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SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 200, 227, 232, 239, 240 and 249

[Release Nos. 33-9470; 34-70741; File No. S7-09-13]

RIN 3235-AL37

CROWDFUNDING

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rules.

SUMMARY: The Securities and Exchange Commission is proposing for comment new Regulation Crowdfunding under the Securities Act of 1933 and the Securities Exchange Act of 1934 to implement the requirements of Title III of the Jumpstart Our Business Startups Act. Regulation Crowdfunding would prescribe rules governing the offer and sale of securities under new Section 4(a)(6) of the Securities Act of 1933. The proposal also would provide a framework for the regulation of registered funding portals and brokers that issuers are required to use as intermediaries in the offer and sale of securities in reliance on Section 4(a)(6). In addition, the proposal would exempt securities sold pursuant to Section 4(a)(6) from the registration requirements of Section 12(g) of the Securities Exchange Act of 1934.

DATES: Comments should be received on or before [insert date 90 days from publication in the Federal Register].

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form

(*http://www.sec.gov/rules/proposed.shtml*);

- Send an e-mail to *rule-comments@sec.gov*. Please include File Number S7-09-13 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-09-13. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (*http://sec.gov/rules/proposed.shtml*). Comments also are available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you would like to make publicly available.

FOR FURTHER INFORMATION CONTACT: With regard to requirements for issuers, Sebastian Gomez Abero or Jessica Dickerson, Division of Corporation Finance, at (202) 551-3500, and with regard to requirements for intermediaries, Joseph Furey, Joanne Rutkowski, Leila Bham, Timothy White or Carla Carriveau, Division of Trading and Markets, at (202) 551-5550, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

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I. Introduction and Background

A. Overview of Crowdfunding

Crowdfunding is a new and evolving method to raise money using the Internet. Crowdfunding serves as an alternative source of capital to support a wide range of ideas and ventures. An entity or individual raising funds through crowdfunding typically seeks small individual contributions from a large number of people.[1] A crowdfunding campaign generally has a specified target amount for funds to be raised, or goal, and an identified use of those funds. Individuals interested in the crowdfunding campaign – members of the "crowd" – may share information about the project, cause, idea or business with each other and use the information to decide whether or not to fund the campaign based on the collective "wisdom of the crowd."[2] Crowdfunding has been used to fund, for example, artistic endeavors, such as films and music recordings, where contributions or donations are rewarded with a token of value related to the project (*e.g.*, a person contributing to a film's production budget is rewarded with tickets to view the film and is identified in the film's credits) or where contributions reflect the pre-purchase of a finished product (*e.g.*, a music album). A number of entities operate websites that facilitate

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1 *See, e.g.*, C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 10 (2012) ("Bradford"). Crowdfunding has some similarities to "crowdsourcing," which is the concept that "the power of the many can be leveraged to accomplish feats that were once the province of the specialized few." *See* Jeff Howe, *The Rise of Crowdsourcing*, Wired (Jun. 2006) ("Howe"). Crowdsourcing is an approach for problem solving that employs the "wisdom of crowds," where "the very success of a solution is dependent on its emergence from a large body of solvers." Daren C. Brabham, *Crowdsourcing as a Model for Problem Solving*, 14 Convergence 75, 79-80 (2008) ("Brabham").

2 *See* Stephenson Letter; Richard Waters, *Startups seek the 'wisdom of crowds,'* FINANCIAL TIMES, Apr. 3, 2012, *available at* http://www.ft.com/intl/cms/s/0/c1f1695c-7da8-11e1-9adc-00144feab49a.html#axzz2b7QxIH5L ("[T]he backers of [crowdfunding] argue that the hard work of making investment decisions – filtering out the best investments and limiting fraud – can be solved by tapping the 'wisdom of crowds' over the internet.").

crowdfunding in its current form,[3] with some websites specializing in certain industries, such as computer-based gaming, music and the arts, and other websites focusing on particular types of entrepreneurs.[4]

The Jumpstart Our Business Startups Act (the "JOBS Act"),[5] enacted on April 5, 2012, establishes the foundation for a regulatory structure for startups and small businesses to raise capital through securities offerings using the Internet through crowdfunding.[6] The crowdfunding provisions of the JOBS Act were designed to help provide startups and small businesses with capital by making relatively low dollar offerings of securities less costly.[7] They also permit Internet-based platforms to facilitate the offer and sale of securities without having to register with the Commission as brokers.

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3 Examples of current crowdfunding websites include: www.indiegogo.com, www.kickstarter.com, www.kiva.com and www.rockethub.com.

4 *See* Bradford, note 1at 12-13 (citing "Unbound: Books Are Now in Your Hands" (http://unbound.co.uk/), specializing in book publishing, "My Major Company" (http://www.mymajorcompany.com/), specializing in music, "Spot.us: Community-funded Reporting" (http://spot.us/), specializing in journalism, and "Heifer International" (http://www.heifer.org/) specializing in agriculture and ranching). *See also* Liz Gannes, *Crowdfunding for a Cause: Nonprofits Can Now Hold Fundraisers on Crowdtilt*, AllThingsD (Nov. 21, 2012), *available at* http://allthingsd.com/20121121/crowdfunding-for-a-cause-non-profits-can-now-hold-fundraisers-on-crowdtilt/ (describing the use of crowdfunding for charitable purposes).

5 Pub. L. No. 112-106, 126 Stat. 306 (2012).

6 To facilitate public input on JOBS Act initiatives, the Commission solicited comment on each title of the JOBS Act through its website at http://www.sec.gov/spotlight/jobsactcomments.shtml. The public comments we received on Title III are available on our website at http://www.sec.gov/comments/jobs-title-iii/jobs-title-iii.shtml. Exhibit A of the release includes a citation key to the comment letters the Commission received on Title III.

7 *See, e.g.*, 158 CONG. REC. S1781 (daily ed. Mar. 19, 2012) (statement of Sen. Carl Levin) ("Right now, the rules generally prohibit a company from raising very small amounts from ordinary investors without significant costs."); 157 CONG. REC. S8458-02 (daily ed. Dec. 8, 2011) (statement of Sen. Jeff Merkley) ("Low-dollar investments from ordinary Americans may help fill the void, providing a new avenue of funding to the small businesses that are the engine of job creation. The CROWDFUND Act would provide startup companies and other small businesses with a new way to raise capital from ordinary investors in a more transparent and regulated marketplace."); 157 CONG. REC. H7295-01 (daily ed. Nov. 3, 2011) (statement of Rep. Patrick McHenry) ("[H]igh net worth individuals can invest in businesses before the average family can. And that small business is limited on the amount of equity stakes they can provide investors and limited in the number of investors they can get. So, clearly, something has to be done to open these capital markets to the average investor[.]").

In the United States, crowdfunding in its current form generally has not involved the offer of a share in any financial returns or profits that the fundraiser may expect to generate from business activities financed through crowdfunding.[8] Such a profit or revenue-sharing model – sometimes referred to as the "equity model" of crowdfunding[9] – could trigger the application of the federal securities laws because it likely would involve the offer and sale of a security.[10] Under the Securities Act of 1933 ("Securities Act"), the offer and sale of securities is required to be registered unless an exemption is available. At least one commenter has stated that registered offerings are not feasible for raising smaller amounts of capital, as is done in a typical crowdfunding transaction, because of the costs of conducting a registered offering and the resulting ongoing reporting obligations under the Securities Exchange Act of 1934 ("Exchange Act") that may arise as a result of the offering.[11] Limitations under existing regulations, including restrictions on general solicitation and general advertising and purchaser qualification requirements, have made private placement exemptions generally unavailable for crowdfunding

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8 *See* Bradford, note 1; Jenna Wortham, *Start-Ups Look to the Crowd*, N.Y. TIMES at B1 (Apr. 30, 2012); Joan MacLeod Heminway and Shelden Ryan Hoffman, *Proceed At Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879 (2011); Thomas Lee Hazen, *Crowdfunding or Fraudfunding? Social Networks and the Securities Laws – Why the Specially Tailored Exemption Must be Conditioned on Meaningful Disclosure*, 90 N.C.L. REV. 1735 (2012) ("Hazen"); C. Steven Bradford, *The New Federal Crowdfunding Exemption: Promise Unfulfilled*, 40 SEC. REG. L.J. 1 (2012).

9 *See* Bradford, note 1 at 33.

10 *See* Securities Act Section 2(a)(1) and Exchange Act Section 3(a)(10) (setting forth the definition of a "security" under the Securities Act and the Exchange Act, respectively). *See, e.g.*, *Reves v. Ernst & Young*, 494 U.S. 56 (1990) (outlining the requirements for a note to be considered a security); *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) (setting forth the definition of an investment contract).

11 *See* Bradford, note 1 at 42.

transactions, which are intended to be made to a large number of potential investors and not limited to investors that meet specific qualifications.[12]

Moreover, a third party that operates a website to effect the purchase and sale of securities for the account of others generally would, under existing regulations, be required to register with the Commission as a broker-dealer and comply with the laws and regulations applicable to broker-dealers.[13] A person that operates such a website only for the purchase of securities of startups and small businesses, however, may find it impractical in view of the limited nature of that person's activities and business to register as a broker-dealer and operate under the full set of regulatory obligations that apply to broker-dealers.

B. Title III of the JOBS Act

Title III of the JOBS Act ("Title III") added new Securities Act Section 4(a)(6),[14] which provides an exemption from the registration requirements of Securities Act Section 5 for certain crowdfunding transactions. To qualify for the exemption under Section 4(a)(6), crowdfunding

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12 *But see Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings*, Release No. 33-9415 (July 10, 2013) [78 FR 44771 (July 24, 2013)] ("*General Solicitation Adopting Release*") (adopting rules to implement Title II of the JOBS Act). Title II of the JOBS Act directed the Commission to amend Rule 506 of Regulation D to permit general solicitation or general advertising in offerings made under Rule 506, provided that all purchasers of the securities are accredited investors. Accredited investors include natural persons who meet certain income or net worth thresholds. Although this rule facilitates the type of broad solicitation emblematic of crowdfunding, crowdfunding is premised on permitting sales of securities to any interested person, not just to investors who meet specific qualifications, such as accredited investors.

13 Exchange Act Section 15(a)(1) generally makes it unlawful for a broker or dealer to effect any transactions in, or induce the purchase or sale of, any security unless that broker or dealer is registered with the Commission pursuant to Exchange Act Section 15(b). 15 U.S.C. 78*o*(a). *See* discussion in Section II.D.2 below. Because brokers and dealers both register as broker-dealers (*i.e.*, there is no separate "broker" or "dealer" registration under Exchange Act Section 15(b)), we also use the term "broker-dealer" in this release.

14 Title III amended Securities Act Section 4 to add Section 4(6); however, Title II of the JOBS Act also amended Securities Act Section 4 and inserted subsections (a) and (b). The U.S. Code implemented the amendment by adding paragraph (6) at the end of subsection (a).

transactions by an issuer (including all entities controlled by or under common control with the issuer) must meet specified requirements, including the following:

- the amount raised must not exceed $1 million in a 12-month period (this amount is to be adjusted for inflation at least every five years);
- individual investments in a 12-month period are limited to:
  - the greater of $2,000 or 5 percent of annual income or net worth, if annual income or net worth of the investor is less than $100,000; and
  - 10 percent of annual income or net worth (not to exceed an amount sold of $100,000), if annual income or net worth of the investor is $100,000 or more (these amounts are to be adjusted for inflation at least every five years); and
- transactions must be conducted through an intermediary that either is registered as a broker or is registered as a new type of entity called a "funding portal."

In addition, Title III:

- adds Securities Act Section 4A, which requires, among other things, that issuers and intermediaries that facilitate transactions between issuers and investors in reliance on Section 4(a)(6) provide certain information to investors and potential investors, take certain other actions and provide notices and other information to the Commission;
- adds Exchange Act Section 3(h), which requires the Commission to adopt rules to exempt, either conditionally or unconditionally, "funding portals" from having to register as brokers or dealers pursuant to Exchange Act Section 15(a)(1);
- includes disqualification provisions under which an issuer would not be able to avail itself of the Section 4(a)(6) exemption if the issuer or other related parties, including an intermediary, was subject to a disqualifying event; and

- adds Exchange Act Section 12(g)(6), which requires the Commission to adopt rules to exempt from the registration requirements of Section 12(g), either conditionally or unconditionally, securities acquired pursuant to an offering made in reliance on Section 4(a)(6).

In this release, we are proposing new rules and forms to implement Securities Act Sections 4(a)(6) and 4A and Exchange Act Sections 3(h) and 12(g)(6). The proposed rules are described in detail below. Until we adopt rules relating to crowdfunding transactions and such rules become effective, issuers and intermediaries may not rely on the exemption provided under Section 4(a)(6).

C. Approach to Proposed Rules

We understand that Title III was designed to help alleviate the funding gap and accompanying regulatory concerns faced by startups and small businesses in connection with raising capital in relatively low dollar amounts.[15] The proposed rules are intended to align crowdfunding transactions under Section 4(a)(6) with the central tenets of the original concept of crowdfunding, in which the public – or the crowd – is presented with an opportunity to invest in an idea or business and individuals decide whether or not to invest after sharing information about the idea or business with, and learning from, other members of the crowd.[16] In this role,

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15 *See* note 7.

16 *See* notes 1 and 2. As discussed in Section II.C.5.c below, the proposed rules would require a person to open an account with an intermediary before posting comments on the intermediary's platform. However, as discussed in Section II.C.5.a below, a person would not need to open an account with the intermediary in order to view the issuer's disclosure materials.

members of the crowd are not only sharing information about the idea or business, but also are expected to help evaluate the idea or business before deciding whether or not to invest.[17]

At the same time, Congress provided important investor protections for crowdfunding transactions under Section 4(a)(6), including individual investment limits, required disclosures by issuers and the use of intermediaries. The proposed rules would require that all crowdfunding transactions under Section 4(a)(6) be conducted through a registered intermediary on an Internet website or other similar electronic medium to help ensure that the offering is accessible to the public and that members of the crowd can share information and opinions. Registered intermediaries are necessary to bring the issuer and potential investors together and to provide safeguards to potential investors.[18] The proposed rules also would require that intermediaries provide communication channels to facilitate the sharing of information that will allow the crowd to decide whether or not to fund the idea or business.[19] The proposed rules further provide intermediaries a means by which to facilitate the offer and sale of securities without registering as brokers. We are mindful of the timing and presentation of information required to be disclosed to investors pursuant to the terms of the statute. The proposed rules would require that this information be provided to investors at various points in time in connection with an offering and through various electronic means, such as through filings with the Commission and disclosures provided on the intermediary's platform. We believe this approach would be most practical and useful to investors in the crowdfunding context.

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17 *See* Hazen, note 8.

18 *See* 158 CONG. REC. S1829 (daily ed. Mar. 20, 2012) (statement of Sen. Jeff Merkley) ("The websites are subject to oversight by the SEC and security regulators of their principal States . . . This is a key predatory protection to prevent pump-and-dump schemes.").

19 *See* Mollick Letter (stating that allowing ongoing discussions between potential investors, community members and issuers is a vital aspect of avoiding fraud and improving proposed projects).

