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August 31, 2012

Via email (pubcom@finra.org)

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

Re: Regulatory Notice 12-34
Jumpstart Our Business Startups Act

Dear Ms. Asquith:

We appreciate the opportunity to offer comments and suggestions in response to your request for comments on Proposed Regulation of Crowdfunding Activities. We recognize that your Jumpstart Our Business Startups Act ("**JOBS Act**") mandate to create rules "written specifically for registered funding portals" will need to be consistent with the SEC's yet-to-be-written rules and appreciate your effort to commence drafting the funding portal regulatory program and guidelines for registered broker-dealers within the established framework of Title III of the JOBS Act.

Section 302 of the JOBS Act introduces the exemption for crowdfunding in new Section 4(a)(6)[1] and sets forth the requirements for "intermediaries" in new Section 4A ("**Section 4A**"), both under the Securities Act of 1933, as amended (the "**Securities Act**"). Pursuant to Section 4A, a person acting as an intermediary must comply with a dozen enumerated requirements including:

1. register with the SEC as either a broker or "funding portal";
2. register with FINRA;
3. provide disclosures, including investment risks, and other investor education materials, compliant with SEC rulemaking;
4. ensure that each investor—
   a. reviews investor-education information (standards to be set by the SEC);
   b. affirms that they understand there is risk of losing the entire investment and that they can bear the loss; and

[1] This is incorrectly referenced throughout Title III of the JOBS Act as Section 4(6).

c. answers questions demonstrating an understanding of the risks inherent in investments in startups, emerging businesses, and small issuers, including illiquidity and any other key concerns the SEC identifies;

5. take measures to reduce the risk of fraud with respect to crowdfunded transactions, as established by the SEC, including obtaining a background and securities enforcement regulatory history check on each officer, director, and person holding more than 20% of the outstanding equity of every issuer whose securities are offered through the portal;
6. provide a 21-day[2] window for the SEC and potential investors to review the information required to be posted by issuers pursuant to Section 4A(b);
7. ensure that the issuer does not receive any investment funds until a target offering amount is committed, and allow all investors to cancel their commitments to invest, pursuant to SEC rules;
8. make such efforts as the SEC determines appropriate, by rule, to ensure that no investor in a 12-month period has purchased securities offered pursuant to section 4(6) that, in the aggregate, from all issuers, exceed the investment limits set forth in section 4(6)(B);
9. take such steps to protect the privacy of information collected from investors as the SEC shall, by rule, determine appropriate;
10. not compensate promoters, finders, or lead generators for providing the broker or funding portal with the personal identifying information of any potential investor;
11. prohibit its directors, officers, or partners (or any other person in a similar status or performing a similar function) from having any financial interest in an issuer using its services; and
12. meet any other requirements the SEC prescribes for the protection of investors and in the public interest.

While these elements will be applied to both a broker and a funding portal, the JOBS Act expressly provides that FINRA must design rules "written specifically for funding portals."

We note that our comments do not address JOBS Act Title II Section 201(c) changes to Section 4(b) under the Securities Act that currently permits platforms to conduct private placements pursuant to the exemptions in Rule 4(2) and Regulation D Rule 506 subject to certain conditions. That provision allows a portal to co-invest and provide ancillary services so long as the platform does not receive sales-related compensation.

JOBS Act Section 304(b) sets forth Section 3(a)(80) ("**Section 3(a)(80)**") of the Securities Exchange Act of 1934 (the "**Exchange Act**") to add a definition for "funding portal" as "any person acting as an intermediary[3] in a transaction involving the offer or

[2] The JOBS Act allows the SEC to change this timeframe.

[3] We note that the term "intermediary" in Section 4A refers to both a broker and funding portal. JOBS Act Section 304(a), which adds the "Limited Exemption for Funding Portals" to Section 3 of the Exchange Act,

sale of securities for the account of others, solely pursuant to section 4(6) of the Securities Act of 1933, that does not—

(A) offer investment advice or recommendations;
(B) solicit purchases, sales, or offers to buy the securities offered or displayed on its website or portal;
(C) compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal;
(D) hold, manage, possess, or otherwise handle investor funds or securities; or
(E) engage in such other activities as the SEC, by rule, determines appropriate.

