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FOR THE U.S. SECURITIES AND EXCHANGE COMMISSSION 2010 SEC GOVERNMENT-BUSINESS FORUM ON SMALL BUSINESS CAPITAL FORMATION

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Thank you for the opportunity to provide a statement during this important forum and provide recommendations for the SEC to consider in ensuring a strong angel capital market that helps small businesses start and grow.

I am Executive Director of the Angel Capital Association (ACA), the professional alliance of angel groups in North America, which includes 150 member angel groups in 44 states. More than 6,500 accredited angel investors belong to our member angel organizations. ACA is focused on building the skills of angel investors so that they are better mentor capitalists to start-up companies and on increasing the number of angels participating in high quality groups in the United States.

Angel Investors, Small Businesses, and the Economy

Before discussing regulatory recommendations, let me first talk about the importance of angel investors and the entrepreneurial firms they support through investment and mentoring.

Analysis by the U.S. Census Bureau and the Ewing Marion Kauffman Foundation in 2009 and 2010 found that businesses that were less than five years old created all of the net new jobs in our country over the last 25 years. The majority of these jobs came from innovative businesses that grew exponentially, with angel-backed company examples such as Google, Facebook, and Starbucks.

As our country thinks about job growth and building a healthy economy, we believe it is important to consider the best ways to ensure these early-stage innovative entrepreneurial businesses have access to the resources they need. Angels specialize in high-growth innovative businesses. These firms are financed in a number of ways, but 30,000 to 50,000 of them receive equity investment from angel investors each year.

We estimate 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 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.

The exact number of angel investors in the country is not known, but experts estimate that about 250,000 angels invest \$20 to \$30 billion per year in promising early-stage companies. Many angel investments are made by individual angels who invest \$10,000 to \$200,000 per company. A trend in our field is for individual angels to join together in formal angel groups to pool their expertise and capital to make total investments of \$100,000 to as much as \$2 million, per survey data from our membership. A large portion of the companies that receive angel group investment are in technology, clean tech, and life science fields.

The angel investors who participate in angel groups have built strong processes for evaluating and making investments and also for ensuring the survival and growth of their portfolio companies. All ACA member groups require that their member angels are accredited investors.

Recommendations Related to Angel Investing

We recommend several actions or decisions for the SEC to continue a healthy angel market for high growth startups after a good process of gathering facts and analyzing input from experts and participants. Many of our recommendations are related to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, as we note that the SEC will need to make rules that assist in implementing the Act over the next several months.

We make these recommendations in the general context that some rules need to be made or updated quickly because the Dodd-Frank Act requires that, but then it is important to leave the Regulation D environment for angel investing as it is to assure a stable and common understanding of the requirements by small business issuers and angel investors. More angel investors will build their activity when they know the regulations are set and not subject to regular change.

Because of the impact angel investors and the companies they invest in have on our economy, we encourage the Commission to do everything in its power to ensure that angel investing in high-growth early-stage companies continues to be as easy and low-cost as possible. Regulation D angel financings should continue using the framework that has worked well for many years.

Accredited Investor Standards

Congress, particularly the Senate, was clear in its intent to ensure that the Dodd-Frank Act did not negatively impact angel investing and the small businesses in which they invest. As of today, the Web site of the Senate Banking Committee still includes a press release heralding amendments to the Act that "saved angel investing." We believe it is important to recognize this intent during the rule-making process on several issues:

Net Worth Threshold

In a compromise which ACA supported, the Dodd-Frank Act updated the net worth standard to be \$1 million, not including the value of the primary residence of the investor. We believe, however, that small businesses would be best served by maximizing the number of accredited investors in the angel investor market. Our preference is to include equity owned in homes as part of the net worth calculation, if possible. To the extent the Commission can develop clear rules that don't punish individuals for negative value in their homes, (i.e., don't debit nonrecourse deficiencies of underwater mortgages from the calculation of net worth exclusive of the principal residence), we believe small businesses will be better off. The Commission may want to keep in mind that under the laws of many states, mortgage debtors are often not liable for such deficiencies. This would ensure that fewer angel investors who were active as angel investors just four months ago would lose their ability to make angel investments with the protections of Regulation D.

