When I explain the background check requirements within the legislation he responded, "Then I'm not that concerned with fraud." Apparently, the biggest challenge enforcement officials face is identifying the fraudster post fraud and the trail leading up to that fraud. With a mandated background check before funding required, potential fraudsters will be self-identifying making for easier accountability. With this entire process happening online, it creates a digital footprint that is recorded in history and easily referenced if needed.

If we look at data from the major existing platforms, they show no successful fraud has been perpetrated through pledge-based crowdfunding. Attempts at fraud have been made but were thwarted by the transparency inherent in crowdfunding: would-be investors asked questions and challenged the fraudulent postings, revealing the frauds and resulting in their removal from funding platforms within 24 hours.

Fraud is a legitimate concern. However, successful fraud with crowdfunding has been relatively rare. While most fraud is perpetrated on a one-to-one basis (for example, an identity scheme solicits personal information via e-mail), fraud in the context of the social media and crowdfund investing in particular would have to occur on a many-to-many basis: a potential fraudster would have to stand up to the wisdom, queries, and insights of the entire crowd. For this reason the most likely scenario for successful fraud involves criminals creating fake crowdfunding platforms and fake companies to attract investors' money.

Of the nearly 50,000 projects funded through Kickstarter to the tune of $815 million, there are four documented cases of attempted fraud. One was a campaign to raise capital for a video game. The campaign received numerous questions and accusations on the Kickstarter comments page that the game developer was unable

to address. This response, combined with the revelation that many of the images and content in their pitch were taken from other companies, was seen as an indicator of potentially fraudulent activity and the campaign was quickly shut down without any donor losing money.

Because no case has been filed, it can be hard to tell the difference between a fraud and a well-intentioned project whose creators failed to fulfill on their promise. The most notorious example was a Kickstarter project called ZionEyez, which claimed to stream video directly from a pair of eyeglasses to a person's Facebook stream. The project netted US$343,415 in 2011, and the creators have yet to deliver its product. The company, which has since changed its name, still claims it intends to deliver and is seeking outside capital.

The primary risk to consumers from donation-based crowdfunding is fulfillment risk. Some companies raise funds through crowdfunding without having thought through production, shipping, tax issues, and other essentials of their business model. There have also been examples of technical failure risk, usually involving the presale of software. In these cases companies received funds for products they intended to build, but technical problems prevented them from shipping the product. These same types of risks appear in debt and equity crowdfunding.

5. The Benefits of Crowdfund Investing

There are many benefits to crowdfunding outside of access to capital. In our World Bank report we identify 8 main benefits to crowdfund investing:

1) It fills a void left by traditional financing and creates an efficient mechanism for raising money by standardizing and centralizing the process of private capital formation.
2) It is an efficient mechanism for investors to analyze if a company fits their portfolio strategy.
3) It disrupts the reliance on business angels and venture capitalist so that enterprising entrepreneurs can leapfrog the venture investor boardroom to their social network. It also provides validation from other investors, which may lower the risk for follow on investment.
4) It expands the geographic range of angel investment. Social networks demonstrate that investments need not be tied to geography, as are many VC investments. Crowdfunding allows entrepreneurs all over the country to have equal access to capital.
5) It provides product validation, support networks and partnerships. Companies can use crowdfunding to explore a product's viability and to engage early adopters at lower costs. This also provides campaigns and the companies hosting them exposure.
6) It provides market testing and demand measurement. Successfully funded projects show crowd validation. This validation, or lack thereof, can help determine if enough of a market exists to fund an idea or not.

7) It provides access to support networks. Crowdfund supporters that become investors are a highly motivated group that acts as product evangelists and feedback providers. These investors have skills and experience from which entrepreneurs can benefit.
8) It provides feedback on the market and how to move forward. Active investors may help enhance an issuer's business plan with ideas and suggestions for moving forward.

Issuers interested in choosing Regulation Crowdfunding over Regulation D would do so for several reasons:

1) Companies that use Regulation D are usually more established and can incur the costs associated with putting together a full private placement memorandum that is usually associated with such offerings. Companies using Regulation Crowdfunding can use technology and software programs to create a business plan and financials necessary for this offering at much lower costs.
2) Companies that use Regulation Crowdfunding are seeking less than $1 million. Companies using Regulation D may be seeking more than $1 million.
3) Companies using Regulation Crowdfunding would benefit from the standardized forms used on crowdfunding platforms and the tools to keep the issuer compliant.
4) Companies using Regulation Crowdfunding want to leverage their social network that includes both accredited and unaccredited investors for which companies using Regulation D are only limited to up to 35 unaccredited investors. and
5) Companies using Regulation Crowdfunding do not have to worry about hitting the investor cap of 2,000 before filing with the SEC that a Regulation D offering would subject them to.
6) However companies using Regulation Crowdfunding will be subject to mandated annual reporting that issuers using Regulation D might not. This may increase the burden on Regulation Crowdfunding companies.