We urge FINRA to be mindful of Congress' expressed direction to take a light touch to regulation"[4] while observing its mandate to protect investors and the markets.

A. PORTAL REGISTRATION

1. Membership Application

Consistent with Section 4A, funding portals must register with FINRA. We propose that FINRA create an application and review process to confirm that prospective funding portals meet the requirements for intermediaries set forth in Section 4A. However, in light of the goals of the JOBS Act, the process should be streamlined in scope and time relative to the application process for broker-dealer members.

a. *Contents* – Since crowdfunded offerings will be managed via the internet, we suggest that applicants provide planned web pages for pre-approval by FINRA as the central part of the registration process. This will allow FINRA to confirm that the required investor education and other Section 4A information is properly presented on the web site. FINRA's standard for review should conform to the SEC's guidelines for funding portals. Applicants will need to detail how they will meet their obligations under Section 4A for issuer background checks, templates for issuer/offering information, handling investor funds, complying with investor limitations, setting parameters for offerings to be posted, proposed terms of use and privacy policy, fee structures, as well as other requirements that may be imposed, such as insurance.

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provides that "the term 'broker or dealer' includes a funding portal and the term 'registered broker or dealer' includes a registered funding portal.

[4] Rep. Patrick McHenry (R-NC), authored the House version of Title III, quoted at a crowdfunding symposium hosted by the Crowdfund Intermediary Regulatory Advocates on July 13, 2012 that included industry members, representatives from the SEC and FINRA, members of Congress and other interested parties (http://www.cfira.org/?p=705). See also, Statement for the Record of Senator Jeff Merkley Regarding Crowdfunding in Title III of H.R. 3606 dated July 26, 2012.

b. *Timing* - The review and approval process should be substantially shorter than the 180 days accorded to broker-dealer membership applications and the required documentation should be similarly abbreviated. We suggest no more than a 30 – 45-day window (which is measurably longer than the 10-day window to review proposed firm websites in new FINRA Rule 2210 which will become effective in February 2013).

We hope that FINRA can coordinate with the SEC on the adoption of the new regulations to afford funding portals the opportunity to submit their registration applications prior to the date of formal implementation to minimize delays in becoming operational.

c. *Fees* – Funding portals could pay an application fee for review (and perhaps an incremental sum for expedited review) which would supplement FINRA's budget for development of a program for and oversight of these entities.[5]

2. Licensing
Portal personnel should not be required to be licensed under to the existing examination series (e.g., Series 7, 63, and 24). This is consistent with both Section 3(a)(80) and the "light touch" approach intended by Congress. As an alternative, we suggest creation of a certification whereby operating executives[6] objectively demonstrate their understanding of the rules and requirements applicable to funding portals. Each funding portal should have at least one certified manager who should be certified by the conclusion of the application process.

3. Gateway and CRD
Similar to broker-dealer membership applications, the information and materials for a funding portal application can be submitted electronically through the Gateway system. Once registered, information about funding portals and certified executives could be centralized in CRD and available to the public via the BrokerCheck database.[7] This is one way investors ascertain whether a funding portal is registered and to deter fraud.

B. PORTAL REQUIREMENTS

The JOBS Act already details several aspects of funding portal obligations, subject to interpretation and further rulemaking by the SEC.

[5] The fee should be relative to the limited scope of FINRA's review and oversight.
[6] As distinguished from owners who provide only capital sourcing, in the same manner as a silent owner of a broker-dealer would not be required to register under Rule 1021 and FINRA Standards for Admission.
[7] In the same manner as BrokerCheck denotes "Brokerage Firm" and "Investment Adviser Firm," there could be a designation for "Funding Portal."

