The Senate Committee on Banking, Housing, and Urban Affairs
Spurring Job Growth Through Capital Formation
Tuesday, March 6, 2012

Written comments for the record
Timothy Rowe
Founder and CEO, Cambridge Innovation Center
Cambridge, Massachusetts

Thank you for inviting me to speak today. As you know, I am the CEO and Founder of Cambridge Innovation Center (CIC). CIC houses approximately 450 startup companies in a large office tower in Kendall Square, Cambridge, Massachusetts. We are told that CIC has more startups under one roof than any other building anywhere. More than $1.5B dollars have been invested in these companies. We have been a launch-pad for several well-known companies, including Google Android and Great Point Energy.

I also serve as the President of the Kendall Square Association. Kendall Square is home to the Massachusetts Institute of Technology (MIT) and more tech and biotech companies per square mile than anywhere else in the world, and includes such global leaders such as Amgen, Biogen, the Broad Institute, Google, MIT, Microsoft, Novartis, Genzyme, VMWare, and the Whitehead Institute. Our goal is to ensure that Kendall Square remains a place where the world gathers to develop breakthrough discoveries that positively impact our society.

In other responsibilities, I serve on the investment committee for New Atlantic Ventures, a $120M early stage venture capital firm. Together with my partners, we have helped make dozens of investments in small companies.

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This past December, Massachusetts was asked to send a delegation to the Startup America Summit at the White House to share what we believe to be the national priorities for helping grow jobs through entrepreneurship. Many Massachusetts leaders got involved, and together we settled on five key measures: 1) Crowdfunding, 2) IPO on-ramp legislation, 3) easier Visas for overseas entrepreneurs who want to come create jobs in the United States, 4) better mid-skills job training, and 5) limitations on non-compete agreements in employment contracts (some states already ban them). I was selected by the group to present our conclusions, and I will do my best to do so again today. Given the topic of today's hearing, I plan to talk about the first two measures.

We believe startups are at the root of restoring the United States to full economic health. As is now well known, a Kauffman Foundation study using US Census data recently found that, over the last quarter century, *all* net new jobs in the United States have come from companies *five years old and younger*. Existing firms (those 6 years old and older) collectively *lost* jobs during that same quarter-century period analyzed (1980 to 2005). For every job lost by existing firms, new firms generated three. It seems clear that supporting startups and entrepreneurship is the key to job creation in the United States.

Enabling better access to capital will be the single most impactful step government can take. I will speak in particular to two proposals:

1) Crowdfunding (S. 1791 and S. 1970)

Risk capital is distributed unevenly in our country. Startups do not today have adequate places to go to find the money to start a new business. Everyday businesses that are the bread and butter of our communities--businesses like restaurants, small construction companies and the like--are starved for capital. There are, for instance, nearly 8 million women-owned businesses in the United States, yet only a few hundred a year are able to raise venture capital.[1]

I believe that crowdfunding legislation can change this. As we have all heard, the Internet changes everything. One of the things that the Internet has changed is the ease with which an organization can broadcast its needs and attract supporters online. Another thing that has changed is that it is much harder for bad actors to hide from the scrutiny of the masses. Many companies have sprung up to help individuals and small businesses find loans, donations, and first customers this way. Politicians have found the Internet effective to raise campaign donations.

In an example that shows the power of crowdfunding, popular website Kickstarter, which collects money from fans to support principally film, arts and design-oriented projects, raised almost half as much money for the arts in 2011 as the National Endowment for the Arts (NEA). Due to its rapid growth, it appears likely to roughly tie the NEA in 2012[2]. The NEA acknowledged this, stating "Kickstarter and the other platforms that crowdsource donations for arts organizations and projects are becoming increasingly important in helping the arts."

Crowdfunding proposes to harness this same power to help people start new businesses, and create new jobs. It will enable individuals to make small equity investments in others' businesses without the usual regulatory burdens associated with a public offering.

Many of us in the startup community believe that such a mechanism will allow far more startups to get going in the United States, thereby creating much-needed new jobs. This is evidenced by a petition started by some entrepreneurs in my center, which can be found at Wefunder.com. They obtained commitments from more than two thousand five hundred individuals to invest over $6M through crowdfunding.

How big could the impact of crowd-funding be? Americans have about $30 trillion dollars in savings plans (401Ks, IRAs, and the like). Amy Cortese, author of the book *Locavesting*, points out that if Americans diverted just 1% of this amount into crowd-funding type investments, the amount raised would equally half of all small-business loans in the country, and would be about 10 times the total amount of venture capital invested each year in the United States. The potential benefit to the country from this is very large.