We understand that these proposed rules, if adopted, could significantly affect the viability of crowdfunding as a capital-raising method for startups and small businesses. Rules that are unduly burdensome could discourage participation in crowdfunding. Rules that are too permissive, however, may increase the risks for individual investors, thereby undermining the facilitation of capital raising for startups and small businesses.[20] We have directed the Commission staff, accordingly, to develop a comprehensive work plan to review and monitor the use of the crowdfunding exemption under Section 4(a)(6) and the rules the Commission adopts to implement crowdfunding. Upon adoption of final rules, the Commission staff will monitor the market for offerings made in reliance on Section 4(a)(6), focusing in particular on the types of issuers using the exemption, the level of compliance with Regulation Crowdfunding by issuers and intermediaries and whether the exemption is promoting new capital formation while at the same time providing key protections for investors. These efforts will assist the Commission in evaluating the development of market practices in offerings made in reliance on Section 4(a)(6). These efforts also will facilitate future Commission consideration of any potential amendments to the rules implementing crowdfunding that would be consistent with the Commission's mission

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[20] One press article, for example, described non-securities-based crowdfunding campaigns that successfully raised funds but have had problems manufacturing and delivering the "perks" or products that were promised in exchange for contributions. *See* Matt Krantz, *Crowd-funding dark side: Sometimes investments go down drain*, USA TODAY at B1 (Aug. 15, 2012). Investor confidence in crowdfunding could be eroded if such delays occur with regularity in securities-based crowdfunding and compounded by any prevalence of fraud. *See, e.g.*, *Laws Provide Con Artists with Personal Economic Growth Plan*, North American Securities Administrators Association (Aug. 21, 2012) (identifying crowdfunding and Internet-based offers of securities as a threat to investors), *available at* http://www.nasaa.org/14679/laws-provide-con-artists-with-personal-economic-growth-plan/. *See also* Adrianne Jeffries, *This is What a Kickstarter Scam Looks Like,* BetaBeat (Apr. 30, 2012), *available at* http://betabeat.com/2012/04/this-is-what-a-kickstarter-scam-looks-like/. *But see* Olga Khazan, *Kickstarter spies a sunglass start-up*, WASHINGTON POST at A14 (May 28, 2012) (discussing a successful sunglasses company that used crowdfunding for startup funds); *Crowdfunding: Invested Central raises $120,000*, WASHINGTON POST at A10 (Jul. 23, 2012) (mentioning a company that was able to raise capital through crowdfunding when it could not otherwise secure traditional financing for an expansion of its business).

of protecting investors, maintaining fair, orderly and efficient markets and facilitating capital formation. We urge commenters, as they review the proposed rules, to consider and address the role that our oversight, enforcement and regulation should play once a crowdfunding market under Section 4(a)(6) begins to develop.

II. Discussion of Proposed Regulation Crowdfunding

A. Crowdfunding Exemption

New Securities Act Section 4(a)(6) provides an exemption from the registration requirements of Securities Act Section 5 for certain crowdfunding transactions. To qualify for the exemption under Section 4(a)(6), crowdfunding transactions by an issuer must meet specified requirements, including requirements with regard to the dollar amount of the securities that may be sold by an issuer and the dollar amount that may be invested by an individual in a 12-month period. The crowdfunding transaction also must be conducted through a registered intermediary that complies with specified requirements.[21] Title III also provides limitations on who may rely on the exemption and establishes a liability scheme for improper use of the exemption. As discussed below, the rules we are proposing are designed to aid issuers and investors in determining the applicable limitations on capital raised and individual investments.

1. Limitation on Capital Raised

The exemption from registration provided by Section 4(a)(6) is available to a U.S. issuer provided that "the aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the exemption provided under [Section 4(a)(6)] during the 12-month period

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[21] *See* Section II.C below for a discussion of the requirements on intermediaries. *See also* Section II.D below for a discussion of the additional requirements on funding portals.

preceding the date of such transaction, is not more than $1,000,000."[22] Under Section 4A(h), the Commission is required to adjust the dollar amounts in Section 4(a)(6) "not less frequently than once every five years, by notice published in the Federal Register, to reflect any change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics."

Several commenters indicated that the $1 million maximum aggregate amount is too low.[23] Several commenters requested that the Commission state that the $1 million aggregate limit pertains only to offerings under Section 4(a)(6) and does not include all exempt offerings.[24] Two commenters suggested, however, that the calculation of the $1 million aggregate limit should include all issuer transactions that were exempt under Securities Act Section 4(a) during the preceding 12-month period.[25] Another commenter requested clarification that the limitations and requirements of the offering exemption under Section 4(a)(6) would not affect other methods of raising capital that do not involve the sale of securities, such as contributions from friends and family, donation crowdfunding, gifts, grants or loans.[26] Several commenters had concerns about the possible integration[27] of an offering under Section 4(a)(6) with other exempt offerings and

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22 Securities Act Section 4(a)(6)(A).

23 *See* High Tide Letter; TechnologyCrowdfund Letter 3 (stating that a minimum of $5 million to $10 million is necessary to start any business other than a software business); EnVironmental Letter (stating that the upper limit should be increased to $5 million or higher); VTNGLOBAL Letter (stating that Rule 506 of Regulation D permits an unlimited capital raise from accredited investors and that the same should apply to crowdfunding).

24 *See* NSBA Letter (stating that the $1 million limitation should pertain only to offerings made in reliance on Section 4(a)(6)); ABA Letter 1; NCA Letter.

25 *See* CommunityLeader Letter; Ohio Division of Securities Letter.

26 *See* Crowdfunding Offerings Ltd. Letter 6.

27 The integration doctrine seeks to prevent an issuer from improperly avoiding registration by artificially dividing a single offering into multiple offerings such that Securities Act exemptions would apply to multiple offerings that would not be available for the combined offering.

suggested that the Commission should allow for simultaneous or sequential offerings under Regulation D[28] and Section 4(a)(6) without integration.[29]

Section 4(a)(6) specifically provides for a maximum aggregate amount of $1 million sold in reliance on the exemption in any 12-month period. The only reference in the statute to changing that amount is the requirement that the Commission update the amount not less frequently than every five years based on the Consumer Price Index. Additionally, statements in the Congressional Record indicate that Congress believed that $1 million was a substantial amount for a small business.[30] We do not believe that Congress intended for us to modify the maximum aggregate amount permitted to be sold under the exemption when promulgating rules to implement the statute.[31] Therefore, we are not proposing to increase the limitation on the aggregate amount sold.

Title III provides that the $1 million limitation applies to the "aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the exemption provided under [Section 4(a)(6)]." Section 4A(g), however, provides that "[n]othing in the exemption

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28 17 CFR 230.501 through 230.508.

29 *See* ABA Letter 1; Lingam Letter 2 (stating that offerings under Regulation D and Section 4(a)(6) should not be integrated if: (1) no general solicitation takes place; (2) the Section 4(a)(6) offering closes prior to any general solicitation related to a Regulation D offering; or (3) the Regulation D and the Section 4(a)(6) offerings occur simultaneously and the offerings have the same economic terms, but the size of the Regulation D offering is greater than the size of the Section 4(a)(6) offering); CFIRA Letter 8 (stating that CFIRA's members have opposing views on whether the integration doctrine should be applied to crowdfunded offerings); Liles Letter 1; CFIRA Letter 2; CommunityLeader Letter. *See also* Final Report of the 2012 SEC Government-Business Forum on Small Business Capital Formation (April 2013) ("2012 SEC Government-Business Forum"), *available at* http://www.sec.gov/info/smallbus/sbforumreps.htm (recommending that we consider permitting concurrent offerings to be made to accredited investors in excess of the $1 million limit).

30 158 CONG. REC. S1829 (daily ed. Mar. 20, 2012) (statement of Sen. Jeff Merkley) ("[T]he amendment allows existing small businesses and startup companies to raise up to $1 million per year. That is a substantial amount for a small business.").

31 *Cf.* Securities Act Section 4A(b)(1)(D)(iii) (giving the Commission discretion to increase the aggregate target offering amount that requires audited financial statements).

shall be construed as preventing an issuer from raising capital through means other than [S]ection 4[(a)](6)." These two provisions create statutory ambiguity because the first provision could be read to provide for the aggregation of amounts raised in all exempt transactions, even those that do not involve crowdfunding, while the second provision could be read to provide that nothing in the Section 4(a)(6) exemption should limit an issuer's capital raising through other methods. We believe that the overall intent of providing the exemption under Section 4(a)(6) was to provide an additional mechanism for capital raising for startup and small businesses and not to affect the amount an issuer could raise outside of that exemption. Thus, we believe the capital raised in reliance on the exemption provided by Section 4(a)(6) should be counted toward the limitation. Capital raised through other means should not be counted in determining the aggregate amount sold in reliance on Section 4(a)(6). The opposite approach – requiring aggregation of amounts raised in any exempt transaction – would be inconsistent with the goal of alleviating the funding gap faced by startups and small businesses because it would place a cap on the amount of capital startups and small business could raise. An issuer that already sold $1 million in reliance on the exemption provided under Section 4(a)(6), for example, would be prevented from raising capital through other exempt methods and, conversely, an issuer that sold $1 million through other exempt methods would be prevented from raising capital under Section 4(a)(6).

In determining the amount that may be available to be offered and sold in reliance on Section 4(a)(6) in light of the $1 million aggregate amount limitation, an issuer would include amounts sold by the issuer (including amounts sold by entities controlled by the issuer or under common control with the issuer, as well as any amounts sold by any predecessor of the issuer) in reliance on Section 4(a)(6) during the preceding 12-month period. The issuer would aggregate

any amounts previously sold with the amount the issuer intends to raise in reliance on the exemption, and under the proposed rules, the combined amount could not exceed $1 million. An issuer would not include amounts sold in other exempt offerings during the preceding 12-month period. For example, if an issuer sold $800,000 pursuant to the exemption provided in Regulation D during the preceding 12 months, this amount would not be aggregated in an issuer's calculation to determine whether it had reached the maximum amount for purposes of Section 4(a)(6).[32] In addition, in determining the amount sold in reliance on Section 4(a)(6) during the preceding 12-month period, an issuer would not need to consider amounts received through methods that do not involve the offer or sale of securities (such as donations it received from a separate non-securities-based crowdfunding effort, contributions from friends and family, gifts, grants or loans).

Further, in light of Section 4A(g) and the reasons discussed above, we believe that an offering made in reliance on Section 4(a)(6) should not be integrated with another exempt offering made by the issuer, provided that each offering complies with the requirements of the applicable exemption that is being relied upon for the particular offering. An issuer could complete an offering made in reliance on Section 4(a)(6) that occurs simultaneously with, or is preceded or followed by, another exempt offering. An issuer conducting a concurrent exempt offering for which general solicitation is not permitted, however, would need to be satisfied that purchasers in that offering were not solicited by means of the offering made in reliance on

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[32] In contrast, if an issuer sold $800,000 in a crowdfunding transaction pursuant to Section 4(a)(6) during the preceding 12 months, the issuer would be required to count that amount toward the $1 million aggregate amount and, thus, could only offer and sell $200,000 more in reliance on Section 4(a)(6).

Section 4(a)(6).[33] Similarly, any concurrent exempt offering for which general solicitation is permitted could not include an advertisement of the terms of an offering made in reliance on Section 4(a)(6) that would not be permitted under Section 4(a)(6) and the proposed rules.[34]

Under Section 4(a)(6), the amount of securities sold in reliance on Section 4(a)(6) by entities controlled by or under common control with the issuer must be aggregated with the amount to be sold by the issuer in the current offering to determine the aggregate amount sold in reliance on Section 4(a)(6) during the preceding 12-month period. The statute does not define the term "controlled by or under common control with" the issuer; however, the term "control" is defined in Securities Act Rule 405.[35] For purposes of determining whether an entity is "controlled by or under common control with" the issuer, an issuer would be required to consider whether it has "control" based on this definition.[36]

Under the proposed rules, the amount of securities sold in reliance on Section 4(a)(6) also would include securities sold by any predecessor of the issuer in reliance on Section 4(a)(6)

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33 For example, if the prospective investor in a concurrent private placement for which general solicitation is not permitted became interested in that private placement through some means other than the offering made in reliance on Section 4(a)(6), such as through a substantive, pre-existing relationship with the issuer or direct contact by the issuer or its agents outside of the offering made in reliance on Section 4(a)(6), then the fact that the offering made in reliance on Section 4(a)(6) was posted publicly on the intermediary's platform would not affect the availability of the other private placement exemption. On the other hand, if an investor first discovers the issuer through a solicitation in a Section 4(a)(6) offering, that investor would likely not be eligible to participate in a concurrent private placement in which general solicitation is not permitted.

34 *See* proposed Rule 204 of Regulation Crowdfunding. *See also* discussion in Section II.B.4 below.

35 *See* 17 CFR 230.405 ("The term control (including the terms controlling, controlled by and under common control with) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."). Exchange Act Rule 12b-2 similarly defines the term "control." *See* 17 CFR 240.12b-2.

36 *See* proposed Instruction to paragraph (c) of proposed Rule 100 of Regulation Crowdfunding.

during the preceding 12-month period.[37] We believe this approach is necessary to prevent an issuer from exceeding the $1 million limit by reorganizing the issuer into a new entity that would otherwise not be limited by previous sales made by its predecessor. For example, if an issuer reaches the $1 million limit under Section 4(a)(6), we do not believe the reorganization of the issuer into a new entity should permit the successor to make additional offers and sales in reliance on Section 4(a)(6) during the relevant 12-month period.

Request for Comment

1. Should we propose that the $1 million limit be net of fees charged by the intermediary to host the offering on the intermediary's platform? Why or why not? If so, are there other fees that we should allow issuers to exclude when determining the amount to be raised and whether the issuer has reached the $1 million limit?
2. As described above, we believe that issuers should not have to consider the amounts raised in offerings made pursuant to other exemptions when determining the amount sold during the preceding 12-month period for purposes of the $1 million limit in Section 4(a)(6). Should we require that certain exempt offerings be included in the calculation of the $1 million limit? If so, which types of offerings and why? If not, why not? As noted above, at this time the Commission is not proposing to consider the amounts raised in non-securities-based crowdfunding efforts in calculating the $1 million limit in Section 4(a)(6). Should the Commission propose to require that amounts raised in non-

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[37] *See* proposed Rule 100(c) of Regulation Crowdfunding (proposing to define issuer to include all entities controlled by or under common control with the issuer and any predecessor of the issuer).

securities-based crowdfunding efforts be included in the calculation of the $1 million limit? Why or why not?

3. As described above, we believe that offerings made in reliance on Section 4(a)(6) should not necessarily be integrated with other exempt offerings if the conditions to the applicable exemptions are met. How would an alternative interpretation affect the utility of crowdfunding as a capital raising mechanism? Are there circumstances under which other exempt offers should be integrated with an offer made in reliance on Section 4(a)(6)? If so, what are those circumstances? Should we prohibit an issuer from concurrently offering securities in reliance on Section 4(a)(6) and another exemption? Why or why not? Should we prohibit an issuer from offering securities in reliance on Section 4(a)(6) within a specified period of time after or concurrently with a Rule 506(c) offering under Regulation D involving general solicitation? Why or why not? Should we prohibit an issuer from using general solicitation or general advertising under Rule 506(c) in a manner that is intended, or could reasonably be expected, to condition the market for a Section 4(a)(6) offering or generate referrals to a crowdfunding intermediary? Why or why not? Should issuers that began an offering under Section 4(a)(6) be permitted to convert the offering to a Rule 506(c) offering? Why or why not?

