The Commonwealth of Massachusetts
Secretary of the Commonwealth
State House, Boston, Massachusetts 02133

William Francis Galvin
Secretary of the Commonwealth

June 8, 2011

The Honorable Spencer Bachus
Chairman
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Barney Frank
Ranking Member
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Scott Garrett
Chairman
Capital Markets and Government-
Sponsored Enterprises Subcommittee
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
Capital Markets and Government-
Sponsored Enterprises Subcommittee
2129 Rayburn House Office Building
Washington, DC 20515

RE: H.R. 1070 - "Small Company Capital Formation Act of 2011"
Bill to Amend the Provisions of SEC Regulation A

Dear Chairman Bachus, Ranking Member Frank, Subcommittee Chairman Garrett and Subcommittee Ranking Member Waters:

The Massachusetts Securities Division (the "Division") welcomes this opportunity to comment on the Small Company Capital Formation Act of 2011, H.R. 1070. This letter addresses six provisions in the bill. Among other provisions, H.R. 1070 would expand the Regulation A exemption by raising the dollar limit for that exemption from $5 million to $50 million, and it would preempt state authority to review Regulation A offerings.

The Office of the Secretary of the Commonwealth enforces the Massachusetts Uniform Securities Act, and it includes the Massachusetts Securities Division. As such, the Secretary of the Commonwealth is the chief securities regulator for Massachusetts.

I. Delete Language that Preempts State Authority.

We strongly object to Section 6 of the bill, "Exemption from State Regulation," and urge that it be deleted. This language was added to the bill by amendment in the May 3, 2011 markup.

The language of Section 6 states that Regulation A offerings that are not sold through a broker-dealer shall not be covered securities under Section 18 of the Securities Act of 1933 (Section 18 specifies categories of covered securities that the states are preempted from regulating). By implication, under Section 6, Regulation A offerings that are sold through a broker-dealer would be considered covered securities, and state review would therefore be preempted. The preemptive purpose of this language is made explicit by the title of the section, "Exemption from State Regulation."

Despite assertions to the contrary, the language of Section 6 does not address any ambiguity regarding state authority to regulate these offerings. The states now clearly have authority over Regulation A offerings; such offerings are not covered securities under section 18 of the '33 Act. At best, the added language of Section 6 introduces an ambiguity into the securities laws. At worst, Section 6 preempts state authority with respect to a category of securities where investors need the protection provided by state review.

It is crucial that the states keep their authority to review securities offerings under Regulation A. These are often high-risk offerings, and there has been significant fraud in this segment of the market. Also, because Regulation A offerings are not subject to federal registration, and because such companies do not issue ongoing reports like true public reporting companies, the protections provided by state review are even more essential.

The states and NASAA have long been vigilant in protecting retail investors from the risks posed by penny stocks, and by underwriters and promoters who try to swindle investors in speculative, fraudulent, and manipulated offerings. The states have been vital in protecting investors from penny stock fraud, so state jurisdiction over Regulation A offerings must be preserved.

II. Reduce the Proposed $50 Million Offering Limit for the Regulation A Exemption.

We urge that the language in Section 2, which raises the permitted offering amount, be scaled down to permit offerings under the exemption of no more than $25 million. Although the bill is intended to facilitate offerings by smaller issuers, the current language of the bill creates a sweeping exemption for public offerings of up to $50 million. This high dollar cap, combined with other elements of the bill, will also likely result in a poorly regulated trading market for these stocks. These changes create the potential for large numbers of investors to be harmed.

Under the bill, $50 million offerings can be sold publicly using general solicitation, and the securities will be freely transferable. It is anticipated that trading markets, perhaps informal ones, will develop for these securities. Section 4 of the bill addresses trading market issues to a certain degree by permitting the SEC to require that Regulation A issuers provide some periodic disclosures to investors. However, the ongoing disclosure provision under the bill is limited at best. We do not believe that it comes close to providing the kind of reliable information that public companies are now required to provide to investors and the trading markets. This lack of reliable ongoing disclosure will ultimately put investors in harm's way.

In the alternative, if the maximum offering amount for the Regulation A is not reduced to $25 million or less, we urge Congress to require audited financial statements, as well as audited reports, from all issuers that use Regulation A.

III. Give the S.E.C. Discretion in Reviewing the Offering Amount Limitation.

We urge that Section 5 of the bill, "Adjustment," be amended to provide that the S.E.C. regularly review the offering amount limitation and, in its discretion, increase or not increase the offering amount. We object to the current language because it carries a built-in presumption that the offering amount should be increased upon each review. Giving the S.E.C. such flexibility is appropriate because the bill greatly expands the permitted offering amount to $50 million (though we recommend a cap of $25 million). This jump in offering size means larger and more complex issuers will use the exemption, more broker-dealers will participate in the sale and trading of these securities, and large numbers of investors will be affected by these offerings. These changes raise numerous uncertainties about how the exemption will be used, so the S.E.C. should be given full discretion, in the public interest and for the protection of investors, to enlarge or not enlarge the offering amount based upon its periodic reviews.

IV. Apply Prospectus Liability Requirements to Regulation A Offerings.

We urge Congress to require that larger offerings under Regulation A be subject to the same liability that applies to untrue statements in prospectuses under Section 11 of the Securities Act of 1933. The need for this requirement is clear: public offerings of up to $50 million will affect, and potentially harm, larger numbers of investors; therefore, the well-being of investors and the markets will be at stake in these offerings. Accordingly, these issuers should be as prepared to stand by their offering materials as the issuers of registered public offerings.

V. Investor Qualification.

We urge Congress to include investor qualification standards for these offerings, or to permit the S.E.C. to adopt rules to apply such standards when appropriate. Many Regulation A offerings will be made by early-stage companies, so it is likely there will be no aftermarket for these securities or only a limited trading market. It is imperative that these offerings be sold only to investors who can understand and bear these risks.

Experience has demonstrated that many retail investors have not been able to effectively fend for themselves when they have been sold high risk securities offerings. The Securities Division has seen significant numbers of retail investors who have been harmed by investing in risky and illiquid securities sold under Regulation D. Moreover, while registered brokerages and their personnel are subject to the obligation to make only suitable recommendations to their customers, even that requirement provides only limited protection for investors. We urge that risky offerings under the Regulation A exemption be limited to investors with demonstrable sophistication or who meet appropriate financial qualification standards.

VI. Specifically State the Requirement to Sell Through Only Licensed Broker-Dealers.

A number of unlicensed finders and consultants purport to offer capital raising services to early-stage companies. The bill should include language to specifically emphasize that Regulation A does not provide any exemption from the requirement that selling persons must comply with federal and state broker-dealer registration requirements.

In conclusion, an expanded Regulation A exemption will allow issuers to raise funds from large numbers of retail investors, so the protections provided by state review and antifraud must be maintained. The states have been vigilant cops on the beat protecting retail investors. We urge that the bill specifically state that securities sold under Section 3(b) shall not be considered covered securities under Section 18 of the '33 Act, that state antifraud and enforcement authority are specifically preserved, and that selling persons must be appropriately licensed.

I appreciate this opportunity to comment on these important issues of investor protection. If you have questions about this letter, or my office can assist in any way, please contact me or Bryan Lantagne, Director of the Massachusetts Securities Division, at (617) 727-3548.

Sincerely,

William F. Galvin
Secretary of the Commonwealth
Commonwealth of Massachusetts