1. Investor education
   a. *Educational materials*
      One of the main features of Section 4A is the requirement for an educational component. Funding portals must go beyond providing information and disclosures about crowdfunding and the terms and risks of each specific offering a person may invest in. They must affirm that the prospective investor understands the risk of loss and can bear that loss. Funding portals are required to engage in a question and answer exchange to confirm the investors' understanding of risks inherent in investments in startups, illiquid and speculative securities, the various types of securities that may be offered (e.g., common stock, notes, convertible features), ability to bear loss, and any other aspect of a crowdfunded investment, including the terms of a specific offering, that the SEC deems appropriate.

      Existing portals currently employ methods that involve live quizzing and pictorials to ensure investors understand investor risk. We suggest that funding portals use hot links to a central glossary of definitions and explanations of terms used throughout the web site.

   b. *Issuer disclosure requirements for the offering required by Section 4A*[8]
      FINRA could publish a template (in the same manner as it offers guidance on business plans for NMA candidates), including: issuer name, address, contact, names of officers and directors, business overview and plan, intended use of proceeds, target offering amount and price, financial statements, and the like.

   c. *Any additional SEC directed information*

2. Issuer Background Checks
   Section 4A dictates a minimal level of background checks that must be conducted by the funding portal. This screening may be done by the funding portal or outsourced to a third party, but the portal should articulate the scope of the required review in both the educational interchange and on the Terms of Use page that we propose below. It may be appropriate to set forth a disclaimer that the funding portal has a limited obligation to review an issuer and is not endorsing or recommending any issuer's securities for sale.

[8] Section 4A(a)(6) provides a 21-day window for the SEC and public to have access to pose inquiries to the issuer and review the offering information. All investor funds and commitments to invest must be held in escrow or abeyance for this period and possibly longer until the threshold offering amount is reached. As such, the offering cannot close and the securities are not "sold" until these milestones are reached. The SEC has been requested to clarify the terms "sale" and "sold" in this context.

3. Investor investment thresholds based on income and investing history
Notwithstanding the SEC's proposed rules pursuant to Title II of the JOBS Act for general solicitation and advertising in Regulation D Rule 506 offerings[9], we believe that funding portals and issuers should be able to rely on investor self-certification and representations regarding their income. Unlike Title II of the Act, the amount an individual investor may invest in crowdfunded offerings is limited.

   As the equity crowdfunding industry develops, there may be investor databases or other methods of tracking investor compliance offered by independent third party technology.[10]

4. Handling investor funds
Section 3(a)(80) prohibits funding portals from holding, managing or handling investor monies. Subject to SEC rulemaking, to the extent funds are advanced prior to closing, we suggest that FINRA either adapt the existing escrow rules applicable to best efforts offerings[11] conducted by broker-dealers or consider the existing funding techniques used by donation based portals.[12] In the latter alternative, which is suited to smaller offerings involving very limited investment amounts, investors commit to a certain funding amount and provide credit card information which is maintained in a secured fashion until the minimum threshold is reached. At that point, the investor is notified that the charge will be processed.

5. Investment Advice
The JOBS Act does not allow funding portals to provide investment advice or recommendations. Our belief that the activities conducted on a funding portal does not constitute investment advice is in step with FINRA's (and the SEC's) long-standing position that generally available offering information that is not directed at any particular individual does not constitute investment advice[13] and comports with the concept of funding portals serving as neutral conduits for issuers and prospective investors to connect.

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[9] *See* Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, SEC Release 33-9354 (August 29, 2012).
[10] Potential third-party service providers are designing alternatives to address this issue.
[11] Exchange Act Rule 15c2-4 and NASD Notice to Members 84-7.
[12] Donation and pledge-based crowdsourced offerings that require a minimum commitment threshold, will secure credit card or PayPal data pending achievement of the minimum commitments before any funding transactions processed.
[13] *See* Regulatory Notice 12-25 at question 7 and footnote 25.

