

# Protect Angel Funding

*The Accredited Investor Definition*

*ACA Public Policy Update*

June 11, 2014



ANGEL CAPITAL ASSOCIATION



- Use chat to submit questions
- Yes, you'll get the slides
- We're recorded, so come back and listen again



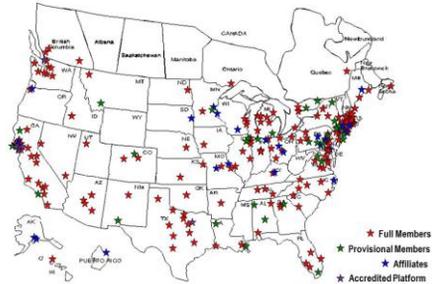
ANGEL CAPITAL ASSOCIATION

# Angel Capital Association

## ACA Mission:

**Fuel the success of angel groups and accredited individuals active in the early-stage landscape**

- World's largest trade group for angel investors
  - 220+ angel groups
  - 12,000 accredited investors
  - Voice of accredited individuals, portals, and family offices
- 50 US states + Canada
- Research/ education partner



## Member Groups & Accredited Platforms



# ACA Partners



FOLEY  
HOAG LLP



OTC Markets



SVB Silicon Valley Bank  
A Member of SVB Financial Group

## Our Moderator



Managing Director  
**Golden Seeds**

- Managing Director, Golden Seeds
- Board Member and Chair of ACA Marketing/Brand Committee
- Previous Senior Executive at Genworth Financial and John Hancock
- Policy analyst to the U.S. House of Representatives' Budget Committee
- Former award winning financial editor and journalist



ANGEL CAPITAL ASSOCIATION

## Our Panelists - and a Little about Them

---



**Evan Burfield**  
Cofounder – 1776 Accelerator



**Mike Eckert**  
Chairman of the NO/LA Angel Network  
Board Member & Executive Committee  
Angel Capital Association



**Joe Wallin**  
Partner  
Davis Wright Tremaine



**Barbara Roper**  
Director of Investor Protection  
Consumer Federation of America



**Kevin Laws**  
COO, Angel List



**Elizabeth Hess**  
CFO, TRX Systems

## Today's Topics

---

- Accredited Investor definition – potential changes
- Importance of angels to the economy and jobs
- Why angel investing has so little fraud
- Importance of angel investors to startup ecosystem
- Status of angel investing moving to online platforms
- View of investor protection organizations



ANGEL CAPITAL ASSOCIATION

## Importance of Angel Investing to Economy and Job Creation



**Mike Eckert**

Chairman of the New Orleans/LA Angel Network  
Board Member & Executive Committee  
Angel Capital Association



ANGEL CAPITAL ASSOCIATION

## Protect Angel Funding & Jobs



- SEC reviewing Accredited Investor definition this year
  - Investor Protection
  - Public Interest
  - Current Economy
- Some organizations advocate increase for inflation
  - \$2.5M net worth, versus \$1M currently
  - \$400K income (\$600K if married), versus \$200K/\$300K currently
  - Supported by state regulators, AARP, etc.
- Increase would eliminate 60% of all accredited investors
  - **Major impact on startup economy**

**Fewer Angels = Fewer Startups = Fewer Jobs**



ANGEL CAPITAL ASSOCIATION

# Impact on Startups & Angels



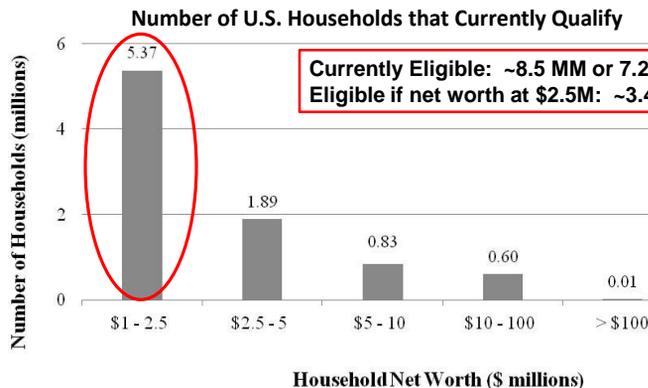
- Angels invested \$24.8B in ~71,000 deals in 2013
  - All 50 states – Main Street, not Wall Street
- Angels provide ~90% of outside equity to startups
  - Virtually only source of seed funding
  - 90% of venture capital is for later stage growth
- Majority of net new jobs in US are from companies < 5 years old – US Census
- Very little fraud in angel investing
  - Due diligence
  - Negotiated terms and information rights