The chief concern with crowdfunding is the threat of fraud. Some have voiced a concern that unscrupulous individuals might take advantage of unsophisticated investors, misrepresenting risks, and effectively stealing investors' money.

While this concern is understandable, the data show that Internet intermediaries have been successful at blocking such fraud. United Kingdom-based crowdfunding startup Crowdcube, for instance, reports zero fraud claims after a year in business (see attached letter from its CEO). They achieve this in part by thoroughly vetting the opportunities they present for investment. Similarly, Prosper.com, a crowd-lending business operating under SEC regulation claims to have raised $124M in loans and to have no reports of fraud or mis-representation. Funding Circle, out of the UK, another crowd-lending platform, claims to have raised £26M in 569 transactions and reports no fraud (and only 5 defaults so far). AngelList is a crowd-funding platform in the US that works only with accredited investors. It operates under the SEC's Regulation D, and has raised "more than $100M" in equity investments using its online platform. AngelList claims zero reports of fraud. Net-net, I conclude that if crowdfunding legislation requires that any investments be made through an SEC-licensed intermediary, the fraud problem can be resolved.

To draw a broader analogy from a different industry, as we all know, eBay is a website that permits one to

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[1] Estimated to be between 140 and 280 deals per year based on data from the Kauffman Foundation at http://www.kauffman.org/research-and-policy/gatekeepers-of-venture-growth.aspx and http://www.pwcmoneytree.com

[2] Analysis from Talking Points Memo at http://idealab.talkingpointsmemo.com/2012/02/the-nea-responds-to-kickstarter-funding-debate.php?m=1

buy items from people they have never met, and never will meet, based solely on an online description. On the face of it, this would similarly seem to be a hotbed for fraud. Yet any eBay user will tell you that the incorporation of a system that tracks the reputation of buyers and sellers significantly mitigates fraud. We believe that the analogous mechanisms will be developed by competing crowdfunding intermediaries, leading to an enviable investment environment that is safe and free from undue regulation.

To the extent that there are continued concerns about fraud, one additional attractive market-based solution could be fraud insurance. Given the low actual incidence of fraud, crowdfunding proponents have attracted the interest of insurers who have voiced an openness to issue policies protecting crowdfunding investors against fraud.

I understand that there are efforts underway to create a "consensus" crowdfunding bill that would incorporate the best of the various bills under consideration. Having studied the topic closely, I would urge the drafters to do so, and to incorporate the following provisions:

a) *Require the use of SEC-licensed intermediaries*. Intermediaries, playing the "eBay" role, are the key to eliminating fraud. Intermediaries will compete to be attractive to investors, offering such incentives as anti-fraud insurance. Intermediaries would creatively develop competing mechanisms to reduced fraud, be that by manually vetting the deals, or using some other mechanism such as crowd input. I don't think we should legislate how the do it, since this is an area where we want creative innovation. Instead, any intermediaries deemed ineffective at eliminating fraud would simply be subject to losing their license. It is important that the regulations that intermediaries should be subject to enable them to flexibly, and at low-cost handle these small transactions (e.g. not subject to the full brunt of onerous broker-dealer regulations, but only the specific intermediary requirements spelled out in the bills, which all look fine). To the extent that a workable definition of such an intermediary can be agreed upon, ideally it would also be extended to the aforementioned Reg-D-based crowd-funding intermediaries as well, since they face the same issues.

b) *Enable investments larger than $1,000 for those who can afford it*. Some of the proposed bills provide formulas for determining limits. Data show that 90%+ of the dollars raised in crowdfunding initiatives are from people investing more than $1,000, so it is highly desirable to enable larger investments. See attached chart. One way to address this concern would be to set a higher limit, say $100,000, or no limit, on the amount accredited investors can invest under crowd-funding legislation, effectively extending this same concept of crowdfunding through intermediaries to cover both crowdfunded & accredited investments.

c) *Don't burden the process with unnecessary restrictions that would render crowdfunding legislation meaningless*. For instance, it is essential that the degree of interaction required with individual states be limited. 50 states and 50 different sets of rules, and these small companies can't handle that amount of complexity. Limited state filings for the issuer's state and a state in which the majority of the issuer's investors live are reasonable, but, in general, it is imperative that state securities laws be preempted by the crowdfunding exemption (with the exception of state anti-fraud laws). Additionally, it is important that overly burdensome disclosure obligations are not placed on issuers. These rules were created with large issuers in mind, and would stifle crowd-funding. Instead, follow the example of Crowdcube—they have a strong incentive to eliminate fraud and do not list opportunities they believe to be inadequately described, or where stories don't check out.

d) *Don't burden crowdfunding issuers with excessive liability*. Issuers should be subject to collective action by investors if they commit wrongs, but some provisions would appear to create the possibility for individual rights of action, and that would create an untenable risk for issuers.

e) *Do require a periodic ongoing review of how this is going*, as called for in S. 1970.