4. Under the proposed rules, whether an entity is controlled by or under common control with the issuer would be determined based on whether the issuer possesses, directly or indirectly, the power to direct or cause the direction of the management and policies of the entity, whether through the ownership of voting

securities, by contract or otherwise. This standard is based on the definition of "control" in Securities Act Rule 405. Is this approach appropriate? Why or why not? Should we define control differently? If so, how?

5. Under the proposed rules, the definition of issuer would include any predecessor of the issuer. Is this approach appropriate? Why or why not? Should an issuer aggregate amounts sold by an affiliate of the issuer when determining the aggregate amount sold in reliance on Section 4(a)(6) during the preceding 12-month period? Why or why not? If so, how should we define affiliate?

2. Investment Limitation

Under Section 4(a)(6)(B), the aggregate amount sold to any investor by an issuer, including any amount sold in reliance on the exemption during the 12-month period preceding the date of such transaction, cannot exceed: "(i) the greater of $2,000 or 5 percent of the annual income or net worth of such investor, as applicable, if either the annual income or the net worth of the investor is less than $100,000; and (ii) 10 percent of the annual income or net worth of such investor, as applicable, not to exceed a maximum aggregate amount sold of $100,000, if either the annual income or net worth of the investor is equal to or more than $100,000." Section 4A(h) further provides that these dollar amounts shall be adjusted by the Commission not less frequently than once every five years based on the Consumer Price Index. As discussed in more detail below, Section 4A(h) also provides that the income and net worth of a natural person who is investing in a crowdfunding transaction pursuant to Section 4(a)(6) shall be

calculated in accordance with the Commission's rules regarding the calculation of income and net worth of an accredited investor.[38]

Several commenters noted that Sections 4(a)(6)(B)(i) and (ii) technically subject some investors to two potential investment limits.[39] The language of the statute may be read to create potential conflicts or ambiguity between the two investment limits because paragraph (i) applies if "either" annual income or net worth is less than $100,000 and paragraph (ii) applies if "either" annual income or net worth is equal to or more than $100,000. Accordingly, in any situation in which annual income is less than $100,000 and net worth is equal to or more than $100,000 (or vice versa), the language of the statute may be read to cause both paragraphs to apply. Paragraph (i) also fixes the maximum annual investment by an investor at 5 percent of "the annual income or net worth of such investor, as applicable" and paragraph (ii) fixes the maximum annual

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[38] The definition of the term "accredited investor" is set forth in Rule 501(a) of Regulation D [17 CFR 230.501(a)] and includes any person who comes within one of the definition's enumerated categories of persons, or whom the issuer "reasonably believes" comes within any of the enumerated categories, at the time of the sale of the securities to that person. For natural persons, Rule 501(a) defines an accredited investor as a person: (1) whose individual net worth, or joint net worth with that person's spouse, exceeds $1 million, excluding the value of the person's primary residence (the "net worth test"); or (2) who had an individual income in excess of $200,000 in each of the two most recent years, or joint income with that person's spouse in excess of $300,000 in each of those years, and has a reasonable expectation of reaching the same income level in the current year (the "income test"). Although the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1577 (July 21, 2010), (the "Dodd-Frank Act") did not change the amount of the $1 million net worth test, it did change how that amount is calculated – by excluding the value of a person's primary residence. This change took effect upon the enactment of the Dodd-Frank Act. In December 2011, we amended Rule 501 to incorporate this change into the definition of accredited investor. See *Net Worth Standard for Accredited Investors*, Release No. 33-9287 (Dec. 21, 2011) [76 FR 81793 (Dec. 29, 2011)]. In addition, Section 413(b) of the Dodd-Frank Act specifically authorizes us to undertake a review of the definition of the term "accredited investor" as it applies to natural persons, it and requires us to undertake a review of the definition in its entirety every four years, beginning four years after enactment of the Dodd-Frank Act. Release No. 33-9416 (July 10, 2013) requests public comments on the definition of "accredited investor."

[39] *See* RocketHub Letter 1 (stating that the Commission should clarify that the greater of income or net worth will be used to determine the investment limit); NASAA Letter (stating that the Commission should resolve the ambiguity by requiring the lesser of the two investment limits); Ohio Division of Securities Letter (stating that the Commission should apply the stricter investment limitation); ABA Letter 1; Friedman Letter.

investment by an investor at 10 percent of "the annual income or net worth of such investor, as applicable", but neither paragraph (i) nor paragraph (ii) explicitly states when that percentage should be applied against the investor's annual income and when the percentage should be applied against the investor's net worth. Finally, paragraph (i) sets a floor for the investment limit of $2,000 per year and paragraph (ii) sets a ceiling for the investment limit of $100,000 per year, but the statutory language does not explicitly state whether the floor applies if the maximum is calculated under paragraph (ii) or whether the ceiling applies if the maximum is calculated under paragraph (i). Accordingly, discretion is required in interpreting and applying this provision of the statute.

We believe that the appropriate approach to the investment limit provision is to provide for an overall investment limit of $100,000, but within that overall limit, to provide for a "greater of" limitation based on annual income and net worth. Under the proposed rules, therefore, if *both* annual income *and* net worth are less than $100,000, then a limit of $2,000 or 5 percent of annual income or net worth, whichever is greater, would apply. If either annual income or net worth exceeds $100,000, then a limit of 10 percent of annual income or net worth, whichever is greater, but not to exceed $100,000, would apply. We believe that this clarification would give effect to the provision and would be consistent with Congressional intent in providing investment limitations; however, we request comment below on whether to calculate the investment limit based on the lesser of annual income or net worth.

As required by Section 4A(h), the proposed rules would require a natural person's annual income and net worth to be calculated in accordance with the Commission's rules for

determining accredited investor status.[40] Securities Act Rule 501 specifies the manner in which annual income and net worth are calculated for purposes of determining accredited investor status.[41] One commenter stated that Section 4(a)(6)(B) is unclear in regard to how to address the joint net worth of spouses.[42] The proposed rules would clarify that an investor's annual income and net worth may be calculated jointly with the income and net worth of the investor's spouse.[43] We believe that this approach is consistent with the rules for determining accredited investor status because the accredited investor definition contemplates both individual and joint income and net worth with a spouse as methods of calculating annual income and net worth.

We also are proposing to allow an issuer to rely on efforts that an intermediary takes in order to determine that the aggregate amount of securities purchased by an investor will not cause the investor to exceed the investor limits,[44] provided that the issuer does not have knowledge that the investor had exceeded, or would exceed, the investor limits as a result of purchasing securities in the issuer's offering.[45]

In discussing the investment limitations, one commenter requested that the Commission distinguish between retail investors and institutional or accredited investors and allow institutional and accredited investors to invest in excess of the investment limitations included in

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40 *See* proposed Instruction 1 to paragraph (a)(2) of proposed Rule 100 of Regulation Crowdfunding. *See also* note 9.

41 *See* Securities Act Rule 501(a)(5) [17 CFR 230.501(a)(5)] (net worth) and Securities Act Rule 501(a)(6) [17 CFR 230.501(a)(6)] (income). Consistent with these rules, the calculation of a natural person's net worth for purposes of the investment limit would exclude the value of the primary residence of such person. A natural person's income for purposes of the investment limit calculation would be the lower of such person's income for each of the two most recent years as long as such person has a reasonable expectation of the same income level in the current year.

42 *See* Friedman Letter.

43 *See* proposed Instruction 2 to paragraph (a)(2) of proposed Rule 100 of Regulation Crowdfunding.

44 *See* discussion in Section II.C.5.b.i below.

45 *See* proposed Instruction 3 to paragraph (a)(2) of proposed Rule 100 of Regulation Crowdfunding.

the statute.[46] Another commenter asked that the Commission clarify whether non-U.S. citizens or non-U.S. residents are bound by the same investment limits.[47] Three commenters proposed that the Commission create a two-tier regulatory system based on different investment limits to reduce the regulatory burden for small, local offerings.[48] One of the commenters suggested that one of the tiers could consist of a "small local offering" in which investment limits would be up to $250 per investor.[49] The commenter asserted that smaller investments could be subject to significantly reduced regulation because a $250 investment is unlikely to pose significant risk to an investor. The second commenter suggested reducing the anticipated personal disclosure requirements for investors who invest less than $500 through an intermediary that is a community development financial institution.[50]

The limitations in Section 4(a)(6)(B) apply to any investor seeking to participate in a crowdfunding transaction. We believe that Congress intended for investment opportunities through crowdfunding transactions relying on Section 4(a)(6) to be available to all types of investors and established the investment limitations accordingly.[51] The statute provides specific investment limits, and the only reference in the statute regarding changing those investment limits is the requirement that the Commission update the investment limits not less frequently

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46 *See* CFIRA Letter 2.

47 *See* TechnologyCrowdFund Letter 5.

48 *See* ASBC Letter; City First Letter. *See also* Spinrad Letter 1 (supporting the two-tier approach described in the ASBC Letter).

49 *See* ASBC Letter.

50 *See* City First Letter.

51 *See* 158 CONG. REC. S1689 (daily ed. Mar. 15, 2012) (statement of Sen. Mark Warner) ("There is now the ability to use the Internet as a way for small investors to get the same kind of deals that up to this point only select investors have gotten that have been customers of some of the best known investment banking firms, where we can now use the power of the Internet, through a term called crowdfunding.").

than every five years based on the Consumer Price Index. Therefore, we do not believe it would be appropriate to alter those limits for any particular type of investor or, at this time, to create a different exemption based on different investment limits. Issuers can rely on other exemptions to offer and sell securities to accredited investors and institutional investors (and, in some cases, investors that do not meet the definition of accredited investor). As discussed above, concurrent offerings to these types of investors are possible if the conditions of the applicable exemption are met. Therefore, as proposed, the limitations would apply to all investors, including retail, institutional or accredited investors and both U.S. and non-U.S. citizens or residents.

Request for Comment

6. While we acknowledge that there is ambiguity in the statutory language and there is some comment regarding a contrary reading, we believe that the appropriate approach to the investment limitations in Section 4(a)(6)(B) is to provide for an overall investment limit of $100,000 and, within that limit, to provide for a "greater of" limitation based on an investor's annual income or net worth. In light of ambiguity in the statutory language, we are specifically asking for comment as to the question of whether we should instead require investors to calculate the investment limitation based on the investor's annual income or net worth at the five percent threshold of Section 4(a)(6)(B)(i) if either annual income or net worth is less than $100,000? Similarly, for those investors falling within the Section 4(a)(6)(B)(i) framework, should we require them to calculate the five percent investment limit based on the lower of annual income or net worth? Should we require the same for the calculation of the 10 percent investment limit within the Section 4(a)(6)(B)(ii) framework? If we were to

pursue any of these calculations, would we unnecessarily impede capital formation?

7. The statute does not address how joint annual income or joint net worth should be treated for purposes of the investment limit calculation. The proposed rules clarify that annual income and net worth may be calculated jointly with the annual income and net worth of the investor's spouse. Is this approach appropriate? Should we distinguish between annual income and net worth and allow only one or the other to be calculated jointly for purposes of calculating the investment limit? Why or why not? Should the investment limit be calculated differently if it is based on the spouses' joint income, rather than each spouse's annual income? Why or why not?

8. We are proposing to permit an issuer to rely on the efforts that an intermediary takes in order to determine that the aggregate amount of securities purchased by an investor will not cause the investor to exceed the investor limits, provided that the issuer does not have knowledge that the investor had exceeded, or would exceed, the investor limits as a result of purchasing securities in the issuer's offering. Is this approach appropriate? Why or why not? Should an issuer be required to obtain a written representation from the investor that the investor has not and will not exceed the limit by purchasing from the issuer? Why or why not?

9. Should institutional and accredited investors be subject to the investment limits, as proposed? Why or why not? Should we adopt rules providing for another crowdfunding exemption with a higher investment limit for institutional and

accredited investors? If so, how high should the limit be? Are there categories of persons that should not be subject to the investment limits? If yes, please identify those categories of persons. If the offering amount for an offering made in reliance on Section 4(a)(6) is not aggregated with the offering amount for a concurrent offering made pursuant to another exemption, as proposed, is it necessary to exclude institutional and accredited investors from the investment limits since they would be able to invest pursuant to another exemption in excess of the investment limits in Section 4(a)(6)?

10. Should we adopt rules providing for another crowdfunding exemption with different investment limits (*e.g.*, an exemption with a $250 investment limit and fewer issuer requirements), as one commenter suggested,[52] or apply different requirements with respect to individual investments under a certain amount, such as $500, as another commenter suggested?[53] Why or why not? If so, should the requirements for issuers and intermediaries also change? What investment limits and requirements would be appropriate? Would adopting such an exemption be consistent with the purposes of Section 4(a)(6)?

11. Should we consider additional investment limits on transactions made in reliance on Section 4(a)(6) where the purchaser's annual income and net worth are both below a particular threshold? If so, what should such threshold be and why?

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52 *See* ASBC Letter.

53 *See* City First Letter.

3. Transaction Conducted Through an Intermediary

Under Section 4(a)(6)(C), a transaction in reliance on Section 4(a)(6) must be "conducted through a broker or funding portal that complies with the requirements of [S]ection 4A(a)." We believe that requiring an issuer to use only one intermediary, rather than allowing the issuer to use multiple intermediaries, to conduct an offering or concurrent offerings in reliance on Section 4(a)(6) would help foster the creation of a crowd and better accomplish the purpose of the statute. As discussed above, a central tenet of the concept of crowdfunding is presenting members of the crowd with an idea or business so members of the crowd can share information and evaluate the idea or business. Allowing an issuer to conduct a single offering or simultaneous offerings in reliance on Section 4(a)(6) through more than one intermediary would diminish the ability of the members of the crowd to effectively share information, because essentially, there would be multiple "crowds." Also, because practices among intermediaries may differ, were multiple intermediaries to conduct a single offering or simultaneous offerings, this could result in significant differences among such offerings. Finally, allowing an issuer to conduct an offering using more than one intermediary would make it more difficult for intermediaries to determine whether an issuer is exceeding the $1 million aggregate offering limit. Therefore, in addition to requiring the use of an intermediary in connection with an offering made in reliance on Section 4(a)(6), the proposed rules would prohibit an issuer from using more than one intermediary to conduct an offering or concurrent offerings made in reliance on Section 4(a)(6).[54]

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[54] *See* proposed Instruction 1 to paragraph (a)(3) of proposed Rule 100 of Regulation Crowdfunding.

Although the statute does not expressly require it, we also believe that in enacting Section 4(a)(6)(C), Congress contemplated that crowdfunding transactions made in reliance on Section 4(a)(6) and activities associated with these transactions would occur over the Internet or other similar electronic medium that is accessible to the public.[55] We believe that an "online-only" requirement enables the public to access offering information and share information publicly in a way that will allow members of the crowd to decide whether or not to participate in the offering and fund the business or idea.[56] We believe that other mechanisms would not offer this opportunity. The proposed rules would require that an intermediary, in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6), effect such transactions exclusively through an intermediary's platform.[57] We propose to define the term "platform" to mean an Internet website or other similar electronic medium through which a registered broker or a registered funding portal acts as an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6).[58] The requirement that a transaction be conducted exclusively through a platform does not preclude an intermediary from performing back office and other administrative functions offline. Therefore, we propose to state that intermediaries

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55 In this regard, we note that Section 301 of the JOBS Act states that "[Title III] may be cited as the 'Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012'". *See* Section 301 of the JOBS Act. *See also* 158 CONG. REC. S1689 (daily ed. March 15, 2012) (statement of Sen. Mark Warner) ("There is now the ability to use the Internet as a way for small investors to get the same kind of deals that up to this point only select investors have gotten . . . , where we can now use the power of the Internet, through a term called crowdfunding."); *id*. at S1717 (Statement of Sen. Mary Landrieu) ("this crowdfunding bill – which is, in essence, a way for the Internet to be used to raise capital . . . .").

