Occupy the SEC

http://www.occupythesec.org

July 31, 2012

Mary Schapiro
Chairman
Securities Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Public Comments on SEC Regulatory Initiatives Under the JOBS Act

Dear Madam:

Occupy the SEC[1] submits this letter in connection with the Securities and Exchange Commission's ("SEC", "Commission") request for comment prior to its implementation of the Jumpstart Our Business Startups ("JOBS") Act. As expressed below, we have serious concerns about the JOBS Act and its capacity to promote fraud at the expense of small-time investors. Equally troubling is the fact that the JOBS Act magnifies the unfair structural advantages already enjoyed by insiders, investment banks and their favored clients, and issuers. Accordingly, we urge the SEC, in issuing regulations under the JOBS Act, to utilize the full extent of its authority to impose additional restrictions that protect the public interest.

I. The Need for Expansive Regulatory Requirements in the Commission's Implementation of the JOBS Act

Creating jobs for our economy is an admirable idea but the JOBS Act does not do that. Rather, the Act makes it easier for companies to commit fraud and to manipulate the price of stocks and the valuations of public companies. Historically, companies had to prove profitability before going public and have been subject to accounting standards that keep them transparent and honest.

[1] Occupy the SEC (http://occupythesec.org) is a group within the New York-based Occupy Wall Street ("OWS") protest movement. This letter represents the opinion of our group's members, and does not represent the viewpoints of OWS as a whole.

As the Act stands now, covered issuers are allowed to operate under a tremendous amount of flexibility and opacity. A loosely implemented JOBS Act has the potential to create a stock bubble similar to the tech bubble that led to the market crash in the year 2000. During the tech-bubble, investment banks stopped insisting on proven track records or real profitability before taking a company public, fueling massive investment into many unknown and overvalued Internet companies that were actually distorting the market. This meant that companies with no track records went from having no revenues at all to having billions of dollars worth of market capitalization overnight. The result was inevitable: the bubble burst, jobs were lost, little economic value was created and the public suffered.

This unfortunate history has the strong potential to repeat itself. Ostensibly geared towards small-time investors, the Act loosens existing regulations in a way that only serves to facilitate investment banker profits, not investor gains. The recent Facebook IPO debacle highlights that the public offering process is already rife with an unequal playing field that heavily privileges underwriters and other insiders, leaving the public at a distinct disadvantage.

> What's most worrying to investors are the reports that insiders were privy to information about Facebook's financial worries that the rest of us were somehow expected to infer from some exceedingly vague verbiage added to Facebook's prospectus before the launch.[2]

What is actually most worrying is that the JOBS Act, if loosely implemented, would routinize Facebook-styled botched IPOs, greatly amplifying opportunities for exploitation by insiders. The Commission has been delegated broad rulemaking and enforcement powers by existing securities law, and it must deploy these tools to protect investors from undue dilution of securities protections by the JOBS Act.

Our country already faces a fragile moment – the Commission should not make it any easier for companies to commit fraud. There are too many predators in our financial markets who have caused infections to spread to every corner of our financial system. It is time for our regulators to be the cure, by implementing and enforcing regulations that keep investors protected, and the markets transparent and stable. We understand that the Commission does not have the authority to undo the JOBS Act. However, it does have ample authority to define the regulatory contours of the Act in a way to minimize its detriment to the public interest.

II. Specific Recommendations for Regulatory Provisions

The statute's provisions for "emerging growth companies" are so overly broad that they would eliminate many important protections for investors. We propose various additional regulatory requirements to mitigate this harm.

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[2] David Futrelle, *Has Facebook Jinxed the IPO Market for Everyone?*, Time Business, May 24, 2012, *available at* http://business.time.com/2012/05/24/has-facebook-jinxed-the-ipo-market-for-everyone/.

A. Section 102(a)(1) - Exempting EGCs from 15 U.S.C. 78n-1(a) and (b)

This provision eliminates certain executive compensation-related investor protections. The SEC should impose a separate requirement that any issuer availing of this exemption from disclosure should be required to provide a detailed breakdown of executive compensation at the issuer, including a cross-industry comparison of executive compensation for similar companies. While the JOBS Act would reduce the ability to shareholders to explicitly vote on compensation, they should at least be provided with sufficient information to decide whether or not to remain as shareholders.

The SEC can impose this requirement by relying on its expansive authority to mandate disclosure under various provisions of the Securities Exchange Act of 1934. This change is required to ensure that the insiders at the issuer are not enriching themselves. Even a company as publicly visible as Facebook faces questions about insider profiteering.[3] Surely much smaller companies like ECGs (having gross revenues of $1 billion or less) are more likely to enrich insiders and exploit outside investors, if left to their own devices.