**Fewer Angels = Fewer Startups = Fewer Jobs**



ANGEL CAPITAL ASSOCIATION

# Accredited Investor Definition & Net Worth



**Currently Eligible: ~8.5 MM or 7.2%**  
**Eligible if net worth at \$2.5M: ~3.4 MM or 2.8%**

**~60% of Accredited Investors Would Be Eliminated at \$2.5MM Net Worth**

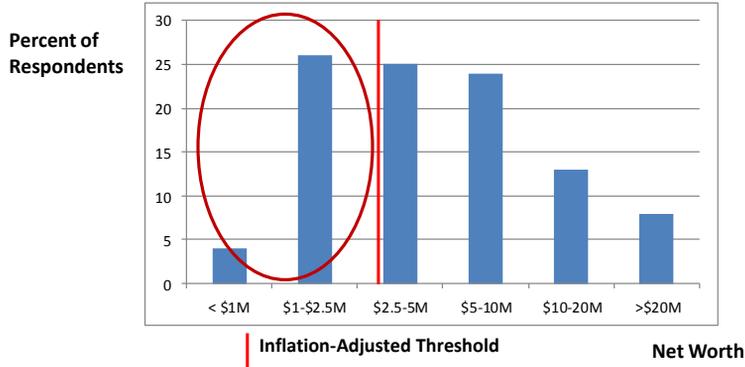
Source: SEC and General Accounting Office – Based on 2010 Net Worth



ANGEL CAPITAL ASSOCIATION

## ACA Members Average Higher Net Worth, But Still Affected

Percent of Surveyed ACA Members Who Qualify as Accredited Investors Based on 2013 Net Worth



\* Some could still qualify based on income

Source: ACA Survey, December 2013-January 2014 – 1009 members



## 28% of ACA Members Don't Meet Higher Thresholds

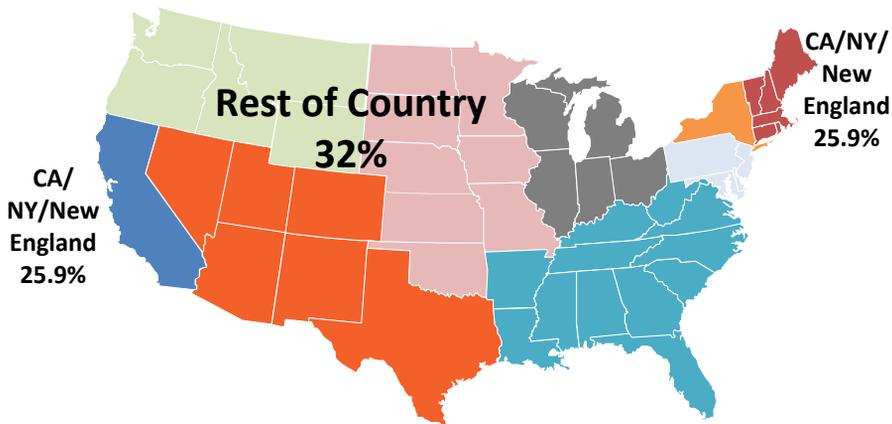


Source: ACA Survey, December 2013-January 2014 – 1009 members



## Impact is Higher Outside Top Venture Areas

Percentage of ACA Members Who Would Not Qualify, by Region



Source: ACA Survey, December 2013-January 2014 – 1009 members



## ACA Recommendations to SEC

- Maintain current financial thresholds
  - \$1 million net worth and \$200K/\$300K income
- Let individuals certify using detailed questionnaire
  - Qualifying questionnaire should satisfy “issuer verification” requirement for Rule 506(c) (general solicitation) deals
- Add sophistication criteria, without financial limit
  - Previous investment in Reg D deal
  - Member of an Established Angel Group
  - Board, executive, financial responsibility for business
  - Relevant degree or certification: MBA, CPA, etc.
  - Certificate of education from ACA or similar



## What ACA Needs You to Do



### • Write to SEC and Congress

- Let them know startup funding is critical to jobs, innovation and your community
- Template letters and instructions for submitting; ACA Comment letter: [www.angelcapitalassociation.org/aca-public-policy-protect-angel-funding/](http://www.angelcapitalassociation.org/aca-public-policy-protect-angel-funding/)
- All Accredited Definition comment letters are posted at: [www.sec.gov/comments/s7-06-13/s70613.shtml](http://www.sec.gov/comments/s7-06-13/s70613.shtml)
- Engage your startup community
- Your voice is important! Please let it be heard!