2) IPO on-ramp legislation (S. 1933)

While most jobs are created by companies 5 years old and younger, an exception is larger companies that go public and raise substantial amounts of capital. Data show that companies that go public grow their headcount approximately 5-fold, often creating thousands of jobs.

Unfortunately, the current regulatory frameworks impacting public companies have had the unintended consequence of substantially reducing the number of companies that are able to go public. It costs an estimated $2.5M for a company to go public today, and $1.5M per year to stay public. These are heavy burdens for young companies to bear.

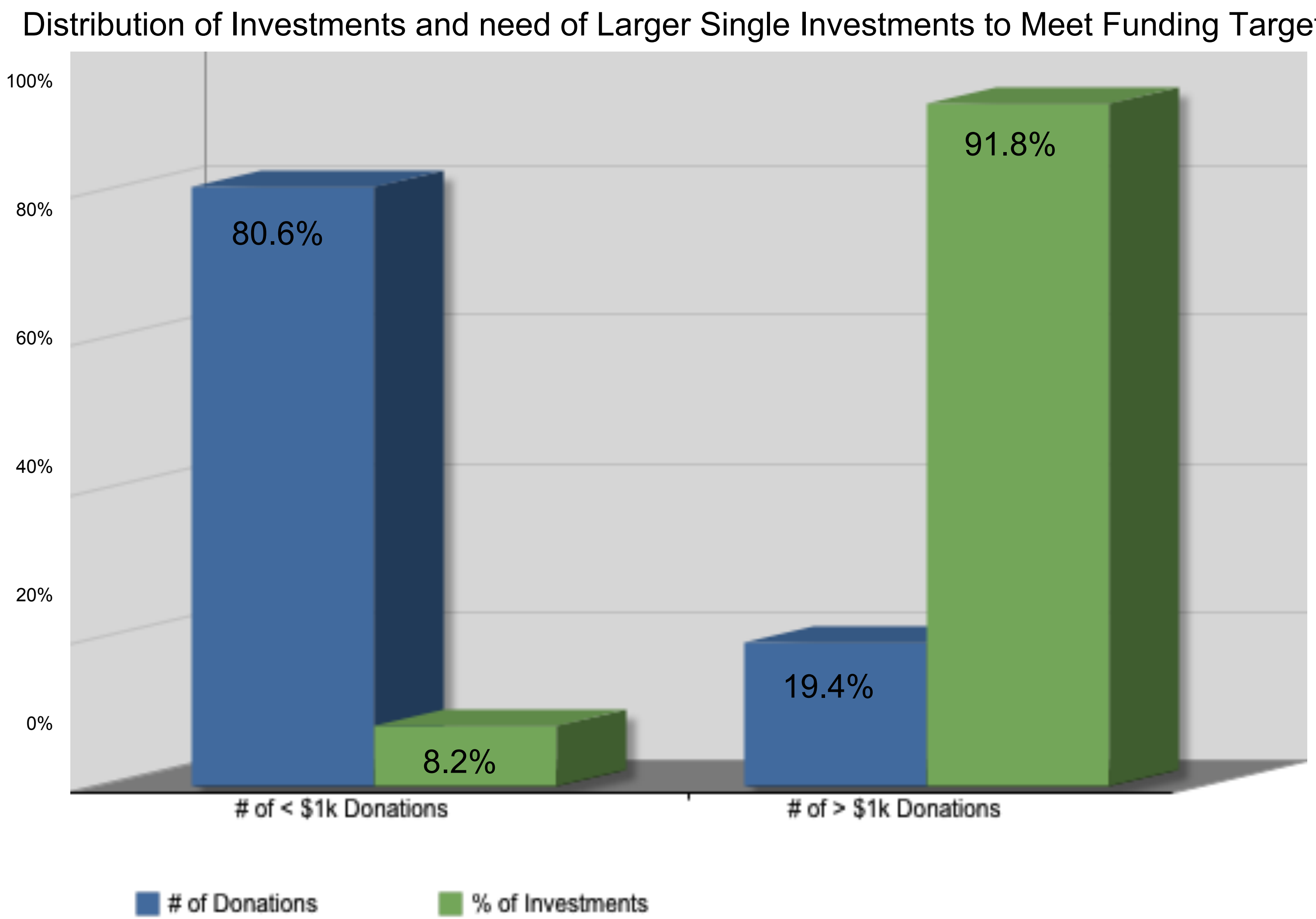
Proposed legislation would reduce this regulatory and paperwork burden for so-called “Emerging Growth Companies”: smaller, younger companies that are less likely to go public otherwise. This category, by virtue of being comprised of young companies, today represents only a small 3% of the total value of publicly traded companies. At the same time, it represents our future. It is important that we nurture it.

