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Asset Management ADVocate

The Financial Choice Act Aims to Help Angel Investors

The proper treatment of angel investing groups under the Federal securities laws can be a vexing question. If it were appropriate to describe the angel investing group as a "company" as defined in Section 2(a)(8) of the Investment Company Act of 1940, and if the "company" were appropriately viewed as issuing interests or shares, then the angel investing group would have to seek to rely on Sections 3(c)(1) or 3(c)(7) of the Investment Company Act and comply with the requirements of Regulation D under the Securities Act of 1933. Yet these views seem to beg the questions of who is giving investment advice to the "company" and who is acting as a broker in offering and selling interests in the "company."

Regulatory Risks for Angel Investors

The status of angels (at least the investing type) is not a philosophical question. For example, if a choir of angels were treated as an investment company, Section 47(b) of the Investment Company Act would make voidable any contract the group entered into in violation of the Act. Possible violations of the Investment Advisers Act and other Federal and state securities laws, not to mention the applicability of the antifraud provisions in the 1933 Act and in Rule 10b-5 under the Securities Exchange Act of 1934, pose additional risks. Such risks cause angels to express serious concerns about the restrictions that appear to be imposed by those statutes.

The Proposed "HALOS" Act

Some of these concerns appear to have been heard by the House of Representatives, which added H.R. 79 as Subtitle K of the Financial Choice Act that has passed the House of Representatives and been sent to Senate. Section 1 gives this piece of legislation the charming name of "Helping Angels Lead Our Startups Act," or the "HALOS Act." The HALOS Act would require the SEC to amend Regulation D to permit the issuers relying on the regulation to participate in events sponsored by a:

- government entity,
- educational institution,
- nonprofit organization,
- angel investor group,
- venture forum, venture capital association, or trade association, or
- another organization determined by the SEC.

The sponsor must not: (a) refer to specific securities when advertising the event, (b) make investment recommendations, (c) become involved in negotiations with the issuer or (d) receive any compensation other than administrative fees. The issuer must limit its communications to:

- the type and amount of securities offered;
- the amount already subscribed for; and
- the intended use of the proceeds.

Definition of "Angel Investment Group"

Although the HALOS Act would not define a venture forum or association, it does include a definition of an "angel investment group," as any group:

- composed of accredited investors interested in investing personal capital in early-stage companies,
- that holds regular meetings and has defined processes and procedures for making investment decisions, either individually or among the membership of the group as a whole, and
- is neither associated nor affiliated with brokers, dealers, or investment advisers.

Introduction of any newly defined terms provides an opportunity for practitioners to expand its application. In light of Congress's clear intent to foster angel investing, adding "angel investor group" to the books may make it easier to request a no-action letter, order or even a regulation exempting such groups from the Investment Company and Investment Advisers Acts or from broker-dealer regulations. Meanwhile, in the interests of parallelism and certainty, it would be nice if Congress could, Federalism notwithstanding, require the various states to take the same positions that are articulated and implied by the HALOS Act.

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