ANGEL CAPITAL ASSOCIATION

## Legislative and Regulatory History of Accredited Investor Definition



Joe Wallin  
Partner  
Davis Wright Tremaine



ANGEL CAPITAL ASSOCIATION

# The Case for Changing the Accredited Investor Definition

Barbara Roper  
Director of Investor Protection  
Consumer Federation of America



ANGEL CAPITAL ASSOCIATION

## Public/Private Market Evolution

---

- Accredited investor definition plays a central role in defining the border between public and private offerings.
- In 1953 the Supreme Court ruled: “An offering to those who are shown to be able to fend for themselves is a transaction ‘not involving any public offering.’”
- Today, the private market rivals the public market in amount of capital raised, making standards that apply to such offerings of great significance.



ANGEL CAPITAL ASSOCIATION

## Factors for Analysis

---

- Over the years, whether a particular class of individuals needs protections of the Act generally turned on three factors:
  - Whether individual has access to the kind of information that the Act would make available in the form of a registration statement;
  - Whether the individual is sufficiently financially sophisticated
    - knowledge and experience
    - capability of evaluating the risk and merits, to make an informed investment absent the full disclosure of a public offering;
  - Whether the individual has the wealth to hold often illiquid investments over the long term and/or to withstand a complete loss.



ANGEL CAPITAL ASSOCIATION

## Issues with the Current Definition

---

- Current definition exclusively relies on income and net worth thresholds; does not satisfy any of those 3 tests.
  - Average individual with \$200,000 in income or \$1 million in net worth does not have and cannot negotiate access to the kind of comprehensive information provided in public offering registration statements.
  - Many if not most individuals who satisfy the definition do not have the financial sophistication to assess the risks and merits of an offering based on the limited disclosures available in private offerings.



ANGEL CAPITAL ASSOCIATION

## Issues with the Current Definition

---

- Current definition relies on measures of wealth rather than access to information or financial sophistication in order to define a class of individuals who can afford the risks associated with private offerings. It fails on this basis as well.
  - An individual with \$200,000 in income but few or no financial assets cannot easily shoulder such risks, particularly if the individual is nearing retirement.
  - An individual with more than \$1 million net worth cannot necessarily withstand liquidity risks if that \$1 million is tied up in farmland, a family business, or other non-financial assets.



ANGEL CAPITAL ASSOCIATION

## Issues with the Current Definition

---

- An individual with \$1 million or more in relatively liquid financial assets may still not be able to withstand potential losses in private offerings if that \$1 million takes the form of a retirement nest egg that must be invested to provide income throughout the individual's remaining years.
- In short, the current definition of accredited investor does not effectively define a class of individuals capable of fending for themselves without the protections afforded in a public offering.



ANGEL CAPITAL ASSOCIATION

## Goals for Changing

---

- What should be the goal of any changes to the accredited investor definition?
  - Definition should identify a population of individuals who are truly capable of assessing the risks and merits of offerings based on limited information or at least are able to withstand potential losses without suffering undue financial harm.
  - The definition should be reasonably easy to use.
  - The definition should not inappropriately or unnecessarily shrink the capital available to support private offerings.



ANGEL CAPITAL ASSOCIATION

## Possible Adjustments

---

- How could the definition be adjusted to better achieve its intended goal?
  - We could take a different approach to setting financial thresholds so that they afford better protection against unaffordable losses.
  - We could add a sophistication/experience requirement as an alternative means of satisfying the definition.
  - We could strengthen protections for investors who rely on an investor representative to satisfy the definition.



ANGEL CAPITAL ASSOCIATION

## Possible Adjustments

---

- Possible changes to the financial threshold
  - Raise thresholds to a level that better reflects an ability to afford a total loss.
  - Maintain thresholds but eliminate non-financial assets and retirement accounts from the net worth calculation, so that the thresholds better protect against liquidity and other risks.
  - Base thresholds on a percentage of financial assets or income to allow a broader range of individuals to safely qualify as accredited investors.



ANGEL CAPITAL ASSOCIATION

## Possible Adjustments

---

- Possible approaches to adding a sophistication/ experience requirement to the definition
  - Recognize certain credentials (e.g., Chartered Financial Analyst) as satisfying the sophistication requirement and thus the definition, without regard to financial thresholds.
  - Recognize certain professional experience as satisfying the sophistication requirement regardless of income or net worth.
  - Develop a test that investors who do not meet the financial thresholds could opt to take to demonstrate their ability to assess the risks and merits of private offerings.