Annual Income Standard

We particularly note that the Senate compromise completely rejected increasing income requirements at this time. Earlier versions of the Dodd-Frank bill included a requirement to increase the annual income standard under the accredited investor definition for inflation, with most people understanding that the increase would track back to when the standard was set nearly 30 years ago. Based on most of the reports we read, this inflationary adjustment would have at least doubled the income threshold from \$200,000 to \$400,000. It was clear that such an increase would significantly reduce the number of angel investors and hurt innovative small businesses as a result. The final Act that is now law includes no inflationary increase for income.

ACA is aware that recommendations for increasing the income standard come up to the Commission every few years and it appears that such a request is being made in 2010. We highly recommend that no adjustments be made to the annual income standard.

Increasing the income standard for accredited investors for inflation would dramatically reduce the number of accredited angel investors at a time when the economy needs angel investors to support the early-stage companies that will create jobs. The exact decline depends on the framework used for determining inflation, but 2008 Internal Revenue Service data shows the potential for a very large decline in investors who meet the accredited investor definition based only on annual income. For instance, 3.4 million tax filers had income of \$200,000 to \$500,000 in 2008, while 16 percent of that number (578,000) had incomes of \$500,000 to \$1 million.

We believe the impact caused by the reduction in angel investors would be particularly hard on rural areas and the middle part of the country, where salaries and the cost of living are generally lower than on the east and west coasts. Angel investors are located in every state. Promising startups outside the coasts and major cities would have an even smaller pool of capital to draw upon than they do now.

Reviewing the Accredited Investor Definitions

As the Commission conducts studies and reviews in the future related to accredited investor definitions, Congressional intent must be considered. Under the Act, the Commission should conduct a review "determine whether the requirements of the definition ... should be adjusted or modified for the protection of investors, in the public interest, and in light of the economy." ACA underscores "*in light of the economy*". In fact, our take is that the thresholds could be lowered for angel investors as more is learned about the companies that receive investment, the jobs that are created as a result, and the relative lack of fraud in angel investment.

As mentioned earlier in this statement, angel investors are one of the key funders of the early-stage companies that create all of the net new jobs in the United States. These jobs are critical for the health and growth of the American economy.

In addition, the angel investment arena has been virtually complaint free in terms of fraud. While state securities regulators have mentioned many concerns about fraud in private placements, none of the examples they used were for angel investment. As some of our legal advisors note, in the rare cases where an angel investment is tainted by issuer fraud, the startup ecosystem and investor remedies under federal and state law are more than adequate to punish the bad actors. The startup ecosystem, made up of investors, entrepreneurs, attorneys, accountants, university faculty, and economic development professionals, has a way of communicating and learning from each other to ensure bad actors are eliminated from current and future investments.

Further, we do not see any correlation between amount of income and wealth compared to sophistication of an angel investor. 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 investment opportunities and mentor the entrepreneurs in whom they invest.

One of the ACA Board members and I believe the accredited investor definitions that were set in 1982 were too high and that just recently they have become more appropriate for our economy and angel investment. This has allowed more angels to participate, leading to the launch of more innovative companies, and the creation of more jobs.

General Solicitation Rules

As the Internet and social networking have changed how the world does business, the Commission may want to consider changes to rules for general solicitation and advertising of angel investment opportunities. It is currently fashionable to use Twitter, list serves, postings on social networks and other online means to seek deals or investors. Initiatives like AngelList are attracting well regarded angel investors who are promoting their interest, generally in startup financing, to find candidates for their investment dollars.

In this new world of communication, it makes sense to consider changes to the general solicitation rules. One way to do this is to take away the focus of the rules off of "the means of communication, the chains of introduction, and the manner of the medium" in Rule 504. Instead, the SEC might consider whether, regardless of how an individual heard about the deal, that investor can fend for himself or herself – i.e. the investor is accredited. This approach could include the basic concept that "no communication is a general solicitation if reasonable means or a screening process is used to ensure that such communication is directed only to accredited investors."

Related to this issue is addressing the need of angel investors interested in exiting their investments in the secondary market, via listing their shares on secondary trading platforms. Many angels hope that no new securities regulations are developed that crimp the ability of private companies to help arrange liquidity for angel investors by listing their shares on private securities exchanges.

Thank you for the opportunity to share these ideas with the Commission. We appreciate the SEC's focus on getting transparent feedback from the public on regulatory issues. The Angel Capital Association is focused on promoting strong angel investment practices that help start and grow great companies and that continue to protect investors and small company issuers. If we can provide more information or clarity on any of the above issues, we would be pleased to do so.