We further assert that the use of investor-driven tools and technology does not constitute a recommendation and is not investment advice pursuant to historical FINRA guidance, but we recognize that this interpretation is subject to confirmation by the SEC.[14]

6. Advertising

The JOBS Act does not permit advertising of crowdfunded offerings, other than notices that direct investors to the funding portal. The Act does allow funding portals to market themselves and the activities generally conducted on their sites. We are mindful that the SEC is considering this issue. However, funding portals should be permitted to announce the successful closing of recent offerings in the form of a tombstone.[15] Permissible communications could include the list of communications excluded from the filing requirements in FINRA Rule 2210. We recognize that this issue is subject to SEC interpretation.

7. Commentary

A major feature of crowdsponsored campaigns have relied upon the "wisdom of the crowd." We encourage FINRA to permit funding portals to allow commentary from various parties (particularly prospective investors) to be posted to discussion boards on the web sites. The funding portal should function as a neutral conduit for commentary (unless the content is defamatory or otherwise inappropriate, and should be deleted). Similarly, funding portals should be able to link third party discussion boards to augment information flow and enhance investors' experience. Consistent with SEC and FINRA guidance, the intermediary should not engage or endorse any commentary posted on the discussion boards or linked to the site.[16]

C. PORTAL INVESTOR PROTECTION

While the SEC rulemaking will need to address issues of fraud and the limits of liability, there are several investor protection features FINRA can impose on funding portals that is consistent with their operations as described below. In addition, new Exchange Act Section 3(h)(2) grants FINRA examination and enforcement authority over funding portals.

1. Supervision

[14] *See* NASD Notice to Members 01-23 citing examples of customer-directed web tools that fall outside the definition of recommendation.
[15] *See generally* Regulatory Notice 12-29.
[16] We defer to the SEC's and FINRA's concept of "entanglement" as the model for a "neutral" posture. *See* FINRA Regulatory Notices 11-39 and 10-06 and SEC Interpretation: Use of Electronic Media, Release 34-42728 (2000).

After the initial set up, a funding portal's business will be largely automated. For this reason, there should be little personnel in the day to day operations and limited supervision will be required. There should be limited personnel involved in the day-to-day operations, and supervision should be minimal beyond maintaining the established format. One area for supervision is to monitor changes in the laws and regulations affecting funding portals.

2. Terms of use
This is a common feature on existing crowdsourcing web sites and includes sections describing or explaining terms for using the web site, services provided, products sold, authorized users, investor qualifications, user code of conduct, issuer selection standards, third party content, third party service providers, termination, warranty disclaimer, indemnification, limitation of liability, governing law, arbitration, and an acknowledgement of having read the terms and conditions. It is important for funding portals to emphasize and make clear to any visitor to the web site that they maintain a neutral posture in regard to offerings posted to the web site and clearly disclose that: a funding portal is not offering or selling securities, not conducting issuer due diligence, not recommending securities and not offering investment advice. It must be clear to any visitor to the funding portal that it is not a broker-dealer or acting in the capacity of a broker-dealer.

3. Privacy policy
If not included in the Terms of Use suggested above, funding portals should set forth how they will maintain and secure user data. Disclosure should state whether they use a third party service provider and identify that entity.

4. Recordkeeping
Suggested information to retain for a to-be-determined period may include:
Web pages
Issuer information and background check data
Investor information records
Escrow or other third party arrangement for investor funds
Funding records
Disclosures
Risk factors
Commentary, third party links and posts to a discussion board hosted by the portal
Terms of Use
Privacy Policy
Announcements[17]

[17] We use the term "announcement" to acknowledge the proscription against advertisements, but in recognition of the types of communications cited in FINRA Rule 2210(c)(7).

5. Dispute resolution
   The SEC will need to determine the appropriate forum for dispute resolution, but we believe that the preferred forum for dispute resolution should be up to the individual funding portal. Certainly, arbitration should be a viable alternative, and, if so designated, FINRA should handle disputes through the procedural mechanism in its Code of Arbitration for broker-dealers, but subject to the rules and standards applicable to funding portals as directed in new Section 3(h) of the Exchange Act.