B. Section 102(b)(1)(A) – Amending the Audited Financial Statement Disclosure Requirements of 15 U.S.C. 77(g)(a)

We recommend that the Commission impose additional disclosure requirements that, while not flouting the statutory provision, nevertheless improve transparency.

Normally the need for investor transparency can be addressed, at least partially, by an issuer's disclosure of its audited financial statements. Unfortunately, the JOBS Act limits the duration of such required disclosure for ECGs to 2 years. Accordingly, we recommend that the Commission utilize other disclosure methods for time periods prior to this 2 year timeframe.

For instance, the SEC could require the submission of **un**audited financials, or mandate Board Member certification as to accuracy of the issuer's financial data. By imposing these or similar disclosure provisions, the Commission could comply with the statutory mandate of the JOBS Act, while still ensuring that investors are provided with necessary financial information.

C. Section 106 – Amending 15 U.S.C. 77f to Allow ECGs to Submit Draft Registration Statements

The SEC should require that draft registration statements that are publicly filed under this provision include a simple cover sheet that spells out risks in large font and in plain-English language. While applicable regulations already require registration statements to effectively disclose material data, a registration statement issued pursuant to the JOBS Act should

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[3] Matt Taibbi, *The Facebook IPO: Shareholders Weren't Invited to the Real Party*, Rolling Stone, May 23, 2012, *available at* http://www.rollingstone.com/politics/blogs/taibblog/the-facebook-ipo-shareholders-werent-invited-to-the-real-party-20120523.

contain an accessible summary up-front. This is necessary in light of the low likelihood that the average investor would read beyond the first few pages of the statement.

D. Section 201 – Amending 17 C.F.R. 230.506 to Allow General Advertising to Accredited and Institutional Investors

The statute requires the issuer to "take reasonable steps" to verify that purchasers qualifying under the revised 17 C.F.R. 230.506 are accredited investors or qualified institutional buyers (QIBs). We urge the Commission to recognize that issuers have an incentive to avoid conducting thorough investigations of qualified or accredited status, as truly thorough investigations would only heighten the possibility of lost investment into the issuer. The vague statutory requirement, requiring only "reasonable steps," allows issuers to settle for imperfect compliance.

The Commission can ameliorate this deficiency by requiring all accredited investors and QIBs availing of Section 201 to register on an SEC website. The Commission should keep track of these registered users, and send them periodic email bulletins regarding fraud trends specific to the JOBS Act. Further, the SEC should verify accredited/QIB status by requiring submission of tax returns or accountant-certified financial documents.

E. Section 302 – Amending 15 U.S.C. 77d to Create an Exemption for Crowdfunding Transactions

The crowdfunding provisions of the JOBS Act contain certain safeguards to protect investors from investing excessive income and to ensure that they possess sufficient knowledge and understanding of financial markets sufficient to make prudent investments. However, the statute does not specify exactly how those safeguards will be put into practice, and it is incumbent upon the SEC to implement regulations giving full force to the investor protection component of the Act.

As with Section 201 sophisticated investors (discussed above), the Commission should require all putative crowdfunding investors to register on a central SEC website dedicated to the crowdfunding process. The Commission would email registered users issuer-specific information as well as general information regarding crowdfunding fraud trends. Investors should submit tax returns or CPA-certified financial statements to the Commission (or at least to the intermediary) to show qualification under the limits established by Section 4(6)(B) of the Securities Act of 1933 ("'33 Act").

i. Requirements for Intermediaries – Section 4(A)(a) of the '33 Act

Intermediaries should also have a compliance obligation to ensure that crowdfunding investors have registered on the proposed SEC crowdfunding website. Intermediaries should further be required to verify that crowdfunding investors have passed a Commission-approved investor education test administered at a secure, unaffiliated, third party location. Passage of this test should be a pre-requisite for investing under Section 4A. After investors have

successfully passed these preliminary requirements, all investment data on the crowdfunding portal should be automatically integrated, in real-time, with the SEC's crowdfunding website. This integration would allow the Commission maximum visibility over compliance issues, would ease the Commission's regulatory burden and would facilitate enforcement efforts.

Furthermore, crowdfunding intermediaries should be required to keep collected crowdfunding investments in escrow for six months. The investor should be automatically eligible for a refund of invested money during the first six months if 5% or more of investors seek redemption of their investment, or if the issuer violates any material SEC or SRO rule.