56 *See* note 2 and accompanying text. The Internet is considered to be a "perfect technology capable of aggregating millions of disparate, independent ideas in the way markets and intelligent voting systems do, without the dangers of 'too much communication' and compromise." Brabham, note 1 (citing James Surowiecki, *The Wisdom of Crowds* xix (2004)).

57 *See* proposed Rule 100(a)(3) of Regulation Crowdfunding.

58 *See* proposed Rule 100(d) of Regulation Crowdfunding.

may engage in back office and other administrative functions other than on their platforms.[59] Examples of such functions include document maintenance, preparation of notices and confirmations, preparing internal policies and procedures, defining and approving business security requirements and policies for information technology, and preparing information required to be filed or otherwise provided to regulators.

The proposed rules would accommodate other electronic media that currently exist or may develop in the future. For instance, applications for mobile communication devices, such as cell phones or smart phones, could be used to display offerings and to permit investors to make investment commitments. In our releases concerning the use of electronic media for delivery purposes, we discussed so-called "electronic-only" offerings as those in which investors are permitted to participate only if they agree to accept electronic delivery of all documents and other information in connection with the offering.[60] As discussed below, the proposed rules would require that an intermediary, in its standard account opening materials, obtain from investors consent for such electronic delivery.[61]

Some commenters appear to assume that all offers and sales made in reliance on Section 4(a)(6) would be conducted online.[62] One commenter recommended that the Commission

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59 *See* proposed Instruction 2 to paragraph (a)(3) of proposed Rule 100 of Regulation Crowdfunding.

60 *See, e.g.*, *Use of Electronic Media by Broker-Dealers, Transfer Agents and Investment Advisers for Delivery of Information,* Release No. 34-37182 (May 9, 1996) [61 FR 24644 (May 15, 1996)]; *Use of Electronic Media*, Release No. 34-42728 (Apr. 28, 2000) [65 FR 25843 (May 4, 2000)] ("*Use of Electronic Media*").

61 *See* proposed Rule 302(a) of Regulation Crowdfunding. The proposed rules would require consent to electronic delivery because we believe Congress contemplated that crowdfunding would, by its very nature, occur exclusively through electronic media.

62 *See, e.g.*, MacDonald Letter (stating that readily-available information on the Internet already provides a safeguard for crowdfunding investors); NAASA Letter (stating that NASAA is considering whether open Internet access to funding portals would provide sufficient and updated information to state regulators).

expressly require that all disclosure and affirmations required for crowdfunding transactions take place online.[63] In contrast, another commenter requested that we permit some crowdfunding elements to take place offline to encourage local community investments through entities such as community banks, community development companies and business development companies.[64] This commenter stated that permitting crowdfunding to take place offline also will help persons without Internet access to invest. The proposed rules would, subject to certain conditions, separately permit outreach by third parties and a third party's promotion of an issuer's offering through communication channels provided by an intermediary.[65] In addition, an issuer may provide a notice, subject to the conditions in the proposed rules, that directs potential investors to the intermediary's platform through which the issuer will conduct its offering.[66] Finally, we are not proposing to permit offerings to be conducted through means other than the Internet or similar electronic medium because we believe that allowing other non-electronic means would be inconsistent with the underlying principles of crowdfunding and the statute. Offerings made by other means would not be widely accessible by the public, which would defeat the benefit of the collective wisdom of the members of the crowd. We also believe that Internet access may be available to the public, such as through local public libraries, alleviating one commenter's concern about some persons not being able to invest unless the offerings also take place offline.

Request for Comment

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63 *See* Cera Technology Letter.

64 *See* Tally Letter.

65 *See* proposed Rule 205 of Regulation Crowdfunding (promoter compensation), proposed Rule 305 of Regulation Crowdfunding (payments to third parties) and proposed Rule 402(b)(6) of Regulation Crowdfunding (conditional safe harbor), discussed below in Sections II.B.5, II.C.7 and II.D.3, respectively.

66 *See* proposed Rule 204 of Regulation Crowdfunding (advertising) discussed below in Section II.B.4.

12. The proposed rules would prohibit an issuer from conducting an offering or concurrent offerings in reliance on Section 4(a)(6) using more than one intermediary. Is this proposed approach appropriate? Why or why not? If issuers were permitted to use more than one intermediary, what requirements and other safeguards should or could be employed?

13. Should we define the term "platform" in a way that limits crowdfunding in reliance on Section 4(a)(6) to transactions conducted through an Internet website or other similar electronic medium? Why or why not?

14. Should we permit crowdfunding transactions made in reliance on Section 4(a)(6) to be conducted through means other than an intermediary's electronic platform? If so, what other means should we permit? For example, should we permit community-based funding in reliance on Section 4(a)(6) to occur other than on an electronic platform?[67] To foster the creation and development of a crowd, to what extent would such other means need to provide members of the crowd with the ability to observe and comment (*e.g.*, through discussion boards or similar functionalities) on the issuer, its business or statements made in the offering materials?

15. Should we allow intermediaries to restrict who can access their platforms? For example, should we permit intermediaries to provide access by invitation only or only to certain categories of investors? Why or why not? Would restrictions such as these negatively impact the ability of investors to get the benefit of the

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[67] *See* City First Letter and note 355.

crowd and its assessment of an issuer, business or potential investment? Would these kinds of restrictions affect the ability of small investors to access the capital markets? If so, how?

16. As noted above, the proposed rules would not require intermediaries' back office or other administrative functions to be conducted exclusively on their platforms. Do the proposed rules require any clarification? Are there other activities in which an intermediary may engage that would not be considered back office or administrative functions and that should be permitted to occur other than on a platform? If so, what activities are they, and why should they be permitted to occur other than on a platform?

4. Exclusion of Certain Issuers from Eligibility under Section 4(a)(6)

Section 4A(f) excludes certain categories of issuers from eligibility to rely on Section 4(a)(6) to engage in crowdfunding transactions. These issuers are: (1) issuers that are not organized under the laws of a state or territory of the United States or the District of Columbia; (2) issuers that are subject to Exchange Act reporting requirements;[68] (3) investment companies as defined in the Investment Company Act of 1940 (the "Investment Company Act")[69] or companies that are excluded from the definition of investment company under Section 3(b) or 3(c) of the Investment Company Act;[70] and (4) any other issuer that the Commission, by rule or regulation, determines appropriate.

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68 These are issuers who are required to file reports with the Commission pursuant to Exchange Act Sections 13(a) (15 U.S.C. 78m(a)) or 15(d) (15 U.S.C. 78*o*(d)).

69 15 U.S.C 80a-1 *et seq*.

70 15 U.S.C. 80a-3(b) or (c).

One commenter suggested that the Commission's rules should specify that the crowdfunding exemption under Section 4(a)(6) is not available for blank check companies or hedge funds and noted that "permitting these kinds of high-risk and often complex entities to use the exemption is not consistent with the statutory goal of deterring fraud and unethical non-disclosure in crowdfunding offerings."[71]

The proposed rules would exclude the categories of issuers identified in the statute,[72] as well as issuers that are disqualified from relying on Section 4(a)(6) pursuant to the disqualification provisions of Section 302(d) of the JOBS Act.[73] The proposed rules also would exclude an issuer that has sold securities in reliance on Section 4(a)(6) if the issuer has not filed with the Commission and provided to investors, to the extent required, the ongoing annual reports required by Regulation Crowdfunding[74] during the two years immediately preceding the filing of the required new offering statement.[75] We believe that the ongoing reporting requirement should benefit investors by enabling them to consider updated information about the issuer, thereby allowing them to make more informed investment decisions. If issuers fail to comply with this requirement, we do not believe that they should have the benefit of relying on the exemption under Section 4(a)(6) again until they file, to the extent required, the two most recent annual reports.

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71 Commonwealth of Massachusetts Letter.

72 *See* proposed Rules 100(b)(1)-(3) of Regulation Crowdfunding.

73 *See* proposed Rule 100(b)(4) of Regulation Crowdfunding. *See also* proposed Rule 503 of Regulation Crowdfunding and Section II.E.6 below for a discussion of the disqualification provisions.

74 *See* proposed Rules 202 and 203(b) of Regulation Crowdfunding and Section II.B.2 below for a discussion of the ongoing reporting requirements.

75 *See* proposed Rule 100(b)(5) of Regulation Crowdfunding.

The proposed rules also would exclude an issuer that has no specific business plan or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies. As described above, crowdfunding is a new and evolving method to raise money that serves as an alternative source of capital to support a wide range of ideas and ventures. We believe that the exemption under Section 4(a)(6) is intended to provide an issuer with an early stage project, idea or business an opportunity to share it publicly with a wider range of potential investors. Those potential investors may then share information with each other about the early stage proposal and use that information to decide whether or not to provide funding based on the "wisdom of the crowd." Under such circumstances, this mechanism requires the public to have sufficient information about the issuer's proposal to discuss its merit and flaws.[76]

At the same time, an early stage proposal may not allow the crowdfunding mechanism to work appropriately if the issuer does not describe a specific project, idea, or business, or is seeking funding for unspecified corporate transactions. In such cases, individuals reviewing the proposal may not have sufficient information to formulate a considered view of the proposal, or the proposal may be less likely to attract enough perspectives to inform a crowd decision. Investors who nonetheless choose to participate may therefore be more likely to be participating in an issuance that has not been reviewed by the crowd in the manner contemplated by the exemption under Section 4(a)(6).

We are cognizant of the challenges associated with distinguishing between early stage proposals that should provide information sufficient to support the crowdfunding mechanism and

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[76] *See*, *e.g.*, Section 4A(b)(1)(C) (requiring a description of the business of the issuer and the anticipated business plan of the issuer).

those that cannot by their terms do so. We preliminarily believe that an appropriate balance can be struck by excluding an issuer that has no specific business plan or that has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies. As described below, we do not expect that a specific "business plan" requires a formal document prepared by management or used for marketing to investors.[77] We understand that issuers engaging in crowdfunding transactions may have businesses at various stages of development in differing industries, and therefore, we believe that a specific "business plan" could encompass a wide range of project descriptions, articulated ideas, and business models. In particular, we recognize that the business plan for startups or small businesses seeking to rely on Section 4(a)(6) may not be fully developed or highly specific and that for many it may be less defined or detailed than the plan associated with larger issuers.

With respect to hedge funds, we believe that under Section 4A(f)(3), hedge funds would be excluded from eligibility to rely on Section 4(a)(6) because hedge funds and other private funds typically rely on one of the exclusions from the definition of investment company under Section 3(c) of the Investment Company Act.[78]

Request for Comment

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77 *See* discussion below in Section II.B.1.a.i.(b) below.

78 Investment Advisers Act ("Advisers Act") Form PF defines a "hedge fund" generally as any "private fund" (other than a securitized asset fund) that: (1) pays a performance fee or allocation calculated by taking into account unrealized gains (other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses); (2) may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital); or (3) may sell securities or other assets short or enter into similar transactions (other than for the purpose of hedging currency exposure or managing duration). *See* Form PF: Glossary of Terms at 4, *available at* http://www.sec.gov/rules/final/2011/ia-3308-formpf.pdf. A "private fund" is defined as any issuer that would be an investment company as defined in Section 3 of the Investment Company Act but for Section 3(c)(1) or 3(c)(7) of that Act. *Id*. at 7.

17. Section 4A(b)(4) requires that, "not less than annually, [the issuer] file with the Commission and provide to investors reports of the results of operations and financial statements of the issuer . . . ." Should an issuer be excluded from engaging in a crowdfunding transaction in reliance on Section 4(a)(6), as proposed, if it has not filed with the Commission and provided to investors, to the extent required, the ongoing annual reports required by proposed Regulation Crowdfunding during the two years immediately preceding the filing of the required offering statement? Why or why not? Should an issuer be eligible to engage in a crowdfunding transaction in reliance on Section 4(a)(6) if it is delinquent in other reporting requirements (*e.g.*, updates regarding the progress of the issuer in meeting the target offering amount)?[79] Why or why not? Should the exclusion be limited to a different timeframe (*e.g.*, filings required during the five years or one year immediately preceding the filing of the required offering statement)?

18. Is the proposed exclusion of issuers who fail to comply with certain ongoing annual reporting requirements too broad? If so, how should it be narrowed and why? Should the exclusion cover issuers whose affiliates have sold securities in reliance on Section 4(a)(6) if the affiliates have not complied with the ongoing annual reporting requirements? If so, should this encompass all affiliates? If not, which affiliates should it cover? Should we exclude any issuer with an

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[79] *See* Section II.B.1.b below for a discussion of progress updates.

officer, director or controlling shareholder who served in a similar capacity with another issuer that failed to file its annual reports? Why or why not?

19. What specific risks do investors face with "idea-only" companies and ventures? Please explain. Do the proposed rules provide sufficient protection against the inherent risks of such ventures? Why or why not?

20. Does the exclusion of issuers that do not have a specific idea or business plan from eligibility to rely on Section 4(a)(6) strike the appropriate balance between the funding needs of small issuers and the information requirements of the crowd? Why or why not? Are there other approaches that would strike a better balance among those considerations? If the proposed approach is appropriate, should we define "specific business plan" or what criteria could be used to identify them? How would any such criteria comport with the disclosure obligations described in Section II.B.1.a.i.(b) (description of the business) below?

21. Are there other categories of issuers that should be precluded from relying on Section 4(a)(6)? If so, what categories of issuers and why?

B. Requirements on Issuers

1. Disclosure Requirements

Section 4A(b)(1) provides that an issuer offering or selling securities in reliance on Section 4(a)(6) must file specified disclosures, including financial disclosures, with the Commission, provide these disclosures to investors and the relevant broker or funding portal and make these disclosures available to potential investors. These disclosures include:

- the name, legal status, physical address and website address of the issuer;[80]
- the names of the directors and officers (and any persons occupying a similar status or performing a similar function), and each person holding more than 20 percent of the shares of the issuer;[81]
- a description of the business of the issuer and the anticipated business plan of the issuer;[82]
- a description of the financial condition of the issuer;[83]
- a description of the stated purpose and intended use of the proceeds of the offering sought by the issuer with respect to the target offering amount;[84]
- the target offering amount, the deadline to reach the target offering amount and regular updates regarding the progress of the issuer in meeting the target offering amount;[85]
- the price to the public of the securities or the method for determining the price;[86] and

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80 Section 4A(b)(1)(A).

81 Section 4A(b)(1)(B).

82 Section 4A(b)(1)(C).

83 Section 4A(b)(1)(D). This provision also establishes a framework of tiered financial disclosure requirements based on aggregate offering amounts for offerings under Section 4(a)(6) within the preceding 12-month period.

