



## ANGEL CAPITAL ASSOCIATION

September 11, 2020

The Honorable James Inhofe  
Chairman  
Senate Committee on Armed Services  
228 Russell Senate Building  
Washington, DC 20510

The Honorable Jack Reed  
Ranking Member  
Senate Committee on Armed Services  
228 Russell Senate Building  
Washington, DC 20510

The Honorable Adam Smith  
Chairman  
House Committee on Armed Services  
2216 Rayburn House Office Building  
Washington, DC 20515

The Honorable Mac Thornberry  
Ranking Member  
House Committee on Armed Services  
2216 Rayburn House Office Building  
Washington, DC 20515

Dear Chairmen and Ranking Members:

As the leadership representatives of the Angel Capital Association, we are submitting the following comments to the Corporate Transparency Act of 2019 (the “CTA”), which has been included in the National Defense Authorization Act. While we applaud the anti-money-laundering goals of the CTA, we have grave concerns about the chilling effect it will have on startup company formation and funding, job growth and national competitiveness.

The CTA will require each new business created in America (and all existing businesses except those specifically excluded) to report beneficial ownership information to the Treasury Department’s Financial Crimes Enforcement Network (FinCEN). We believe this will be the first time in the history of our country that a filing of this kind will have to be made with the federal government to start a new business.

The bill requires applicants forming companies to submit to FinCEN a list of the beneficial owners of the company, identifying beneficial owners by name, date of birth, current address, and unique identifying number from a passport or government identification card or driver’s license. In addition, the companies themselves will have to make an annual filing containing a list of the current beneficial owners of the company, and any changes in beneficial ownership in the prior year. Companies may also have to update these lists within a time period prescribed by rule.

These reporting requirements are going to be very burdensome for startups and early stage technology companies that go through a lot of beneficial ownership changes as they grow. To grow a startup, you need to raise capital, and this usually involves selling equity to investors (startups and early stage companies frequently don't qualify for bank financing). The typical startup that is seeking funding from angel investors will conduct multiple rounds of financing through successive sales of equity to private, usually accredited only, investors. Beneficial ownership reporting will be an expensive regulatory burden for the sector of our economy that creates the most jobs in our nation.

FinCEN rules already require financial institutions to collect beneficial ownership information of business customers when they open bank accounts. This legislation feels like an attempt by the financial services industry, which is made up of many very large institutions with considerable resources, to shift an existing regulatory burden onto the startup community which is made of the smallest companies with the fewest resources. Such a shift would result in a massive and unreasonable new reporting requirement on small businesses.

The bill's definition of "beneficial owner," which is the basis of the reporting obligation, is poorly defined. Of the three definitions of beneficial owner, two are vague (substantial control or substantial economic benefit), and the third asks companies to calculate an ownership percentage without providing clarification on how the percentage is to be calculated.

If passed, these ambiguities have the potential to cause timely and costly problems for founders, companies and regulators alike, as well as cause significant privacy and cybersecurity risks. We believe that should this bill pass, as currently drafted, it will jeopardize the growth of early-stage businesses as well as create data security and privacy issues where none currently exist (e.g., companies are going to have to collect this data and adopt expensive security solutions to prevent unauthorized access to the information).

We do not believe it is appropriate for the Conferees to include beneficial ownership reporting in the reconciliation given that the Senate has yet to pass a comparable bill. We have no objection to the provision in the bill that prohibits companies from issuing certificates in bearer form. In fact, perhaps a reasonable approach would be to apply the beneficial ownership reporting obligations only with respect to companies that did issue certificates in bearer form. In the early stage company space in which angel investors invest, no companies issue certificates in bearer form.

If it is not feasible during the Conference Committee proceedings to exclude beneficial ownership reporting in the reconciled bill, then we ask that you adopt language that would carve out from the definition of beneficial owners US angel investors who meet the SEC's definition of Accredited Investor (as defined in Rule 501 of Regulation D), as well as entities comprised solely of US accredited investors. If the Committee does not feel excluding US Accredited Investors is desirable, then we respectfully request that companies be allowed to protect the privacy and personal information of such investors by being able to report them to FinCEN as a single aggregated line item labeled "Individuals who are Accredited Investors," without all of the personal information otherwise required to be disclosed (name, address, date of birth, and unique identifying number).

The bill contains a lengthy list of entities that are not considered corporations or limited liability companies and thus exempt from the obligation to collect and report beneficial ownership information to FinCEN.

The list of exempt entities includes, but is not limited to:

- public companies;
- banks, credit unions, bank holdings companies, broker dealers, registered investment advisors and investment companies, insurance companies, public accounting firms, and pooled investment vehicles operated or advised by such persons; and
- any business with more than 20 employees and more than \$5,000,000 in gross receipts with an operating presence at a physical office in the US.

Given these exclusions, the bill by definition covers small businesses only. The ACA has over 14,000 members including angel groups and individuals, and our industry, perhaps because of the dynamic of having active angel investors who by their very nature are interested in watching their companies, and making sure good governance practices are in place, experience very little fraud. We have not heard from our members of experiences investing in companies that later turned out to be money laundering operations.

We believe the bill should exclude operating businesses, meaning corporations or LLCs with active trade and businesses (not shell companies) with physical presences in the US that are backed by US resident accredited investors (or groups of accredited investors investing through pooled investment vehicles).

We also believe that Established Angel Groups that satisfy the below standards (which have been established by the Angel Capital Association) should also be included in the list of entities that are not considered corporations or limited liability companies under the CTA and thus do not need to collect and report beneficial ownership information to FinCEN.

Under ACA standards, in order to be deemed an “Established Angel Group,” a group must meet the following criteria:

- The group is a private organization of accredited investors organized for the purpose of investing in early-stage companies and includes one or more members who have previously invested under a Rule 506 exemption.
- Membership is only by invitation or referral from a current member who has a pre-existing relationship with the applicant and is familiar with the professional and financial status of the applicant, and reasonably believes he or she is an accredited investor.
- Each applicant completes a questionnaire that includes professional experience and sector expertise and certifies at least annually that he or she is an accredited investor.
- Members invest their own funds at their own discretion. The group makes no recommendation in regard to any individual member’s investment in any offering under consideration.
- Neither the group nor any of its members or employees (if any) receives any transaction-based compensation in connection with offerings considered by the group.
- The group has established investment processes, consistent with those recommended by Angel Capital Association for member groups (see [www.angelcapitalassociation.org/angel-group-operations/](http://www.angelcapitalassociation.org/angel-group-operations/)), and also operates under a strict code of conduct and/or is a member of a professional association such as ACA, and adheres to its code of conduct.

Should the Committee be unable to incorporate this type of language into the conference bill, then we ask that you define beneficial ownership to include a 25% ownership requirement for all three definitions of beneficial owner (meaning, an investor would not be deemed to have substantial control or substantive economic benefit unless they owned at least 25% of a company), and that the mathematical test for determining 25% ownership be defined to mean that it is calculated based on a fully-diluted basis; specifically all shares outstanding, plus all outstanding instruments (e.g., convertible debt, stock options, warrants) which are convertible into shares.

We remain at your disposal to further address our concerns that the CTA would inhibit the economic growth in the US and have chilling effect on the small businesses in particular. Thank you very much for your consideration.

Sincerely,



Pat Gouhin  
Chief Executive Officer



Tony Shipley  
Chairman of the Board