ANGEL CAPITAL ASSOCIATION

March 22, 2010

Senator Christopher J. Dodd, Chairman
Committee on Banking, Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510-4605

Dear Sen. Dodd:

The **Restoring American Financial Stability Act of 2010** addresses important issues for our country, but it also currently includes three sections that would harm financing for start-ups. We believe that the bill didn't intend to negatively affect angel investors, small business, and jobs, and therefore recommend updates to the bill.

The problematic sections are:

- **Section 412 and 413**, ***Adjusting the Accredited Investor Standard for Inflation***. As currently written, this section could result in the elimination of as many as 77 percent of all accredited investors who invest directly in start-up and early-stage small businesses.

- **Section 926**, ***Authority of State Regulators Over Regulation D Offerings***. This section could make it more difficult to raise angel capital from investors in different states, make it unclear what entities regulate angel investments, and introduce potential lengthy waiting periods for businesses to receive their capital, possibly resulting in the death of those businesses.

There are several reasons to ensure that these sections are either eliminated or language is added to clarify that they are not aimed at angel investors and the companies that receive angel investment:

- **Start-up firms are job creators**. A 2009 Census Bureau study found that start-up firms (in business five years or less) created all of the net new jobs in the United States in the last 25 years – in other words, if you excluded the jobs from new firms in normal years, overall employment in the country would decrease.

- **Angels invest in the kinds of small businesses that create jobs**. Angel investors are high-net-worth individuals who provide capital for start-up firms with high growth potential. Many angels started, built and sold their own companies and are now in a position to invest not only their money by their time in new businesses. The nation's leading expert on entrepreneurship, the Ewing Marion Kauffman Foundation, estimates that angel investors may be responsible for up to 90 percent of the outside equity raised by start-ups after the capital resources of their founders, friends, and family are exhausted. These firms rarely have the collateral to receive bank loans and they are generally too small and too young to receive venture capital.

Angel-backed companies have been some of the most prolific job creators and innovators in recent times: Google, Yahoo, Amazon, Facebook, Costco, and PayPal are just a few examples of these businesses. Without the angel investors who helped these companies get started, these businesses might not be around today. Many of these promising firms need capital, mentoring and other support to hire new people and develop new innovations. Angels invested an estimated $19.2 billion in 55,480 companies in 2008.

- **Innovative start-ups and angel investors are more important than ever.** In today's economic recession, the jobs that come from new firms are critical to America's vitality. Access to loans and capital has been a real problem for small business, and these problems could increase if there were significantly fewer angel investors and the process for getting angel investment became more complicated.

- **New standards could lead to loss of the majority of angel investors**. As we understand it, the current requirement for an individual of $1 million in net worth or $200,000 in annual income would increase to $2.3 million in net worth or $450,000 plus in annual income. Analysis of data from a 2007 academic study is that about ***two-thirds*** of angels in angel groups would not meet the new threshold.

- **Rural economic development could take a special hit.** Angel investors are literally located in every state. With thresholds adjusted for inflation, it appears that the angels most affected by increased accredited investor standards would be in rural areas and cities outside of the coasts and major cities. Salaries in these areas are generally smaller than the coasts, while the cost of living is generally lower. Promising startups in these areas would have a smaller pool of angel capital to draw upon.

- **The changes would not result in greater protection for investors or the businesses they invest in**. The angel investment arena has been virtually complaint-free in terms of fraud. Accredited angel investors make their own decisions to invest directly into small businesses, without securities dealers or investment advisors.

- **Increasing accredited standards is arbitrary related to angel investment**. In a review of best practices for angel investment, ACA finds that the best angels are those who understand start-ups, have a risk tolerance for angel investment, and are willing to put in the time to evaluate angel investments and mentor the entrepreneurs in whom they invest. We are not aware of any correlation between amount of wealth and sophistication of an angel investor.

- **Section 926 could complicate and delay financing, killing some small businesses**. The current language makes it unclear on whether angel investments would be SEC "covered securities" and whether specific offerings would be regulated by the SEC or individual state regulators. In addition, it provides a 120 day period for the SEC to determine whether it will review a filing before it would then go to the state regulator. Many entrepreneurial firms – even the most promising ones – cannot wait 120 days plus to receive their capital. They would not be able to make their payroll during that time and would have to close when they ran out of cash. The legal costs of making complicated filings could be large, exceeding the available budgets of both small businesses and angel investors.

- **State by state regulation could make raising angel capital difficult for entrepreneurs**. A set of different regulations in different states could lead to higher costs, more legal risks,

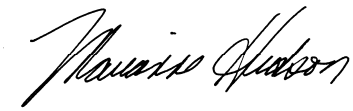
and the potential of not being able to raise capital. It appears that many angel investments are cross-state – investors come from other states than the small business is located in. In an informal survey of ACA member angel groups last week, we found that 22 of 25 groups had syndicated 20 percent or more of their investments with angels and angel groups in other states. The angel groups were from 13 states and they had syndicated with investors in another 23 states, or a total of 36 states.

- **Section 926 is impractical and significantly changes the SEC's role**. Since its founding, the Securities and Exchange Administration has been a disclosure agency, rather than a reviewer of the merits of a specific investment, absent fraud. This section of the bill asks the SEC to review the merits of each Form D filing. Not only is this impractical in terms of quantity – it looks like over 400 Form Ds were filed in three business days last week – but it is unclear that there is any data on the form that would allow for review of the merits of the investment. In addition, the current language is also contradictory to the existing thrust of Section 18(a)3 which says that a State agency shall not review covered securities on the "merits" of the investment.

As we wrote on March 2nd in a letter co-signed by the National Venture Capital Association, we believe that nothing would be gained from these changes: no additional protections would be provided to accredited investors and there would be no benefits to the national financial system or to the economy.

The Angel Capital Association, which has 160 member angel groups and affiliates in nearly every state and 6,500 accredited investors connected to those organizations, urges you to consider changing these two sections so that they are not aimed at angel investment. We understand the need to protect accredited investors in Securities Companies, but think it is counterproductive to cut jobs, innovation, and early-stage capital any time, but especially during the recession. We stand ready to provide additional information and to discuss recommended language to eliminate the problems mentioned in this letter.

Sincerely,



Marianne Hudson
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