6. Liability
   Section 4A(c) imposes liability for material misstatements and omissions on issuers and any person who offers and sells securities. We point out that funding portals are not in the business of 'offering and selling securities'. They function solely as a forum for investors and issuers to meet and exchange information and are intended by Congress to be 'passive and neutral'.[18] Funding portals are prohibited from accepting or holding investor funds or securities. With this in mind, the SEC should set minimal, if any, liability standards for funding portals.

7. Fraud and Manipulation
   JOBS Act Section 302(d) directs the SEC to establish disqualification provisions for both issuers and funding portals. Those rules must be consistent with Rule 262 under the Securities Act which contains "bad boy" exclusions for persons who have been involved with securities-related transgressions and barred from conducting a securities business or violated rules involving fraudulent or deceptive conduct.

   Separately, as we discussed above in regard to the SEC's preliminary interpretation of the JOBS Act provision banning investment advice or recommendations, we contend that the processing of vetting issuers to be posted on the funding portal should function as a screening mechanism. Funding portals should be able to refuse to post any deal if they have concerns, doubts or suspicions about the issuer, regardless of the results of a background check or meeting the stated parameters for posting. We recognize that FINRA will need to wait for the SEC to propose rules on this issue.

8. Insurance
   While portals should not have net capital requirements or carry the same forms of insurance that broker dealers are required to carry, it is advisable for funding portals to carry some form of insurance or bond similar to the fidelity bond requirement in Rule 4360. In view of the stated limit of liability in

[18] See remarks of Senator Merkley cited in footnote 4 above.

Section 4A as the consideration paid for securities purchased under the exemption plus interest on that amount, the level of insurance should be no more than the blanket or fidelity bond coverage required for a $5,000 broker-dealer. This proposal is both good business practice and maintains the goal of a "light touch" approach, but it should not be required.

9. Anti-Money Laundering
   Given that only US issuers are permitted to crowdfund, investment limitations are mandatory, funds must be held by a third party, the investments are generally illiquid, and securities designated for investment holding, there is limited concern about money laundering.

10. FINRA examinations / enforcement
    FINRA may consider requiring mandatory continuing education for the certified managers and executives and/or an electronic question and answer certification process as a means to monitor compliance.

We also suggest that FINRA produce a set of FAQs for the "Investors" portion of their web site with an email or phone contact for questions and concerns about funding portals.

D. FEE STRUCTURE

The JOBS Act is silent on fees for funding portals other than the limitation in Section 4A(a)(10) on payments to employees, agents and others for solicitation based on the sale of securities displayed or referenced on the website or portal.

Using NASD Notice to Members 92-53 "Underwriting Compensation Received by Members in the Public Equity Offerings" as a guide, the maximum amount of compensation considered fair and reasonable should be based on a matrix that includes the size of the offering and the amount of risk assumed by the underwriter (i.e., firm commitment vs. best efforts and initial vs. secondary offering). The Notice presented a fee scale in inverse proportion between the size of the deal and the permissible percentage of fees; according to the matrix, best efforts offerings of $1 million (the smallest deal size on the chart) should have a commission of approximately 11.83%.

Since funding portals will not have to make a commitment to sell a certain number of shares, we look to the "best efforts" fees, and, since offering size is capped at the $1 million threshold, it follows that portals would be entitled to a greater percentage of the smallest deals. That said, FINRA should consider a 12.5% fee for raises of $500,000 - $1 million and 15% for raises under $500,000.

For comparison, "donation" and "reward" based models currently operating charge between 5% and 15% in fees in connection with these offerings. Based upon this model,

we believe that a 12-15% fee should be permissible for "equity" based portals and brokers.

We appreciate your openness to engage in meaningful dialogue with the nascent crowdfunding industry, counsel, regulators and states. We look forward to the opportunity to engage in further discourse on the most effective rules to achieve the dual goals of investor protection and facilitating startup capital raising.

Sincerely,

/s/ *Douglas Ellenoff*
Douglas S. Ellenoff