6. Firms that Might be Interested in Utilizing Crowdfunding

Given the $1 million cap per year that entrepreneurs can seek from the crowd and the all-or-nothing financing mechanism, Regulation CF is geared towards small businesses.

There are many business types that could benefit from crowdfunding. I list some of them below and why:

- High-growth/technology businesses are uniquely suited to crowdfund investing because they find general market understanding and acceptance.

- Research institutions can enable researchers and students to demonstrate broader interest in their research topics.
- Main Street USA businesses may not have access to bank loans since the financial crisis and crowdfunding may serve as a way to convert customers into investors and lenders.
- Franchisees may gain because there has been an absence of financing available to individuals who want to start a business franchise. Individuals well suited for this may be retirees looking for additional financial security or a military veteran who can leverage the franchise support system to transition to business ownership.
- Real estate companies can use crowdfunding as a means to rehabilitate communities ravished by the economic crisis and allow these same communities to benefit from the rehabilitation both physically and financially. And
- Women and minorities who have historically been both underfunded and left out of the startup and small business financing realm can now access capital from other women and minorities who until now haven't had either the way or an efficient means to support their peers.

Because Regulation Crowdfunding has yet to go into effect it is difficult to gauge the impact it will have on the economy and jobs. However, on September 24, 2013 Title II, another provision of the JOBS Act went into affect and this might be a leading indicator. Title II lifted the ban on general solicitation. For the first time in 80 years issuers can raise an unlimited amount of money from investors provided that they only take money from accredited investors. Such a change essentially allows issuers to use crowdfunding websites to market their offering to accredited investors.

This opened the door for platforms like AngelList, an online accredited investor platform, to expand their reach. Based on conversations with Kevin Laws at AngelList, over 2,959 companies have listed since Title II went into effect. At a crowdfunding event last week in New York City it was remarked that over $50 million of capital has already been committed to those companies. To put this into perspective, last year Venture Capitalist funded only 3,800 deals. While VC deployed over $26 billion we can see that increasing both deal flow and reach may lead to more business funding outside of what VC's deploy. Initial estimates from the Program for Innovation in Entrepreneurial and Social Finance, a crowdfunding think tank at the University of California Berkeley estimates that within its first few years the crowdfund investing market size could be as high at $4 billion.

One trend we expect to develop is more and more businesses circumventing the traditional means of finance and seeking funds from the crowd. Successful companies at crowdfunding may use their vested customers to help fine tune product offerings. They will leverage the crowd's marketing power to promote the business, which may in turn lead more sales, visibility and Angels getting involved. Angels who have an interest in the business can play a lead investor role in a Title II

offering or as a syndicate, meaning they come in with say the first $100,000 and syndicate the other $150,000 to accredited investors. Continued growth and success may raise the interest of Venture Capitalists who can come in at a later stage when a business is developed, product tested and market validated. They can provide the stronger hands and deeper pockets to take the company to the next level. All along the way, the crowd investors can either be bought out in successive rounds at the current price thus experiencing liquidation and cash flow or stay along for the ride with the knowledge that they own less (due to dilution) of a more valuable company for which they may experience greater benefit down the road.

When this industry is up and running we should have answers to questions we never could answer before like what is the valuation of dry cleaner, hair salon or small farm. As investors come in and invest in these businesses, valuations at different company sizes will be determined. These valuations will be stored online for all to see and may shed light on what has historically been a challenging exercise; how to value your company?

The disclosure requirements could also improve informational efficiency in the market. Specifically, the required disclosures would provide investors with a useful benchmark to evaluate other private issuers both within and outside of the securities-based crowdfunding market. Companies like Crowdnetic, a New York-based company, are already stepping into the space by providing an in-depth view into the private capital markets, who is getting funded, what sectors see the most funding, where trends are developing and more.