ANGEL CAPITAL ASSOCIATION

## Possible Adjustments

---

- Improving protections for investors who rely on an investor representative
  - Prohibit the investor representative from having a financial interest in the offering being promoted.
  - Require the investor representative to accept a fiduciary obligation to act in the best interests of the investor when making a recommendation about whether to invest.



ANGEL CAPITAL ASSOCIATION

## The Case for Changing the Accredited Investor Definition

---

- If we get away from a debate over whether the current thresholds should be raised or maintained at their current levels, it should be possible to change the accredited investor definition in ways that:
  - Improve protections for investors;
  - Are reasonably easy to comply with; and
  - Preserve small company access to capital.



ANGEL CAPITAL ASSOCIATION



Kevin Laws  
COO, Angel List



# AngelList



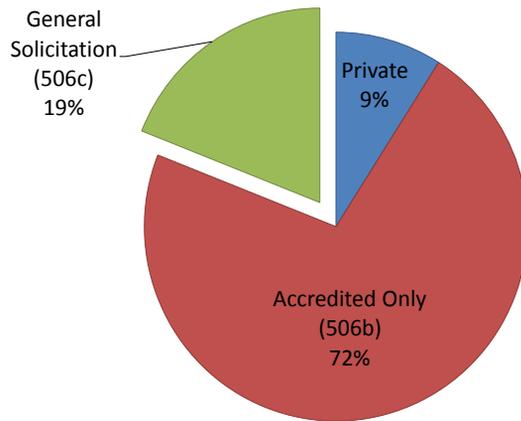
## AngelList Today

---

Startups	145,000
Investors	30,000
Funded Startups	2,500
\$ Invested	\$250 million
...online	\$34 million

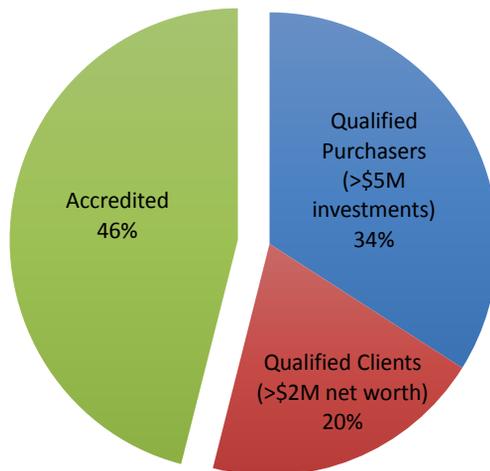


## AngelList Financings 2014



ACA  
ANGEL CAPITAL ASSOCIATION

## Almost Half “Mere Accredited”



ACA  
ANGEL CAPITAL ASSOCIATION

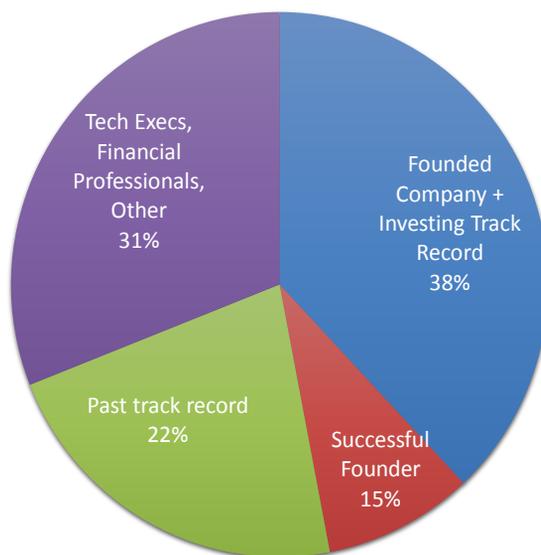
# 23%

capital from “mere” accrediteds



## Sophisticated

---



## Critical

---

- Most “plugged in” to the current scene
- Investors rely on their participation to signal a good deal



ANGEL CAPITAL ASSOCIATION

## Unique To Seed Financing

---

- Angels invest personally – “friction” kills deals
- Deals are tiny (\$300K) - “reasonable” costs for Wall Street are prohibitive for tiny companies
- Deals based on trust & networks – brokers & administrative overhead hurt rather than help
- Experienced investors; inexperienced companies



ANGEL CAPITAL ASSOCIATION

## Devil In The Details

---

- Accredited status must be proved per-financing, per-issuer
  - “... I’ll earn the same this year”
- Evidence only lasts 3 months
- Credit reports...including spouse?
  - Yahoo CEO Marissa Mayer’s spouse must sign off on her investments?