Under this proposal, regulation would “scale”, growing with a company’s compliance abilities. I believe it is important to note that I personally applaud the intent of many of the regulations that are scaled under this bill. I believe each regulation was created with good intentions, and under the proposed legislation, each will, in time, be applied to every company that goes public. This bill simply delays the day that these companies must face the economic burden of compliance.

I am hopeful that the Senate will find these proposals have merit and that Congressional enactment is necessary to jumpstart our economy. This is a time when we must be creative and work together to find solutions to help America get back to work.

Without investments over $1000 Crowdfunding doesn't work

Investments over $1000 make up 91.8% of capital raised



Data provided by Indiegogo, Profounder and Crowdcube

Most popular amounts invested Percentage of users

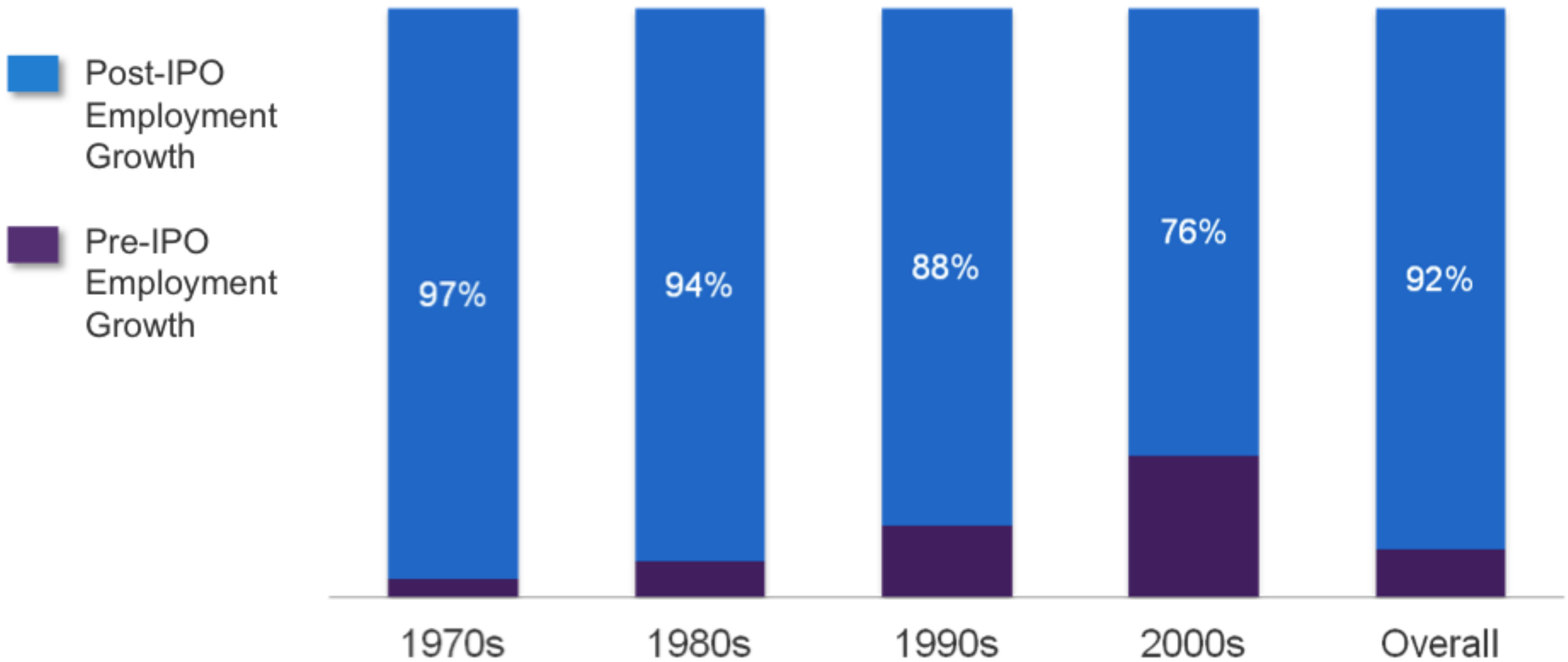
Established on 15 February 2011, Crowdcube is the World's first crowdfunding website that lets ordinary people invest in start-up or growing businesses in exchange for equity.