7. Rulemaking overview

I would like to commend the Securities and Exchange Commission for the detailed and thorough analysis of Regulation Crowdfunding. I personally would like to acknowledge the incredibly hard work performed by the staff at the SEC. Since the bill was signed into law we as an industry have requested and been granted meetings with key stakeholders in the SEC to share our knowledge, experience and concerns. All our meetings were accepted and we are gracious for the staff's time and consideration. We note that the 13 letters from CFIRA, the organization we helped co-found to work with the SEC and FINRA on the rules, was referenced 57 times in the proposed rules.

When considering the 585-page report on the proposed rules put out by the SEC the following thoughts come to mind:

1. The SEC worked really hard to follow the majority of the spirit and intent of the legislation. However they missed the ball on funding portals and need to make some enabling changes.
2. Compliance is the key word to come out of these 585 pages. Issuers will have to files forms with the SEC periodically and these forms are attached to either dates or milestones. It is critically important for a small issuer who is new to

running a business, raising capital or being compliant with regulation to either find an individual, technology or a portal that can keep them compliant. And

3. Education is key. Probably the most important thing potential issuers can do is to learn as much about crowdfunding and these rules as possible. Issuers will need to learn about types of securities, valuation and investor relations. If they want to be successful they should study prior to crowdfunding. This is one of the reasons we started an online education training series called Success With Crowdfunding. Investors too need to be educated and we are pleased to see that the SEC expanded upon what they believe investors should know prior to putting their money behind a crowdfund offering. We were surprised though that there was no mention of the importance of diversification.

The Good

There are parts of the rulemaking that could make this offering more appealing to prospective issuers.

First, the SEC did not create rules that would kill crowdfunding before it had a chance to start. By this I mean, while there is a 2,000 limit on the number of investors before a company needs to essentially be a public reporting company, the SEC understood that since there can be many crowdfund investors, they needed to be grouped together and exempted from that ceiling. Doing so will allow successful crowdfund companies to continue on the funding lifecycle without having to worry about the costs of becoming a reporting company prior to their desire or opportunity to do so.

Second, issuers don't have to decide whether to do a Title III or Title II offering. The proposed rules seem to understand that the type of investors in each Title may be different and not to preclude issuers from choosing one over the other. The proposed rules allow for concurrent offerings without integration, so if an issuer wishes to do parallel offerings, the issuer would be able to exceed the $1 million cap in Title III without losing his exemption.

Third, as mentioned earlier Title II of the JOBS Act lifted the ban on general solicitation provided that investments only come from accredited investors. Title II requires that issuers affirm the status of an accredited investor. In Title III this burden is left with the investor. This will ease the compliance burden of verifying income or net worth of individual investors, allow them to self-disclose these amounts and allow them to represent and certify that they have not gone over their individual investment limits.

Fourth, while there are disclosures mandated the SEC did not define set disclosures for a business plan or use of proceeds. This will help new entrepreneurs who are otherwise unsure of what is in a business plan to try

crowdfunding. It would be highly recommended though that these entrepreneurs use technology, business planning software or advisors to generate the reports necessary for disclosure.

Fifth, you can exceed your offering amount as long as you disclose what you would do with the extra money in your use of proceeds. This is actually very good. It allows issuers to set a minimum amount they need to achieve and allows others who come in toward the end to still have an opportunity to participate even if the company hits its minimum funding target. I believe that companies that exceed their funding targets will be the first point of contact and follow on deal flow for Angels and VCs.

Sixth, while not expressly stated in the legislation, it was good of the SEC to understand that crowdfunding operates in conjunction with the social network and that issuers should use their social networks to drive people to the intermediaries website provided they don't talk about specifics of the offering. And

Seventh, the SEC added the flexibility of dynamic pricing without limiting the types of securities. This may allow issuers to offer different types of shares at different prices to investors. While this may not benefit the untrained issuer, it allows more sophisticated issuers to raise money from more sophisticated investors, reward early supporters and increase the likelihood that the offering would be successful.

The Bad

There are parts of the rulemaking that could make this offering less appealing to prospective issuers.

As mentioned above, the biggest hurdle issuers face will be compliance. There is a lot of reporting required in the system. While such reporting will promote transparency and deter fraud, it may also deter the honest yet new issuer from deciding to crowdfund. It may also force issuers to raise more money to either pay for a compliance officer or an alternative solution. While this may promote jobs, this was not the intent of the legislation.