84 Section 4A(b)(1)(E).

85 Section 4A(b)(1)(F).

86 Section 4A(b)(1)(G). This provision also requires that "prior to sale, each investor shall be provided in writing the final price and all required disclosures, with a reasonable opportunity to rescind the commitment to purchase the securities." This provision is addressed in Sections II.C.5 and II.C.6 below.

- a description of the ownership and capital structure of the issuer.[87]

In addition, Section 4A(b)(1)(I) specifies that the Commission may require additional disclosures for the protection of investors and in the public interest.

Commenters expressed concerns about the extent of the disclosure requirements and stated that overly burdensome rules would make offers and sales in reliance on Section 4(a)(6) prohibitively expensive.[88] We recognize these concerns and have considered them in determining the disclosure requirements that we should propose in this release.

The proposed rules generally describe the type of information that issuers would be required to disclose. We expect, however, that an issuer, along with the intermediary, would determine the format that best conveys the required disclosures and any other information the issuer determines is material to investors.[89] We recognize that there are numerous ways to achieve that goal and, as such, we are not proposing to mandate a specific disclosure format.[90]

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87 Section 4A(b)(1)(H). Specifically, Section 4A(b)(1)(H) requires a description of: "(i) terms of the securities of the issuer being offered and each other class of security of the issuer…; (ii) a description of how the exercise of the rights held by the principal shareholders of the issuer could negatively impact the purchasers of the securities being offered; (iii) the name and ownership level of each existing shareholder who owns more than 20 percent of any class of the securities of the issuer; (iv) how the securities being offered are being valued…; and (v) the risks to purchasers of the securities relating to minority ownership in the issuer, the risks associated with corporate actions, including additional issuances of shares, a sale of the issuer or of assets of the issuer, or transactions with related parties."

88 *See* Vim Funding Letter; ExpertBeacon Letter; CrowdFund Connect Letter.

89 Section II.B.3 below further discusses the proposed format of Form C and requests comments on the format and presentation of the information.

90 While the proposed rules do not mandate a specific disclosure format, Rule 306 of Regulation S-T (17 CFR 232.306) requires that all electronic filings made with the Commission, including the filings that would be required under the proposed rules, be in English. The proposed rules would not, however, prevent an issuer from providing to the relevant intermediary both an English and a foreign language version of the information for the intermediary to make publicly available through its platform. The anti-fraud and civil liability provisions of the Securities Act would apply equally to both the English and the foreign language version of the information.

Similarly, to the extent some of the required disclosures overlap, issuers would not be required to duplicate disclosures.

As discussed further in Section II.B.3, we are proposing to require issuers to file the disclosures with the Commission on Form C.[91] As proposed, Form C would be filed in the standard format of eXtensible Markup Language (XML). An XML-based fillable form would enable issuers to provide information in a convenient medium without requiring the issuer to purchase or maintain additional software or technology. This would provide the Commission with data about offerings made in reliance on Section 4(a)(6). Information not required to be provided in text boxes would be filed as attachments to Form C.

Request for Comment

22. Rule 306 of Regulation S-T requires that all electronic filings made with the Commission, including the filings that would be required under the proposed rules, be in English. Some startups and small businesses, and their potential investors, may principally communicate in a language other than English. Should we amend Rule 306 to permit filings by issuers under the proposed rules to be filed in the other language? Why or why not? If we retain the requirement to make filings only in English, will this impose a disproportionate burden on issuers and potential investors who principally communicate in a language other than English? What will be the impact on capital formation for such issuers?

a. Offering Statement Disclosure Requirements

i. Information about the Issuer and the Offering

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[91] Issuers would use Form C to provide the required disclosures about the crowdfunding transaction and the information required to be filed annually. *See* Section II.B.3 below.

(a) General Information about the Issuer, Officers and Directors

Consistent with Sections 4A(b)(1)(A) and (B), we are proposing to require an issuer to disclose information about its legal status, directors, officers and certain shareholders and how interested parties may contact the issuer. Specifically, an issuer would be required to disclose:

- its name and legal status, including its form of organization, jurisdiction in which it is organized and date of organization;[92]
- its physical address and its website address;[93] and
- the names of the directors and officers, including any persons occupying a similar status or performing a similar function, all positions and offices with the issuer held by such persons, the period of time in which such person served in the position or office and their business experience during the past three years,[94] including:
  - each person's principal occupation and employment, including whether any officer is employed by another employer; and
  - the name and principal business of any corporation or other organization in which such occupation and employment took place.

Although the statute does not define "officer," the term is defined in Securities Act Rule 405[95] and in Exchange Act Rule 3b-2.[96] We are proposing to define "officer" consistent with

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92 *See* proposed Rule 201(a) of Regulation Crowdfunding.

93 *Id*.

94 *See* proposed Rule 201(b) of Regulation Crowdfunding.

95 17 CFR 230.405.

96 17 CFR 240.3b-2.

these existing rules. Thus, an issuer would be required to disclose information regarding its president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer and any person routinely performing corresponding functions with respect to any organization, whether incorporated or unincorporated, to the extent it has individuals serving in these capacities.

We are proposing to require disclosure of the business experience of directors and officers of the issuer during the past three years. A three-year period is less than the five-year period that applies to issuers conducting registered offerings[97] or exempt offerings pursuant to Regulation A.[98] We believe that startups and small businesses that may seek to raise capital in reliance on Section 4(a)(6) generally would be smaller than the issuers conducting registered offerings or exempt offerings pursuant to Regulation A;[99] thus, we believe that the less burdensome three-year period would reduce the compliance cost for issuers while still providing potential investors with sufficient information about the business experience of directors and officers of the issuer to make an informed investment decision.

Section 4A(b)(1)(B) requires disclosure of "the names of . . . each person holding more than 20 percent of the shares of the issuer." In contrast, Section 4A(b)(1)(H)(iii) requires disclosure of the "name and ownership level of each existing shareholder who owns more than 20 percent *of any class* of the securities of the issuer" (emphasis added). The proposed rules would require disclosure of the names of persons, as of the most recent practicable date, who are the beneficial owners of 20 percent or more of the issuer's outstanding voting equity securities,

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97 *See* Item 401(e) of Regulation S-K [17 CFR 229.401(e)].

98 *See* Item 8(c) of Form 1-A [17 CFR 239.90].

99 There is no cap on the amount of proceeds that may be raised in a registered offering, and Regulation A limits offerings to $5 million.

calculated on the basis of voting power.[100] We refer to this group of persons as "20 Percent Beneficial Owners." We believe that the universe of 20 Percent Beneficial Owners should be the same for the disclosure requirements and the disqualification provisions[101] because this would ease the burden on issuers by requiring issuers to only identify one set of persons who would be the subject of these rules. We believe that assessing beneficial ownership based on total outstanding voting securities is consistent with Section 4A(b)(1)(B). Section 4A(b)(1)(B) is not limited to voting equity securities, but we believe the limitation would be necessary to clarify how beneficial ownership would be required to be calculated since issuers could potentially have multiple classes of securities with different voting powers. Assessing beneficial ownership based on ownership of total outstanding voting securities, rather than based on ownership of any class of securities as potentially contemplated by Section 4A(b)(1)(H)(iii), also should ease the burden of compliance because there would be fewer 20 Percent Beneficial Owners to track.

Neither Section 4A(b)(1)(B) nor Section 4A(b)(1)(H)(iii) states as of what date the beneficial ownership should be calculated. The proposed rules would require issuers to calculate beneficial ownership as of the most recent practicable date.[102] This is the same requirement that applies to issuers conducting registered offerings or Exchange Act reporting companies.[103] We believe that it is appropriate to provide issuers relying on Section 4(a)(6) the flexibility to calculate beneficial ownership as of the most recent practicable date, otherwise such issuers

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100 *See* proposed Rule 201(c) of Regulation Crowdfunding.

101 *See* proposed Rule 503 of Regulation Crowdfunding and Section II.E.6 below for a discussion of the proposed disqualification provisions. This approach also would be consistent with how beneficial ownership is calculated for the Rule 506 disqualification rules. *See Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings*, Release No. 33-9414 (July 10, 2013) [78 FR 44729 (July 24, 2013)] ("*Disqualification Adopting Release*").

102 *See* proposed Rule 201(c) of Regulation Crowdfunding.

103 *See* Item 403 of Regulation S-K [17 CFR 229.403].

would be subject to a more burdensome standard than the one that applies to issuers conducting registered offerings or Exchange Act reporting companies.

Request for Comment

23. Under the proposed rules the definition of the term "officer" is consistent with how that term is defined in Securities Act Rule 405[104] and in Exchange Act Rule 3b-2.[105] Should we instead define "officer" consistent with the definition of "executive officer" in Securities Act Rule 405[106] and in Exchange Act Rule 3b-7[107]? Why or why not? Which definition would be more appropriate for the types of issuers that would be relying on the exemption?

24. Are these proposed disclosure requirements relating to the issuer and its officers and directors appropriate? Why or why not? Should we only require the disclosures specifically called for by statute or otherwise modify or eliminate any of the proposed requirements? Should we require any additional disclosures (*e.g.*, disclosure about significant employees)? Is there other general information about the issuer or its officers and directors that we should require to be disclosed? If so, what information and why? For example, should we require disclosure of any court orders, judgments or civil litigation involving any directors and officers, including any persons occupying a similar status or

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104 17 CFR 230.405.

105 17 CFR 240.3b-2.

106 17 CFR 230.405.

107 17 CFR 240.3b-7.

performing a similar function? Why or why not? If so, what time period should this disclosure cover and why?

25. The proposed rules would require disclosure of the business experience of directors and officers of the issuer during the past three years. Is the three-year period an appropriate amount of time? Why or why not? If not, please discuss what would be an appropriate amount of time and why. Should the requirement to disclose the business experience of officers and directors include a specific requirement to disclose whether the issuer's directors and officers have any prior work or business experience in the same type of business as the issuer? Why or why not?

26. The proposed rules would require disclosure of the names of persons who are beneficial owners of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power. Is this approach appropriate? Why or why not? Should the proposed rules require disclosure of the names of beneficial owners of 20 percent or more of any class of the issuer's voting securities, even if such beneficial ownership does not exceed 20 percent of all of the issuer's outstanding voting equity securities? Why or why not? Should the proposed disclosure requirement apply to the names of beneficial owners of 20 percent or more, as proposed, or to more than 20 percent of the issuer's outstanding voting equity securities? Why or why not?

27. The proposed rules would require that beneficial ownership be calculated as of the most recent practicable date. Is this approach appropriate? Why or why not? Should beneficial ownership be calculated as of a different date? For example,

should the reported beneficial ownership only reflect information as of the end of a well-known historical period, such as the end of a fiscal year? Please explain. Should there be a maximum amount of time from this calculation date to the filing to ensure that the information is current? If so, what maximum amount of time would be appropriate?

28. Should we provide additional guidance on how to calculate beneficial ownership on the basis of voting power? If so, what should that guidance include? Should the proposed rules require disclosure of the name of a person who has investment power over, an economic exposure to or a direct pecuniary interest in the issuer's securities even if that person is not a 20 Percent Beneficial Owner? Why or why not?

(b) Description of the Business

Consistent with Section 4A(b)(1)(C), we are proposing to require an issuer to disclose information about its business and business plan.[108] One commenter noted that the term "business plan" traditionally referred to a document prepared by management for internal use only and more recently has been used to refer to a marketing document used to solicit investors.[109] We do not expect issuers to provide those types of documents in response to this requirement.[110] Although two commenters suggested that the Commission clarify the term

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108 *See* proposed Rule 201(d) of Regulation Crowdfunding.

109 *See* Ohio Division of Securities Letter.

110 Companies filing a registration statement or other filings that require a description of the business include a description of the business without providing a formal business plan. *See* Item 101 of Regulation S-K [17 CFR 229.101]. Our approach under proposed Rule 201(d) of Regulation Crowdfunding is consistent with that practice.

"business plan,"[111] the proposed rules would not specify the disclosures that an issuer must include in the description of the business and the business plan. We understand that issuers engaging in crowdfunding transactions may have businesses at various stages of development in differing industries, and therefore, we believe that the proposed rules should provide flexibility for issuers to disclose the information about their businesses.

Request for Comment

29. Are these proposed disclosure requirements appropriate? Why or why not? Should we require any additional disclosures? Should we prescribe specific disclosure requirements about the business of the issuer and the anticipated business plan of the issuer or provide a non-exclusive list of the types of information an issuer should consider disclosing? Why or why not? If so, what specific disclosures about the issuer's business or business plans should we require or include in a non-exclusive list? For example, should we explicitly require issuers to describe any material contracts of the issuer, any material litigation or any outstanding court order or judgment affecting the issuer or its property? Why or why not?

30. Would more specific line item disclosures be more workable for issuers relying on Section 4A or provide more useful guidance for such issuers? Would such disclosures be more useful to investors? Why or why not? For example, should we require issuers to provide a business description incorporating the information that a smaller reporting company would be required to provide in a

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[111] *See* Cones Letter; Ohio Division of Securities Letter.

registered offering pursuant to Item 101(h) of Regulation S-K?[112] Why or why not? Should we require issuers to provide information regarding their plan of operations, similar to that required by Item 101(a)(2) of Regulation S-K[113] in registered offerings by companies with limited operating histories? Why or why not?

(c) Use of Proceeds

The proposed rules, consistent with Section 4A(b)(1)(E), would require an issuer to provide a description of the purpose and intended use of the offering proceeds.[114] One commenter suggested that we require issuers to be specific and detailed when making this disclosure.[115] We expect that such disclosure would provide a sufficiently detailed description of the intended use of proceeds to permit potential investors to evaluate the investment. For example, an issuer may, among other uses, intend to use the proceeds of an offering to acquire assets or businesses, compensate the intermediary or its own employees or repurchase outstanding securities of the issuer. In its description, an issuer should use its judgment regarding the level of detail in its disclosures regarding the assets or businesses that the issuer anticipates acquiring, if applicable. If the proceeds will be used to compensate the intermediary, the issuer should disclose the amount to be used for such compensation. If the proceeds will be used to compensate existing employees and/or to hire new employees, the issuer should consider

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112 17 CFR 229.101(h).

113 17 CFR 229.101(a)(2).

114 *See* proposed Rule 201(i) of Regulation Crowdfunding.

115 *See* Williams Letter (stating that an issuer should disclose how the issuer arrived at the offering target, an itemization of expected expenses within the intended use of the proceeds, a contingency plan for the use of the proceeds should circumstances change and what will be done with any leftover proceeds upon completing the intended use).

disclosing whether the proceeds will be used for salaries or bonuses and how many employees it plans to hire, as applicable. If the issuer will repurchase outstanding issuer securities, it should consider disclosing its plans, terms and purpose for repurchasing the securities. An issuer also should consider disclosing how long the proceeds will satisfy the operational needs of the business. If an issuer does not have definitive plans for the proceeds, but instead has identified a range of possible uses, then the issuer should identify and describe each probable use and factors impacting the selection of each particular use.[116] If an issuer indicates that it will accept proceeds in excess of the target offering amount,[117] the issuer would be required to provide a separate, reasonably detailed description of the purpose and intended use of any excess proceeds with similar specificity.[118]

Request for Comment

31. Are these proposed disclosure requirements appropriate? Why or why not? Should we require any additional disclosures, including specifying items required to be disclosed? Is the proposed standard sufficiently clear such that it would result in investors being provided with an adequate amount of information? If not, how should we change the disclosure requirement? Should the rules include a non-exclusive list of examples that issuers should consider when providing disclosure, similar to the examples discussed above?