The Commission can derive authority to impose all of these requirements from Sections 4A(a)(4), (5) and (12) of the '33 Act, which grant it wide latitude to formulate anti-fraud and investor education requirements.

ii. Requirements for Issuers – Section 4(A)(b) of the '33 Act

Issuers should likewise have certain responsibilities to protect the interests of investors. While the JOBS Act relaxes certain compensation-related requirements for crowdfunding transactions, the Commission has authority, pursuant to Section 4(A)(b)(1)(I) to require any "such [] information as the Commission may, by rule, prescribe, for the protection of investors and in the public interest." Both the principles of investor protection and the public interest militate in favor of enhanced compensation disclosures for insiders at crowdfunded companies. For instance, we suggest that any crowdfunding issuer should be required to provide a detailed breakdown of executive compensation at the issuer, as well as a cross-industry comparison of executive compensation for similar companies.

The risks of insider fraud and Ponzi scheme structures are inversely related with the size of a security-issuing company. Thus, issuers availing of the crowdfunding provision are especially prone to being conduits for undue insider enrichment. This problem can be partly addressed by apprising potential investors of relevant cross-industry compensation information, so that they may be better informed as to whether their investments are likely to have some productive effect aside from merely enriching insiders.

Further, the disclosures required under Section 4A(b)(1)(H)(v) should be stated in a simple cover page that spells out risks in large font and in plain-English language. Despite this simplicity of language, any risks should be delineated as specifically as possible, and not generalized or obfuscated through arcane jargon.

iii. Transactions that Should be Forbidden Under Crowdfunding - Authority

Section 4A(f)(4) of the '33 Act provides the Commission with blanket authority to decree, *a priori*, that certain securities transactions are ineligible for the crowdfunding exemption. We urge the Commission to make vigorous and frequent use of this jurisidictional tool. We also

specifically recommend that the following transactions be excluded from consideration as crowdfunding transactions:

- Issuances in which the founders/managers/directors do not have some equity-based “skin in the game” (to be determined by SEC)
- Issuances by issuers that suffer from any of the factors that normally lead an issuer to be delisted from an exchange (to be monitored and determined by SEC)
- Issuances by issuers that have excessive compensation as compared to industry standard (to be determined by SEC)
- Issuances by issuers that **do not** sign a contract with crowdfunding shareholders that their interests will not be materially diluted in favor of management equity. (In other words, all crowdfunding transactions should require a written promise from the issuer that non-management equity will not be diluted).

F. Section 304 – Amending 15 U.S.C. 77d to Create an Exemption from Broker Dealer Registration Requirements for Funding Portals

As noted above, funding portals should be required to use standardized data that is uploaded/integrated on a real-time basis with the SEC's database, so the SEC can electronically track usage statistics, ensure compliance with limits, and identify fraud indicators. If possible, funding portals should act as mere marketing conduits, with data stored and maintained in a single depository controlled by the SEC.

15 U.S.C. 77d(h) requires the Commission to accede significant regulatory oversight over the broker/dealer activities of funding portals, which creates palpable risks that these websites will misuse customer information or funds for improper purposes. The Commission can reclaim supervisory authority over these funding portals by standardizing their operations and centralizing the collection of data. These recommendations are well within the Commission’s jurisdictional ambit, given that 15 U.S.C. 78c(h)(1)(C) allows the Commission to impose any “such other requirements under” the funding portal section as it determines appropriate.

G. Section 401 – Amending 15 U.S.C. 77c(b) to Create a New Exemption for Certain Small Issues

The JOBS Act at Section 401 creates a new exemption for certain issuances totally $50,000,000 or less within a one year period. The statute leaves it to the Commission to impose conditions and requirements necessary to protect investors and the public interest. The statute grant the Commission the authority to impose certain requirements, as listed at 15 U.S.C. 77c(b)(2)(G), but does not affirmatively require the Commission to do so. We urge the Commission to utilize this authority and impose those listed requirements.

Moreover, the SEC should require any "small company" falling under Section 401 to provide a detailed breakdown of executive compensation at the issuer, including a cross-industry comparison of executive compensation for similar companies. The reasons why such a requirement is good policy have been discussed above, in a different context. The

Commission has authority to impose this requirement under 15 U.S.C. 77c(b)(4), which required periodic disclosures (as specified by the Commission) regarding an issuer's business operations and corporate governance principles. Executive compensation would fall squarely within the scope of these principles.

H. Section 701 – Requiring the Commission to Conduct Outreach and Education Programs

The SEC's outreach responsibilities will be facilitated by the creation of a centralized portal and the online registration requirements for investors, as described above.

Thank you for considering our viewpoints on this important matter of grave public concern.

Sincerely,

/s/

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