Second while the legislation does allow for both accredited and unaccredited investors to support issuers, accredited investors are not usually capped in their investment, within Regulation Crowdfunding, they are capped at $100,000.

Third there are disclosure requirements for directors and officers that include disclosing 3 years of business experience. While such disclosures may help investors understand who is running the company, depending on

the number of owners, their backgrounds and the system used for gathering this information it might be challenging to disclose all this information.

Fourth, while the legislation mandates it, we were still hopeful that the SEC would understand the almost impracticality of audited financials for offerings in excess of $500,000. Audited financials are beneficial for large corporations to uncover nuances. Smaller corporations are more transparent by nature. According to the SEC's figures an audit would cost about $28,700. Given the 2 year required disclosures in the proposed rules, this figure could be well over $50,000 or 10% of the raise. This might deter some issuers. We would hope in future amendments; this figure would be scaled up or just switched to CPA review.

Fifth, while FINRA is the only National Securities Association in the United States and hence assigned to be the oversight authority of the crowdfunding portals, I believe that the industry might be better served if it were overseen by the industry participants itself who are more concerned about developing an efficient, credible, transparent marketplace and building this credible crowdfunding marketplace is their only priority and core competence. Not knowing whether the SEC and FINRA are making rules to benefit brokers over funding portals might deter both intermediaries and issuers from getting into crowdfunding.

The Really Bad

The proposed rules don't allow funding portals much flexibility when determining who can list on their sites. Not giving them the flexibility to deny a business they believe isn't ready for crowdfunding or won't be successful may decrease efficiencies and increase failure.

The proposed rules leave liability with the funding portals for material misstatements by the issuers. While it would seem obvious that material misstatements should be a reason for liability, a portal is not in the same business as the issuer and hence might not know a statement is material. In addition, the roles and responsibilities of a funding portal are much less than that of a broker and while brokers may be paid to provide detailed vetting, portals are not. In reality, under the proposed rules, funding portals have greater liability because the Due Diligence defense afforded to brokers is not afforded to them. When it comes to funding portals, it is the role of the crowd to do the diligence on the issuer and question the disclosures on the comment pages of the campaign. Funding portals should not be held accountable for misstatements. As a matter of fact, funding portals should explicitly state on their websites that it is the job of the issuers to review the disclosures for nonfactual statements and that the portal is just providing the matching service. This was the intent of the legislation.

It is unclear from the proposed rules of funding portals can receive payment for a successful campaign in terms of a percent of the raise. This is how current donation and perks crowdfunding platforms operate and the intent of the legislation. One part of the proposed rules talks about disclosing the amount of compensation paid to the intermediary for conducting the offering. Another part states the funding portal cannot compensate employees, agents or other person for such solicitation or based on the sale of securities displayed or referenced on its platform or portal. And a third part goes on to state the proposed rules would define "funding portal" consistent with the statutory definition of "funding portal," substituting the word "broker" for the word "person," seemingly implying that the intermediary cannot be paid a success fee. This would effectively remove the economic model for the intermediary.

The proposed rules also require the escrow agent for a funding portal to be a bank. While escrow services are part of a bank's duties it is not their primary focus of activity. By not allowing other escrow agents into the process, this makes it not only challenging for funding portals to develop and flourish but increases the cost of capital for the issuer.

The reality of these four items, I believe, will make it very hard for funding portals to succeed in the space. Anyone that wants to be a funding portal will have to form a strategic relationship with a broker. Doing so might allow them to perform more activities but the funding portals will probably have to give up an excessive amount of their fees with the broker. Unfortunately the additional costs of capital will come out of what issuers raise and not where investors want their investment going.

The reality for an issuer is also fairly stark. In my calculations and conversations with Kevin Laws at AngelList we both came to the same conclusion, crowdfunding might be too expensive from a prepare and comply point of view to event get in the game at the low end. Karen Kerrigan, President and CEO of the Small Business & Entrepreneurship Council (SBE Council) stated it another way, "the rules as proposed will prevent or turn off many small businesses and entrepreneurs with limited resources from tapping into this new financing opportunity." Quite simply, at least at present, SBE Council believes the regulations work against the efficiency and transparency of technology in this space.

"The complexity and burden of the SEC's proposed regulations, FINRA requirements, and the potential threat to regulate even more will act as a barrier to entry to new funding portals, which means less innovation and competition," says Kerrigan. "We are not opposed to regulation and accountability, but SEC Title III rules tip the scales, which create immediate barriers to funding portal competition and choice for entrepreneurs in this new space."