32. Under what circumstances, if any, should an issuer be required to update the use of proceeds disclosures?

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116 *See* proposed Instruction to paragraph (i) of proposed Rule 201 of Regulation Crowdfunding.

117 *See* Section II.B.1.a.i(d) below.

118 *See* proposed Instruction to paragraph (i) of proposed Rule 201 of Regulation Crowdfunding.

33. Is there other information regarding the purpose of the offering and use of proceeds that we should require to be disclosed? If so, what information? Should any of the examples above be included as requirements in the rules? Why or why not?

(d) Target Offering Amount and Deadline

Consistent with Section 4A(b)(1)(F), the proposed rules would require issuers to disclose the target offering amount and the deadline to reach the target offering amount.[119] In addition, an issuer would be required to disclose whether it will accept investments in excess of the target offering amount and, if it will, the issuer would be required to disclose, at the commencement of the offering, the maximum amount it will accept.[120] For example, if the issuer sets a target offering amount of $200,000 but is willing to accept up to $750,000, the issuer would be required to disclose both the $200,000 target offering amount and the $750,000 maximum offering amount that it will accept.[121] In addition, the issuer would be required to disclose, at the commencement of the offering, how shares in oversubscribed offerings would be allocated.[122] If this disclosure is made, we do not believe it would be necessary for us to prescribe how oversubscribed offerings would be allocated because this approach would allow issuers the

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119 *See* proposed Rule 201(g) of Regulation Crowdfunding.

120 *See* proposed Rule 201(h) of Regulation Crowdfunding.

121 The issuer in this case also would need to disclose the intended use of the additional proceeds. *See* proposed Instruction to paragraph (i) of proposed Rule 201 of Regulation Crowdfunding. *See also* Section II.B.1.a.i(c) above. In addition, the issuer in this case would need to provide audited financial statements at the commencement of the offering, rather than financial statements reviewed by an independent public accountant as would be required for the lower target amount. *See* Section II.B.1.a.ii below for a discussion of the financial statements requirements. As another example, an issuer that sets a target offering amount of $80,000 and a maximum offering amount of $105,000 would be required to provide financial statements reviewed by an independent public accountant (rather than tax returns for the most recently completed fiscal year and financial statements certified by the principal executive officer).

122 *See* proposed Rule 201(h) of Regulation Crowdfunding.

flexibility to structure the offering as they believe appropriate. At the same time, this approach would provide investors with the disclosure they need to make an informed investment decision.

We believe that investors in a crowdfunding transaction would benefit from clear disclosure about their right to cancel, the circumstances under which an issuer may close an offering early and the need to reconfirm the investment commitment under certain circumstances, so investors are more aware of their rights to rescind an investment commitment.[123] As such, we propose to require issuers to describe the process to cancel an investment commitment or to complete the transaction once the target amount is met,[124] including a statement that:

- investors may cancel an investment commitment until 48 hours prior to the deadline identified in the issuer's offering materials;[125]
- the intermediary will notify investors when the target offering amount has been met;
- if an issuer reaches the target offering amount prior to the deadline identified in its offering materials, it may close the offering early if it provides notice about the new offering deadline at least five business days prior to that new deadline (absent another material change that would require an extension of the offering and reconfirmation of the investment commitment);[126] and

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123 Although not specifically required by Title III, Securities Act Section 4A(b)(1)(I) provides us with discretion to require issuers engaged in transactions in reliance on Section 4(a)(6) to provide additional information for the protection of investors and in the public interest.

124 *See* proposed Rule 201(j) of Regulation Crowdfunding.

125 Section II.C.6 below further discusses the proposed cancelation provisions and requests comments on the proposed approach.

126 *Id.*

- if an investor does not cancel an investment commitment before the 48-hour period prior to the offering deadline, the funds will be released to the issuer upon closing of the offering and the investor will receive securities in exchange for his or her investment.

We also propose to require issuers to disclose that if an investor does not reconfirm his or her investment commitment after a material change is made to the offering, the investor's investment commitment will be cancelled and committed funds will be returned.[127] The proposed rules also would require issuers to disclose that if the sum of the investment commitments does not equal or exceed the target offering amount at the time of the offering deadline, no securities will be sold in the offering, investment commitments will be cancelled and committed funds will be returned.[128]

Request for Comment

34. Are these proposed disclosure requirements appropriate? Why or why not? Should we modify or eliminate any of the proposed requirements? Should we require any additional disclosures?

35. The proposed rules would require an issuer willing to accept investments in excess of the target offering amount to provide, at the commencement of the offering, the disclosure that would be required in the event the offer is oversubscribed. Is this approach appropriate? Why or why not?

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127 *See* proposed Rule 201(k) of Regulation Crowdfunding.

128 *See* proposed Rule 201(g) of Regulation Crowdfunding. *See also* Section 4A(a)(7) (requiring intermediaries to "ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount . . . .") and discussion in Section II.C.6 below.

(e) Offering Price

Consistent with Section 4A(b)(1)(G), the proposed rules would require an issuer to disclose the offering price of the securities or the method for determining the price, provided that prior to the sale, each investor is provided in writing the final price and all required disclosures.[129]

Request for Comment

36. Are these proposed disclosure requirements appropriate? Why or why not? Should we modify or eliminate any of the proposed requirements? Should we require any additional disclosures? Please explain.

(f) Ownership and Capital Structure

Consistent with Section 4A(b)(1)(H), the proposed rules would require an issuer to provide a description of its ownership and capital structure.[130] This disclosure would include:

- the terms of the securities being offered and each other class of security of the issuer, including the number of securities being offered and/or outstanding, whether or not such securities have voting rights, any limitations on such voting rights, how the terms of the securities being offered may be modified and a summary of the differences between such securities and each other class of security of the issuer, and how the rights of the securities being offered may be materially limited, diluted or qualified by the rights of any other class of security of the issuer;

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[129] *See* proposed Rule 201*(l)* of Regulation Crowdfunding. *See also* Sections II.C.5 and II.C.6 below for a discussion of information that issuers would be required to provide to investors.

[130] *See* proposed Rule 201(m) of Regulation Crowdfunding.

- a description of how the exercise of the rights held by the principal shareholders of the issuer could affect the purchasers of the securities;
- the name and ownership level of persons who are 20 Percent Beneficial Owners;
- how the securities being offered are being valued, and examples of methods for how such securities may be valued by the issuer in the future, including during subsequent corporate actions;
- the risks to purchasers of the securities relating to minority ownership in the issuer and the risks associated with corporate actions including additional issuances of securities, issuer repurchases of securities, a sale of the issuer or of assets of the issuer or transactions with related parties; and
- a description of the restrictions on the transfer of the securities.

We believe that investors in crowdfunding transactions would benefit from clear disclosure about the terms of the securities being offered and each other class of security of the issuer. The proposed rules would require disclosure of the number of securities being offered and/or outstanding, whether or not such securities have voting rights, any limitations on such voting rights and a description of the restrictions on the transfer of the securities.[131] Although Section 4A(b)(1)(H) does not specifically call for this disclosure, we believe that such disclosure would be necessary to provide investors with a more complete picture of the issuer's capital structure than would be obtained solely pursuant to the statutory requirements. We believe this would help investors better evaluate the terms of the offer before making an investment decision.

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[131] *See* proposed Rule 501 of Regulation Crowdfunding and Section II.E.2 below for a discussion of restrictions on resales.

Request for Comment

37. Are these proposed disclosure requirements appropriate? Why or why not? Should we modify or eliminate any of the proposed requirements? Should we require any additional disclosures? Please explain.

(g) Additional Disclosure Requirements

In addition to the statutory disclosure requirements,[132] we propose to require:

- disclosure of the name, Commission file number and Central Registration Depository number ("CRD number")[133] (as applicable) of the intermediary through which the offering is being conducted;[134]
- disclosure of the amount of compensation paid to the intermediary for conducting the offering, including the amount of any referral or other fees associated with the offering;[135]
- disclosure of certain legends to be included in the offering statement;[136]
- disclosure of the current number of employees of the issuer;[137]
- a discussion of the material factors that make an investment in the issuer speculative or risky;[138]

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132 Section 4A(b)(1)(I) provides us with discretion to require crowdfunding issuers to provide additional information for the protection of investors and in the public interest.

133 The Financial Industry Regulatory Authority, Inc. ("FINRA") will issue the CRD number.

134 *See* proposed Rule 201(n) of Regulation Crowdfunding.

135 *See* proposed Rule 201(o) of Regulation Crowdfunding.

136 *See* Item 2 of General Instruction III to proposed Form C.

137 *See* proposed Rule 201(e) of Regulation Crowdfunding.

138 *See* proposed Rule 201(f) of Regulation Crowdfunding.

- a description of the material terms of any indebtedness of the issuer, including the amount, interest rate, maturity date and any other material terms;[139]
- disclosure of exempt offerings conducted within the past three years;[140] and
- disclosure of certain related-party transactions.[141]

Requiring an issuer to identify the name, Commission file number and CRD number (as applicable) of the intermediary through which the offering is being conducted should assist investors and regulators in obtaining information about the offering and facilitate monitoring the use of the exemption. It also could help investors obtain background information on the intermediary, for instance through filings made by the intermediary with the Commission as well as through the Financial Industry Regulatory Authority's ("FINRA") BrokerCheck system for brokers[142] or a similar system, if created, for funding portals.

In addition, requiring an issuer to disclose the amount of compensation paid to the intermediary for conducting the offering, including the amount of referral or other fees associated with the offering, would permit investors and regulators to determine how much of the proceeds of the offering are used to compensate the intermediary and to facilitate the monitoring of compensation paid to intermediaries.

The requirement for an issuer to include in the offering statement certain specified legends about the risks of investing in a crowdfunding transaction is intended to help investors understand the general risks of investing in a crowdfunding transaction. In addition, the

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139 *See* proposed Rule 201(p) of Regulation Crowdfunding.

140 *See* proposed Rule 201(q) of Regulation Crowdfunding.

141 *See* proposed Rule 201(r) of Regulation Crowdfunding.

142 *See* FINRA, FINRA BrokerCheck, *available at* http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/P015175.

requirement that an issuer include in the offering statement certain legends about the required ongoing reports, including how those reports would be made available to investors and how an issuer may terminate its ongoing reporting obligations, is intended to help investors understand an issuer's ongoing reporting obligations and inform investors of how they will be able to access those reports.

The proposed rules also would require disclosure of the material factors that make an investment in the issuer speculative or risky.[143] We believe that this risk factor information should help investors to better understand the risks of investing in a specific issuer's offering.

The proposed rules also would require disclosure of certain related-party transactions between the issuer and any director or officer of the issuer, any person who is a 20 Percent Beneficial Owner, any promoter of the issuer (if the issuer was incorporated or organized within the past three years), or immediate family members of the foregoing persons.[144] For purposes of this related-party transactions disclosure, "immediate family member" would have the same meaning that it has in Item 404 of Regulation S-K,[145] which relates to the disclosure of related-party transactions for Exchange Act reporting companies. This related-party transactions disclosure should assist investors in obtaining a more complete picture of the financial relationships between certain related parties and the issuer.

Several commenters suggested that we should model the disclosure form after Securities Act Form 1-A[146] or the North American Securities Administrators Association's ("NASAA")

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143 *See* proposed Rule 201(f) of Regulation Crowdfunding.

144 *See* proposed Rule 201(r) of Regulation Crowdfunding.

145 17 CFR 229.404. *See* proposed Rule 201(r)(4) of Regulation Crowdfunding.

146 17 CFR 239.90. Form 1-A is the form used for securities offerings made pursuant to Regulation A.

uniform Small Company Offering Registration Form (U-7).[147] The proposed disclosure requirements regarding risk factors and related-party transactions are similar to those in Form 1-A except that, with respect to the disclosure about related-party transactions, the proposed rules would require disclosure about transactions since the beginning of the issuer's last full fiscal year, rather than the two fiscal years required in Form 1-A. Given the early stage of development of the small businesses and startups that we expect would seek to raise capital pursuant to Section 4(a)(6), as well as the investment limitations prescribed by the proposed rules, we believe that limiting the disclosure to related-party transactions since the beginning of the issuer's last full fiscal year will reduce the burden on issuers while still providing investors with sufficient information to evaluate the relationship between related parties and the issuer. Also, the proposed rules only would require disclosure of related-party transactions in excess of five percent of the aggregate amount of capital raised by the issuer in reliance on Section 4(a)(6) during the preceding 12-month period, inclusive of the amount the issuer seeks to raise in the current offering under Section 4(a)(6). For example, an issuer seeking to raise $1 million would be required to disclose related-party transactions in excess of $50,000, which is the same threshold required in Form 1-A. We believe that, in light of the sizes and varieties of issuers that may make offerings in reliance on Section 4(a)(6), this scaled approach is more appropriate than the fixed amount approach used in Form 1-A, which might be disproportionate to the size of certain offerings and issuers.

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147 *See* Commonwealth of Massachusetts Letter; Coan Letter; Liles Letter 1; Vim Funding Letter; NASAA Letter.

Two commenters suggested that the Commission require the issuer to disclose the total number of employees.[148] The proposed rules would require disclosure of the issuer's current number of employees.[149] This information should assist investors and regulators in obtaining information about the size of the businesses using the exemption. This information would make data available that could be used to evaluate whether the businesses using the exemption are creating additional jobs.[150]

The proposed rules also would require disclosure of the material terms of any indebtedness of the issuer, including, among other items, the amount, interest rate and maturity date.[151] We believe this information would be important to investors because servicing debt could place additional pressures on an issuer in the early stages of development.

In addition, the proposed rules would require disclosure of exempt offerings conducted within the past three years.[152] For each exempt offering within the past three years, the proposed rules would require a description of the date of the offering, the offering exemption relied upon, the type of securities offered and the amount of securities sold and the use of proceeds.[153] We believe that it would be important to investors to know of prior offerings of securities. This information would better inform investors about the capital structure of the issuer and would provide information about how prior offerings were valued.

Request for Comment

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148 *See* NASAA Letter; Ohio Division of Securities Letter.

149 *See* proposed Rule 201(e) of Regulation Crowdfunding.

150 Issuers would be required to disclose the current number of employees in the offering document and the ongoing reports, which should permit comparison of the number of employees over different time periods.

151 *See* proposed Rule 201(p) of Regulation Crowdfunding.

152 *See* proposed Rule 201(q) Regulation Crowdfunding.

153 *See* proposed Instruction to paragraph (q) of proposed Rule 201 of Regulation Crowdfunding.

38. Are these proposed disclosure requirements appropriate? Why or why not? Should we modify or eliminate any of the proposed requirements? If so, how and why?

39. To assist investors and regulators in obtaining information about the offering and to facilitate monitoring the use of the exemption, the proposed rules would require an issuer to identify the name, Commission file number and CRD number (as applicable) of the intermediary through which the offering is being conducted. Is there a better approach? What other information should be provided? If so, please describe it.

40. Should we require disclosure of the amount of compensation paid to the intermediary, as proposed? Why or why not? Should we require issuers to separately disclose the amounts paid for conducting the offering and the amounts paid for other services? Why or why not?

41. Should we require the issuer to include certain specified legends about the risks of investing in a crowdfunding transaction and disclosure of the material factors that make an investment in the issuer speculative or risky, as proposed? Why or why not? Should we provide examples in our rules of the types of material risk factors an issuer should consider disclosing? Why or why not? If so, what should those examples be?