All statistics run from 15 February 2011 to 8 February 2012.

www.crowdcube.com

crowdcube

IPOs Finance Significant Job Creation



92% of Job Growth in a Company Occurs Post-IPO
86% Post-IPO Job Growth Per August 2011 Survey of 2006+ IPOs

Source: Venture Impact 2007, 2008, 2009 & 2010 by IHS Global Insight; IPO Task Force August 2011 CEO Survey

The Innovation Centre | University of Exeter | Exeter | Devon | EX4 4RN

2nd March 2012

To whom it may concern,

My name is Darren Westlake and I am the CEO of Crowdcube Limited. We are the world's first crowdfunding for equity service and we are based in the UK.

Crowdcube launched its service in February 2011 and since then our service has gained huge momentum and has been acclaimed across the UK and Europe as a pioneer in the arena of start-up finance.

Let me share some of the statistics that represent the first year of Crowdcube:

- 757 companies have applied to list on Crowdcube
- 185 companies were approved to list on Crowdcube (over 75% of applicants were vetted out)
- 15 businesses have been successful in raising money
- £2.68m ($4.24m) has been successfully raised
- £3.37m ($5.34m) has been invested in companies
- None of our successful companies have been fraudulent in any way and so far all have gone on to make good use of their funding and we have excellent feedback from investors

If you need any further information or insight from me please do not hesitate to get in touch.

Kind regards,

Darren Westlake

CEO, Crowdcube Ltd.

AngelList
188 King Street, San Francisco, CA

March 05, 2012

To whom it may concern,

My name is Naval Ravikant. I'm the co-founder and CEO of AngelList. We are the world's largest platform for early stage startups and qualified, accredited investors to meet each other, and are bringing the Silicon Valley ecosystem online and making it available to the entire country.

Since launching in February 2010, we have facilitated over 15,000 introductions between over 3,000 accredited and sophisticated angel investors and thousands of startups. Over 20,000 startup profiles are on our platform, and over a thousand have raised more than $100 Million, spread around the entire US.

Since AngelList does not handle the money or take a transaction fee, we are not privy to the transaction details or to the outcomes. However, dozens of the companies have gone on to be acquired or raise large subsequent financing rounds, and a number, including Pinterest, BranchOut, Uber, and others have become very successful enterprises in their own right.

To date, we have received no word that any of the companies have defrauded investors or absconded with funds.

If you would like to discuss further, please feel free to contact me anytime.

Best,
Naval Ravikant

CEO, AngelList

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March 5, 2012

To whom it may concern,

Prosper Marketplace Inc., a peer-to-peer lending marketplace that brings together creditworthy borrowers with individual and institutional investors, allows people to lend to each other in a way that is financially and socially rewarding. Individual and institutional investors lend in minimum increments of $25 on loan listings they select. In addition to credit scores, ratings and histories, investors can consider borrowers' personal loan descriptions, endorsements from friends, and community affiliations. Prosper handles the servicing of the loan on behalf of the matched borrowers and investors.

Since January 1, 2010, Prosper has facilitated the origination of over $124M in loans through its platform. As of February 29, 2012, the rate of fraud relating to identity theft for these loans has been 0.0% and Prosper has not been required to repurchase any of the loans due to identity theft.

Prosper was co-founded by Chris Larsen, co-founder of E-LOAN. Prosper has raised $83.85 million in venture capital and is backed by financial and technology luminaries including, Tim Draper of Draper Fisher Jurvetson; David Silverman of Crosslink Capital; Accel Partners; CompuCredit; Omidyar Network; Capital One Co-founder Nigel Morris of QED Investors; Court Coursey of TomorrowVentures; and Larry Cheng of Volition Capital.

Sincerely,

Chris Larsen
CEO & Chairman
Prosper.com