In sum, the potential for equity and debt-based crowdfunding will be constrained by the proposed regulations (as they now stand) to implement Title III of the JOBS Act. Entrepreneurs who have the resources to comply with the various requirements at

each step of their funding (pre, during and post raise) will be fine. Small business owners and entrepreneurs with limited resources will have more difficulty tapping into this opportunity.

8. What can we learn from Crowdfunding internationally?

In our World Bank report we have a section titled Early Data from the Developed World. In there we state, "Currently there is limited data to report on equity and debt-based crowdfunding, but Australia and the United Kingdom are demonstrating interesting results. After seven years of crowdfunding companies, the Australian Small Stock Offering Board (ASSOB) shows that 86 percent of companies crowdfunded on its platform were still operating in 2012. This contrasts with a figure of 40 percent of noncrowdfunded (non-ASSOB) companies that fail after three years.

An engaged base of both customer and investors in the business is cited as one of the main reasons for longevity by ASSOB. ASSOB also vets deals prior to posting on their platform. Equity-based crowdfunding platforms have also launched in the Netherlands and Italy. No affirmative data yet exists to show investor returns from these platforms, though projected market size analysis has been completed by the University of California, Berkeley and well-regarded venture capitalist, Fred Wilson.

Debt crowdfunding in the United Kingdom has had some early successes in providing returns to investors. Since 2007 investors in companies listed on U.K.-based Funding Circle have completed financing totaling over £156 million (about US$250 million), receiving an annualized return of 5.8 percent (after expenses and bad debt expense, but before taxes) with a 1.6 percent default rate." This represents much better performance for both investors looking to earn a yield and issuers seeking to borrow at competitive rates.

There have been no successful cases of fraud on any debt or equity-crowdfunding platform globally.

9. Conclusion & Recommendations

With the global financial crisis the funding void for startups and small businesses got bigger. Crowdfunding has emerged as a unique solution and now Congress, the President and the Securities and Exchange Commission see its potential in addressing this problem but there is still work to do.

Youth unemployment in the United States according to one study is more than twice the national average. College graduates are competing for unpaid internships and not experiencing the benefit of having worked toward a degree. As stated by Judith Rodin in Innovations Journal, "Young people who are not on track to secure employment are often stuck in a self-perpetuating cycle of poverty and instability. Their future earning potential is stilted, and they are likely to settle for part-time

jobs or temporary work. As a result, today's youth many of whom are concentrated in urban areas, face high levels of social exclusion and lack clear access to the safety nets that employment can provide: health benefits, retirement accounts and pensions." In other parts of the world we've seen civil unrest as dispirited youth take to the streets in anger. This was even evident during the Occupy movement in the United States.

We may stand at a unique time in history to address both the funding void and unemployment by allowing individuals with aspiring ideas to take them to regulated platforms and let the crowd decide if they are worthy of funding. However, entrepreneurs need to approach this opportunity with eyes wide open. There is a great deal of disclosure and compliance required in this opportunity and it is advised that they take the time to study and learn everything they can about crowdfunding and the proposed rules before moving forward.

For crowdfunding to really flourish under Title III, and be in line with the way crowdfunding currently operates, I would encourage Congress to have the SEC make the following changes to the proposed rules. Doing so will allow funding portals, which were intended to be stand alone entities from brokers in the first place, to survive:

1) Funding portals that are not broker dealers or partnered with a broker be allowed to be paid in the form of a success fee in the form of a commission on deals closed. Without this economic model, portals will not survive. Further clarification on this is needed.
2) Funding portals be allowed to curate deals other than what type of offerings they allow on their portal so that they have the flexibility to keep deals off their platform that they do not deem worthy. This type of curation can only stand to benefit investors because it is not providing investment advice on a specific deal already listed on a platform but in essence keeping out deals that are not ready to raise capital, not fundable or not worthy from the portal's perspective for listing.
3) Funding portals not be liable for any material omissions or misstatements of the issuer. If the legislation approved by Congress and signed into law by the President meant to include funding portals in the liability it would have directly named "funding portals" in the list of those liable, forcing funding portals to diligence deals and be paid for that service like a broker. Funding portals play a limited role and shouldn't be held to the same liability standards as brokers.

With these proposed changes I believe a robust and efficient crowdfund investing market may develop in the United States. I look forward to your questions.