42. Should we require disclosure of certain related-party transactions, as proposed? Why or why not? The proposed rules would require disclosures of certain transactions between the issuer and directors or officers of the issuer, 20 Percent Beneficial Owners, any promoter of the issuer, or relatives of the foregoing

persons. Is this the appropriate group of persons? Should we limit or expand the list of persons? If so, how and why?

43. As proposed, immediate family member, for purposes of related-party transactions disclosure, would have the same meaning that it has in Item 404 of Regulation S-K.[154] Is this the appropriate approach? Why or why not? If not, what would be a more appropriate definition and why? For purposes of restrictions on resales of securities issued in transactions made in reliance on Section 4(a)(6), "member of the family of the purchaser or the equivalent" would, as proposed, expressly include spousal equivalents.[155] Should the definition of immediate family member for purposes of related-party transactions disclosure also expressly include spousal equivalents, or would including spousal equivalents create confusion in light of the fact that the definition for purposes of related-party transactions already includes any persons (other than a tenant or employee) sharing the same household? Please explain.

44. Is it appropriate to limit the disclosure about related-party transactions to transactions since the beginning of the issuer's last full fiscal year? Why or why not? Is it appropriate to limit disclosure to those related-party transactions that exceed five percent of the aggregate amount of capital raised by the issuer in reliance on Section 4(a)(6)? Should we instead require disclosure of all related-party transactions or all transactions in excess of an absolute threshold amount?

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154 17 CFR 229.404. *See* proposed Rule 201(r)(4) of Regulation Crowdfunding.

155 *See* proposed Rule 501(c) of Regulation Crowdfunding and the related instruction thereto. *See also* Section II.E.2 below for a discussion of spousal equivalent.

45. Is it appropriate to require a description of any prior exempt offerings conducted within the past three years, as proposed? Why or why not? Would another time period (*e.g.*, one year, five years, etc.) or no time limit be more appropriate?

46. Should we require any additional disclosures (*e.g.*, should we require disclosure about executive compensation and, if so, what level of detail should be required in such disclosure)? If so, what disclosures and why?

ii. Financial Disclosure

Section 4A(b)(1)(D) requires "a description of the financial condition of the issuer." It also establishes a framework of tiered financial disclosure requirements based on aggregate target offering amounts of the offering and all other offerings made in reliance on Section 4(a)(6) within the preceding 12-month period:

- issuers offering $100,000 or less are required to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors income tax returns filed by the issuer for the most recently completed year (if any) and financial statements that are certified by the principal executive officer to be true and complete in all material respects;
- issuers offering more than $100,000, but not more than $500,000, are required to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors financial statements reviewed by a public accountant that is independent of the issuer; and
- issuers offering more than $500,000 (or such other amount as the Commission may establish) are required to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors audited financial statements.

Section 4A(h) further provides that these dollar amounts shall be adjusted by the Commission not less frequently than once every five years, by notice published in the Federal Register, to reflect any change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics.

(a) Financial Condition Discussion

Consistent with Section 4A(b)(1)(D), the proposed rules would require an issuer to provide a narrative discussion of its financial condition.[156] This discussion should address, to the extent material, the issuer's historical results of operations in addition to its liquidity and capital resources. If an issuer does not have a prior operating history, the discussion should focus on financial milestones and operational, liquidity and other challenges. If an issuer has a prior operating history, the discussion should focus on whether historical earnings and cash flows are representative of what investors should expect in the future. An issuer's discussion of its financial condition should take into account the proceeds of the offering and any other known or pending sources of capital. Issuers also should discuss how the proceeds from the offering will affect their liquidity and whether these funds and any other additional funds are necessary to the viability of the business. In addition, issuers should describe the other available sources of capital to the business, such as lines of credit or required contributions by principal shareholders.

We expect that the discussion required by the proposed rule and instruction would inform investors about the financial condition of the issuer in a manner similar to the management's discussion and analysis of financial condition and results of operations ("MD&A") required by

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[156] *See* proposed Rule 201(s) of Regulation Crowdfunding.

Item 303 of Regulation S-K[157] for registered offerings. Because issuers seeking to engage in crowdfunding transactions would likely be smaller, less complex and at an early stage of development compared to issuers conducting registered offerings or Exchange Act reporting companies, we expect that the discussion would not generally need to be as lengthy or detailed as the MD&A of Exchange Act reporting companies. We are not proposing to prescribe content or format for this information, but rather to set forth principles of disclosure. To the extent these items of disclosure overlap with the issuer's discussion of its business or business plan, issuers are not required to make duplicate disclosures. While we are not proposing to mandate a specific presentation, we expect issuers to present the required disclosures, including any other information that would be material to an investor, in a clear and understandable manner.

Request for Comment

47. Are these proposed requirements for the discussion of the financial condition of the issuer appropriate? Why or why not? Should we modify or eliminate any of the requirements in the proposed rule or instruction? If so, which ones and why? Should we require any additional disclosures? If so, what disclosures and why? Should we prescribe a specific format or presentation for the disclosure? Please explain.

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157 17 CFR 229.303.

48. Should we exempt issuers with no operating history from the requirement to provide a discussion of their financial condition? If so, why? Should we require such issuers to specifically state that they do not have an operating history, as proposed? Why or why not?

49. In the discussion of the issuer's financial condition, should we require issuers to provide specific disclosure about prior capital raising transactions? Why or why not? Should we require specific disclosure relating to prior transactions made pursuant to Section 4(a)(6), including crowdfunding transactions in which the target amount was not reached? Why or why not?

(b) Financial Disclosures

As noted above, Section 4A(b)(1)(D) establishes tiered financial statement disclosure requirements that are based on aggregate target offering amounts within the preceding 12-month period. We received a range of comments on this requirement.

In response to the requirement for issuers offering $100,000 or less to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors their income tax returns for the most recently completed year, one commenter suggested that, even if redacted, income tax returns should not be made public.[158] One commenter suggested that financial statements should cover the most recently completed fiscal year.[159] Other commenters suggested that issuers offering $100,000 or less should provide financial statements prepared in accordance with generally accepted accounting principles

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158 *See* RocketHub Letter 1 (stating that information can be taken from the issuer's tax return and entered digitally, by the issuer, for inclusion in the offering materials).

159 *See* CompTIA Letter.

("GAAP"), including explanatory notes, even though those financial statements would not be subject to an independent accountant's review or audit.[160]

For issuers offering more than $100,000, but not more than $500,000, one commenter suggested that the Commission require the financial statement review to be done by accountants in good standing for at least five years.[161] Another commenter stated that issuers in existence for less than 12 months should not be required to provide independently reviewed financial statements.[162]

Several commenters objected to the requirement for issuers to provide audited financial statements when offering more than $500,000 and suggested alternatives.[163] One commenter suggested that an issuer should not be required to provide audited financial statements if: (1) the target offering amount is not greater than $100,000 (notwithstanding any other transactions made in reliance on Section 4(a)(6) within the preceding 12-month period); and (2) the issuer has not

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160 *See* Commonwealth of Massachusetts Letter; NASAA Letter.

161 *See* Philipose Letter 1.

162 *See* CFIRA Letter 2.

163 *See* CFIRA Letter 2 (stating that the requirement to provide audited financial statements should apply solely to issuers that have been engaged in their current business for more than 12 months and which are seeking to raise at least $1,000,000); Vim Funding Letter (stating that the statute gives the Commission the discretion to raise the threshold at which audits are required, "in theory all the way up to the $1,000,000 level" and asking that the Commission exercise its discretion); RocketHub Letter 1 (stating that the threshold for the audit requirement should be raised to an amount in excess of $1,000,000 and audited financial statements should only be required for issuers that have been in operation for more than two years); Parker Letter (stating that the audit requirement is an unnecessary expense); Cera Technology Letter (stating that the audit requirement should be raised to $1,000,000); ABA Letter 1 (stating that the Commission should consider a higher threshold, such as $750,000, or identify additional criteria, such as revenue levels, that would require audited financial statements); Loofbourrow Letter (stating that the Commission should not impose an audit requirement); InitialCrowdOffering Letter (stating that the requirement for audited financial statements should be eliminated); Genedyne Letter 1 (stating that the Commission should not impose an audit requirement for offerings under $1,000,000); BrainThrob Laboratories Letter (stating that the Commission should defer imposing an audit requirement until further study can determine whether it is economically beneficial to the investment community); Vogele Letter (stating that obtaining audited financial statements takes time and new businesses do not have a lot of time). *See also* 2012 SEC Government-Business Forum, note 29 (recommending that the Commission consider raising the offering amount at which audited financial statements are required).

conducted a transaction in reliance on Section 4(a)(6) within the preceding six months.[164] Another commenter suggested that issuers should be required to identify the accountant used to certify or audit the financial statements.[165]

Under the proposed rules, in determining the financial statements that would be required, an issuer would need to aggregate the amounts offered and sold in reliance on Section 4(a)(6) within the preceding 12-month period with the target offering amount (or the maximum offering amount, including the aggregate amount of any possible oversubscriptions if the issuer will accept oversubscriptions) of the offering for which disclosure is being provided.[166] The statute refers to aggregate "offering amounts" within the preceding 12-month period. We are proposing to require issuers to aggregate only amounts offered and sold (rather than all offered amounts, including those not sold) within the preceding 12-month period with the amount the issuer is seeking to raise in the transaction.[167] We do not believe that this provision should require an issuer to aggregate amounts offered in prior offerings but not sold (for example, because the target offering amount was not met). Otherwise, an issuer that initially sought to raise $400,000, did not complete the crowdfunding transaction because the target offering amount was not met, and would like to raise $200,000 in a second attempt would be required to provide audited financial statements rather than financial statements reviewed by a public accountant in

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164 *See* ABA Letter 1.

165 *See* RocketHub Letter 1 (stating that disclosure of the identity of the accountant used to review or audit the financial statements would allow investors to conduct diligence on the accountant and permit the intermediary to track accountant activities and block issuers on their platform from using accountants who produce poor quality or fraudulent work).

166 *See* proposed Instruction 1 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

167 *See also* Hutchens Letter (suggesting that the Commission "devise a rule that creates a relationship between the amount of capital actually raised by an issuer in a crowdfunding offering and the degree of financial disclosure the issuer must provide").

connection with that $200,000 offering. We believe that this result would increase costs to issuers when those issuers were unsuccessful in prior offerings within the preceding 12-month period. Requiring issuers to aggregate amounts offered and sold should still prevent issuers from circumventing the framework of tiered financial disclosure requirements by structuring a larger offering as a series of smaller offerings.[168] We do not propose to prohibit issuers from providing financial statements that meet the requirements for a higher aggregate target offering amount than the proposed rules would require.[169]

The proposed rules would require all issuers to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors a complete set of their financial statements (a balance sheet, income statement, statement of cash flows and statement of changes in owners' equity), prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"), covering the shorter of the two most recently completed fiscal years or the period since inception of the business.[170] In proposing this requirement we considered commenters' suggestions that we require financial statements prepared in accordance with U.S. GAAP,[171] as well as the fact that the same requirement applies to offerings under Regulation A.[172]

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168 For example, we believe aggregating completed offerings within the preceding 12-month period is necessary to avoid having an issuer who seeks to raise more than $500,000, which requires audited financial statements, structure the offering as a series of smaller offerings to circumvent this requirement.

169 *See* proposed Instruction 10 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

170 *See* proposed Instruction 2 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding. Financial statements prepared in accordance with U.S. GAAP are generally self-scaling to the size and complexity of the issuer, which should reduce the burden of preparing financial statements for many issuers.

171 *See* Commonwealth of Massachusetts Letter; NASAA Letter.

172 *See* Part F/S of Form 1-A. [17 CFR 239.90].

We considered proposing to require financial statements covering only the most recently completed fiscal year, as one commenter suggested,[173] rather than the two most recently completed fiscal years; however, we believe that requiring a second year will provide investors with a basis for comparison against the most recently completed period, without substantially increasing the burden for the issuer.[174] We also considered proposing to require a third year of financial statements, but we are concerned that this could be overly burdensome for the types of issuers that likely would engage in crowdfunding transactions.[175]

During the first 120 days of the issuer's fiscal year, an issuer would be able to conduct an offering in reliance on Section 4(a)(6) and the related rules using financial statements for the fiscal year prior to the most recently completed fiscal year if the financial statements for the most recently completed fiscal year are not otherwise available or required to be filed.[176] We believe this accommodation is needed because otherwise issuers would not be able to conduct offerings in reliance on Section 4(a)(6) for a period of time between the end of their fiscal year and the date when the financial statements for that period are available.[177] The issuer could not do this,

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173 *See* CompTIA Letter.

174 *See Smaller Reporting Company Regulatory Relief and Simplification*, Release No. 33-8876 (Dec. 19, 2007) [73 FR 934 (Jan. 4, 2008)] (in the context of requiring two years, rather than just one year, of audited balance sheet data for smaller reporting companies, the Commission noted that comparative balance sheets will provide a much more meaningful presentation for investors without a significant additional burden on smaller reporting companies, since the earlier year data should be readily available for the purposes of preparing the other financial statements). *See also SEC Advisory Committee on Smaller Public Companies, Final Report* (Apr. 23, 2006), *available at* http://www.sec.gov/info/smallbus/acspc.shtml.

175 Requiring a third year of financial statements also would place a greater burden on issuers relying on Section 4(a)(6) than on emerging growth companies conducting registered offerings. *See* Section 102(b) of the JOBS Act.

176 *See* proposed Instruction 8 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

177 Issuers conducting a registered offering after the end of their fiscal year also are permitted to use financial statements for their prior period until the 90th day after their fiscal-year end for non-accelerated filers (or 75th day for accelerated filers and 60th day for large accelerated filers) if certain conditions are satisfied. *See* Rule 3-01(c) of Regulation S-X [17 CFR 210.3-01(c)].

however, if it was otherwise required to provide updated financial statements by the ongoing reporting requirements[178] or financial statements are otherwise available.[179] For example, if an issuer that has a calendar fiscal year end conducts an offering in April 2014, it would be permitted to include financial statements for the fiscal year ended December 31, 2012 if the financial statements for the fiscal year ended December 31, 2013 are not yet available. Once more than 120 days have passed since the end of the issuer's most recent fiscal year, the issuer would be required to include financial statements for its most recent fiscal year.[180] Regardless of the age of the financial statements, an issuer would be required to include a discussion of any material changes in the financial condition of the issuer during any time period subsequent to the period for which financial statements are provided, including changes in reported revenue or net income, to inform investors of changes to the financial condition of the issuer.[181]

Section 4A(b)(1)(D)(i) requires issuers to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors income tax returns and financial statements. As specified in the statute, we are proposing to require an issuer that is conducting an offering of $100,000 or less in reliance on Section 4(a)(6) to provide its filed income tax returns for the most recently completed fiscal year, if any, and its financial statements certified by its principal executive officer.[182] Although one commenter suggested the

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178 *See* Section II.B.2 below for a discussion of ongoing reporting requirements.

179 Additionally, if the offering period remains open beyond 120 days after the end of the issuer's fiscal year (resulting in financial statements older than 485 days at the time the offering closes), then the issuer would be required to update the disclosure in the offering statement to include financial statements for the most recently completed fiscal year. *See* proposed Instruction 8 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

180 *Id.*

181 *See* proposed Instruction 9 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

182 *See* proposed Rule 201(t)(1) of Regulation Crowdfunding.