ANGEL CAPITAL ASSOCIATION

## Devil In The Details

---

- Must prove per-financing, per-issuer
  - “... I’ll earn the same this year”
- Evidence only lasts 3 months
- Credit reports...including spouse?
  - Yahoo CEO Marissa Mayer’s husband must sign off on her investments?

0%

Lost accredited status because  
of the complicated checks



ANGEL CAPITAL ASSOCIATION

## Opportunity: Simplicity

---

- Accredited status demonstrated once yearly (and travels with investor)
- Sophistication as another way to accredit
- Easily verifiable
  - No proving negatives like “lack of debt”
  - No intermediaries required
  - No steps that only screen <0.1% of investors (likely to be sophisticated anyway)



ANGEL CAPITAL ASSOCIATION

Simplicity → Ubiquity

## Importance of Angel Investors to the Startup Ecosystem

---



Evan Burfield  
Cofounder – 1776 Accelerator



## The Entrepreneur Perspective

---



Elizabeth Hess  
CFO, TRX Systems



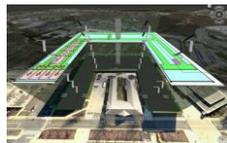
## TRX NEON Delivers Universal 3D Location

Location services for buildings and dense urban areas not easily mapped via current GPS technology. In some places, GPS is totally unavailable.

Why is this important?

- First responders, emergency personnel need interior guidance for timely, accurate rescue relief
- Visually impaired have no accurate guidance indoors
- Military need to “map” interiors, terrain and provide navigation under extreme circumstances

Unique sensor fusion, ranging, and map-building technology



Crowd-sourced Collaborative Mapping

Sensor Fusion      RF Ranging



ANGEL CAPITAL ASSOCIATION

## Entrepreneurs Rely on Angel Investors

Early stage innovation most difficult to fund before business-level proof points established

- Early funding is basis on which **everything** is created
  - Financial security to make first hires
    - 14 jobs created at TRX with \$1M from Angel Investors
    - Now 19 jobs plus distributors, sales agents, consultants
    - **Without early investors, these jobs would not exist**
  - Spending can't wait until VC funding received
    - IP protection must start early in first to file environment; 7 years to receive first patent
    - **Without early investors, innovation would not occur**
  - Closing VC funding is time-consuming and all-encompassing
    - Angel investors allow management to build company
    - **Without early investors, VC financing would not be possible**



ANGEL CAPITAL ASSOCIATION

## Angel Investors Bring Commitment ...

---

- Angel investors -- part of company's growth process
  - Invest their own \$\$, and make personal commitment to success
    - Connection to company is individual, not just a portfolio item
    - Investment funds innovation and growth in local community
    - Investment in pursuit of favored technology or market
  - New Dominion Angels (NDA) has a TRX board seat
    - Only a phone call away
    - Active not just during board meetings



ANGEL CAPITAL ASSOCIATION

## ... and Know-How

---

### Angel investors have done this before

- Provide operational knowledge accumulated through career
  - Technology alone does not create a company
  - Developing and bringing productizing to market requires variety of expertise and experience
- Networks extend throughout layers of company
  - Decision-makers/champions can occur at many points
  - NDA board member provides invaluable connections
    - Sales support in Middle East
    - Sources of short-term financing
    - 409a valuation



ANGEL CAPITAL ASSOCIATION

## Accredited Investors Mean Jobs

---

- Loss of Accredited Investors will lead to less job creation
  - Technology investments create good jobs with good salaries
  - Bootstrapping is not an option for most
  - While you cannot spend your way to success, you can definitely cost-cut your way to failure
  - Job creation will be less geographically diverse if investor pool shrinks



ANGEL CAPITAL ASSOCIATION

## Call to Action!

---



- Write to SEC and Congress
  - Let them know that startup funding is critical to jobs, innovation and your community
  - Template letters and instructions for submitting; ACA Comment letter: [www.angelcapitalassociation.org/aca-public-policy-protect-angel-funding/](http://www.angelcapitalassociation.org/aca-public-policy-protect-angel-funding/)
  - All Accredited Definition comment letters: [www.sec.gov/comments/s7-06-13/s70613.shtml](http://www.sec.gov/comments/s7-06-13/s70613.shtml)
- Engage your startup community
- Your voice is important! Please let it be heard!



ANGEL CAPITAL ASSOCIATION



## Audience Questions



## Thank you for attending!

**Webinar programs archived at:  
[www.angelcapitalassociation.org/events/webinars/](http://www.angelcapitalassociation.org/events/webinars/)**