Commission should provide otherwise,[183] the statute specifically calls for the Commission to require the filing of income tax returns. To address the privacy concerns raised by commenters with regard to the requirement to provide tax returns, we are proposing to require issuers to redact personally identifiable information, such as social security numbers, from their tax returns before filing. Issuers that offer securities in reliance on Section 4(a)(6) before filing their tax returns for the most recently completed fiscal year would be allowed to use the tax return filed for the prior year, provided that the issuer discloses any material changes since that prior year. In addition, the issuer would be required to provide the tax return for the most recent fiscal year when filed with the U.S. Internal Revenue Service (if filed during the offering period). With regard to the requirement to provide financial statements that are certified to be true and complete in all material respects, we are proposing a form of the certification that would be provided by the issuer's principal executive officer.[184]

For offerings of more than $100,000, but not more than $500,000, Section 4A(b)(1)(D)(ii) requires issuers to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors financial statements reviewed by a public accountant who is "independent" of the issuer, using professional standards and procedures or standards and procedures established by the Commission for this purpose. The statute does not define the term "independent." We propose that to qualify as an independent public accountant for purposes of this requirement, the accountant would need to comply with

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183 *See* RocketHub Letter 1.

184 *See* proposed Instruction 4 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

the Commission's independence rules, which are set forth in Rule 2-01 of Regulation S-X.[185] We believe that accounting professionals could benefit from the guidance the Commission and staff have provided about these independence rules. We also believe that financial statement reviews under these standards could provide investors with more confidence regarding the reliability of the financial statements.[186] An issuer subject to this requirement that seeks to eventually become an Exchange Act reporting company may have an easier transition because the issuer would already be complying with our independence rules.[187]

The statute also gives the Commission discretion to determine the professional standards and procedures used for the review of the financial statements. To implement this requirement, the proposed rules would require issuers to provide financial statements reviewed in accordance with the Statements on Standards for Accounting and Review Services ("SSARS") issued by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants ("AICPA").[188] We are not proposing new review standards for purposes of these

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185 17 CFR 210.2-01. Rule 2-01 of Regulation S-X is designed to ensure that auditors are qualified and independent both in fact and in appearance. The rule sets forth restrictions on, including but not limited to, financial, employment, and business relationships between an accountant and a client and restrictions on an accountant providing certain non-audit services to a client. The general standard of independence is set forth in Rule 2-01(b). The rule does not purport to, and the Commission could not, consider all the circumstances that raise independence concerns, and these are subject to the general standard in paragraph (b) of Rule 2-01. In considering this standard, the Commission looks in the first instance to whether a relationship or the provision of a service: (a) creates a mutual or conflicting interest between the accountant and the client; (b) places the accountant in the position of auditing his or her own work; (c) results in the accountant acting as management or an employee of the client; or (d) places the accountant in a position of being an advocate for the client.

186 For example, under the Commission's independence rules, an auditor cannot provide bookkeeping services to an audit client, so investors would be able to rely on the benefits that accompany the prohibition against an auditor auditing its own work. *See* Rule 2-01(c)(4) of Regulation S-X [17 CFR 210.2-01(c)(4)].

187 Using an accountant that is not independent in accordance with our independence rules could result in increased expense and delay to the extent that an issuer seeking to become an Exchange Act reporting company would need to obtain an audit of the financial statements by an accountant complying with the Commission's independence standards.

188 *See* proposed Rule 201(t)(2) of Regulation Crowdfunding.

rules at this time because we do not believe it is necessary. The AICPA's review standard is widely utilized, and we are not aware of any other widely utilized standards for reviews. Many accountants reviewing financial statements of crowdfunding issuers should be familiar with the AICPA's standards and procedures for review, which could make it less burdensome for issuers.

The issuer would be required to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors a copy of the public accountant's review report.[189] This should benefit investors by giving them the ability to consider any modification that may have been made to the review report. It also would serve as a way to identify the accounting firm used to review the financial statements. As one commenter suggested,[190] investors then could conduct due diligence on the accounting firm by, for example, researching the other offerings made in reliance on Section 4(a)(6) in which the accounting firm was involved or reviewing the accounting firm's licensure status and any publicly-available disciplinary proceedings.

For offerings of more than $500,000, consistent with the threshold identified in Section 4A(b)(1)(D)(iii), the proposed rules would require issuers to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors audited financial statements. While Congress authorized the Commission to establish a different threshold, we are not proposing at this time to raise the threshold at which an issuer would be required to provide audited financial statements, as some commenters suggested.[191] We note that Congress specifically selected $500,000 as the threshold at which to require audited financial

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189 *See* proposed Instruction 5 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

190 *See* RocketHub Letter 1.

191 *See* CFIRA Letter 2; Vim Funding Letter; RocketHub Letter 1; Cera Technology Letter; Genedyne Letter 1; Schwartz Letter.

statements. If we were to raise the threshold to $1 million, as suggested by some commenters,[192] it would eliminate the requirement for issuers ever to provide audited financial statements because the maximum offering amount under Section 4(a)(6) is $1 million. Leaving the $500,000 threshold unchanged also would provide the Commission, investors and issuers an opportunity to become familiar with the new offering exemption before considering possible changes to the threshold.

Under the proposed rules, the auditor conducting the audit of the financial statements would be required to be independent of the issuer and the audit would have to be conducted in accordance with the auditing standards issued by either the AICPA or the Public Company Accounting Oversight Board ("PCAOB").[193] The proposed instructions to the rules would provide that the auditor would be required to be independent of the issuer based on the Commission's independence standard in Rule 2-01 of Regulation S-X.[194] Providing issuers with a choice of auditing standards could provide a benefit in a number of ways. If an issuer currently has audited financial statements using one of the specified standards, the issuer would not need to obtain a new audit or engage a different auditor to conduct an audit in order to engage in a crowdfunding transaction in reliance on Section 4(a)(6). If an issuer chooses to have an audit conducted in accordance with PCAOB auditing standards, it generally would not need to obtain a new audit in order to file a registration statement with the Commission for a registered offering or to register a class of securities under the Exchange Act and become an Exchange Act reporting company. The proposed rules would not require the audit to be conducted by a

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192 *See* CFIRA Letter 2; Vim Funding Letter; Cera Technology Letter; Genedyne Letter 1.

193 *See* proposed Rule 201(t)(3) of Regulation Crowdfunding.

194 17 CFR 210.2-01.

PCAOB-registered firm. This should mean that a greater number of accountants would be eligible to audit the issuers' financial statements, which may reduce issuers' costs.

An issuer would be required to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors a copy of the audit report.[195] This should benefit investors by serving as a way to identify the accounting firm used to audit the financial statements. Investors then could conduct due diligence by, for example, researching other offerings made in reliance on Section 4(a)(6) in which the accounting firm was involved or reviewing the accounting firm's licensure status and any publicly-available disciplinary proceedings.

An issuer that received an unqualified or a qualified audit opinion would be in compliance with the audited financial statement requirements.[196] An issuer that received an adverse opinion or a disclaimer of opinion, however, would not be in compliance with the audited financial statement requirements,[197] because the auditor determined that the financial statements of the issuer do not present fairly its financial position, results of operations or cash flows in conformity with U.S. GAAP, or that the auditor does not express an opinion on the financial statements.

Under Rule 2-01 of Regulation S-X, the Commission does not recognize as a public accountant any person who: (1) is not duly registered and in good standing as a certified public accountant under the laws of the place of his residence or principal office; or (2) is not in good standing and entitled to practice as a public accountant under the laws of the place of his

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195 *See* proposed Instruction 6 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

196 *Id.*

197 *Id.*

residence or principal office.[198] We believe that this rule promotes the use of qualified accountants that are in compliance with the requirements for their profession for the review or audit of the financial statements with respect to all offerings, including offerings in reliance on Section 4(a)(6).[199] We are not proposing to require that the public accountant be in good standing for at least five years, as one commenter suggested,[200] because that could unnecessarily restrict the pool of available public accountants by, for example, excluding accountants who are in good standing but who have been in business for fewer than five years.

We believe that many issuers engaging in crowdfunding transactions in reliance on Section 4(a)(6) are likely to be at a very early stage of their business development and may not have an operating history. In many instances, these issuers will have no more than a business plan for which they are seeking investors to help fund. We are not proposing to exempt these issuers (or issuers that have been in existence for less than 12 months, as one commenter suggested)[201] from the requirement to provide financial statements based on the tiered offering amounts. Financial statements prepared in accordance with U.S. GAAP are generally self-scaling to the size and complexity of the issuer, which reduces the burden of preparing financial statements for many early stage issuers. We would not expect that the required financial statements would be long or complicated for issuers that are recently formed and have limited

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198 *See* 17 CFR 210.2-01(a).

199 Accountants also would be subject to Rule 102(e) of the Rules of Practice and Investigations. *See* 17 CFR 201.102(e). Under Rule 102(e), the Commission can censure, suspend or bar professionals who appear or practice before it if it finds such professionals, after notice and an opportunity for hearing: (1) not to possess the requisite qualifications to represent others; or (2) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the Federal securities laws or the rules and regulations thereunder. *See* 17 CFR 201.102(e)(1)(i), (ii) and (iii).

200 *See* Philipose Letter 1.

201 *See* CFIRA Letter 2.

operating histories. We preliminarily believe, nevertheless, that financial statements for such issuers would be useful for investors, particularly when presented along with a description of the issuer's financial condition. This would give investors a more complete picture of the issuer and would highlight its early stage of development.

Request for Comment

50. Under the statute and the proposed rules, issuers are required to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors financial statements. The proposed rules would require all issuers to provide a complete set of financial statements (a balance sheet, income statement, statement of cash flows and statement of changes in owner's equity) prepared in accordance with U.S. GAAP. Should we define financial statements differently than under U.S. GAAP? If so, what changes would be appropriate and why? What costs or challenges would be associated with the use of a model other than U.S. GAAP (*e.g.*, lack of comparability)? What would be the benefits? Please explain.

51. Should we exempt issuers with no operating history or issuers that have been in existence for fewer than 12 months from the requirement to provide financial statements, as one commenter suggested?[202] Why or why not? Specifically, what difficulties would issuers with no operating history or issuers that have been in existence for fewer than 12 months have in providing financial statements? Please explain.

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202 *Id.*

52. If we were to exempt issuers with little or no operating history from the requirement to provide financial statements, should we require additional discussion of the fact that the issuer does not have an operating history? If so, what additional discussion should we require?

53. Section 4A(b)(1)(D) establishes tiered financial statement requirements based on aggregate target offering amounts within the preceding 12-month period. Under the proposed rules, issuers would not be prohibited from *voluntarily* providing financial statements that meet the requirements for a higher aggregate target offering amount (*e.g.*, an issuer seeking to raise $80,000 provides financial statements reviewed by a public accountant who is independent of the issuer, rather than the required income tax returns and a certification by the principal executive officer). Is this approach appropriate? Why or why not?

54. Should we allow issuers to prepare financial statements using a comprehensive basis of accounting other than U.S. GAAP? For example, should issuers be allowed to provide financial statements prepared on an income tax basis, a cash basis or a modified cash basis of accounting? Why or why not? If so, should we allow all issuers to use a comprehensive basis of accounting other than U.S. GAAP, or only issuers seeking to raise $100,000 or less, or $500,000 or less? Why or why not?

55. Should we require issuers to provide two years of financial statements, as proposed? Should this time period be one year, as one commenter suggested,[203] or three years? Please explain.

56. Should we require some or all issuers also to provide financial statements for interim periods, such as quarterly or semi-annually? Why or why not? If so, which issuers and why? Should we require these financial statements to be subject to public accountant or auditor involvement? If so, what level of involvement is appropriate?

57. As proposed, subject to certain conditions, issuers would be able to conduct an offering during the first 120 days of the issuer's fiscal year if the financial statements for the most recently completed fiscal year are not yet available. For example, an issuer could raise capital in April 2014 by providing financial statements from December 2012, instead of a more recent period. Is this an appropriate approach? If the issuer is a high growth company subject to significant change, would this approach result in financial statements that are too stale? Should the period be shorter or longer (*e.g.*, 90 days, 150 days, etc.)? What quantitative and qualitative factors should we consider in setting the period? Should issuers be required to describe any material changes in their financial condition for any period subsequent to the period for which financial statements are provided, as proposed? Please explain if you do not believe this description should be required.

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[203] *See* CompTIA Letter.

58. The proposed rules would require issuers offering $100,000 or less to provide financial statements that are certified by the principal executive officer to be true and complete in all material respects. Should we require issuers offering more than $100,000, but not more than $500,000, and/or issuers offering more than $500,000 to provide financial statements that are certified by the principal executive officer to be true and complete in all material respects? Why or why not?

59. Have we adequately addressed the privacy concerns raised by the requirement to provide income tax returns? Should we require issuers to redact personally identifiable information from any tax returns, as proposed? Is there additional information that issuers should be required or allowed to redact? In responding, please specify each item of information that issuers should be required or allowed to redact and why. Under the statute and proposed rules, an issuer must be a business organization, rather than an individual. Does this requirement alleviate some of the potential privacy concerns? Please explain.

60. If an issuer has not yet filed its tax return for the most recently completed fiscal year, should we allow the issuer to use the tax return filed for the prior year and require the issuer to update the information after filing the tax return for the most recently completed fiscal year, as proposed? Should the same apply to an issuer that has not yet filed its tax return for the most recently completed fiscal year and has requested an extension of the time to file? Should issuers be required, as proposed, to describe any material changes that are expected in the tax returns for the most recently completed fiscal year? Please explain.

61. As proposed, the accountant reviewing or auditing the financial statements would have to be independent, as set forth in Rule 2-01 of Regulation S-X. Should we require compliance with the independence standards of the AICPA instead? Why or why not? If so, similar to the requirement in Rule 2-01 of Regulation S-X, should we also require an accountant to be: (1) duly registered and in good standing as a certified public accountant under the laws of the place of his or her residence or principal office; or (2) in good standing and entitled to practice as a public accountant under the laws of his or her place of residence or principal office? Is there another independence standard that would be appropriate? If so, please identify the standard and explain why. Alternatively, should we create a new independence standard for purposes of Section 4(a)(6)? If so, what would be an appropriate standard? Please explain.

62. As proposed, the accountant reviewing or auditing the financial statements must be independent based on the independence standard in Rule 2-01 of Regulation S-X. Are there any requirements under Rule 2-01 that should not apply to the accountant reviewing or auditing the financial statements that are filed pursuant to the proposed rules? Why or why not? Are there any that would not apply, but should? For example, should the accountant reviewing or auditing the financial statements of issuers in transactions made in reliance on Section 4(a)(6) be subject to the partner rotation requirements of Rule 2-01(c)(6)? Why or why not?

63. As proposed, an issuer with a target offering amount greater than $100,000, but not more than $500,000, would be required to file with the Commission, provide

to investors and the relevant intermediary and make available to potential investors financial statements reviewed by an independent public accountant in accordance with the review standards issued by the AICPA. Is this standard appropriate, or should we use a different standard? Why or why not? If so, what standard and why? Alternatively, should we create a new review standard for purposes of Section 4(a)(6)? If so, what would be an appropriate standard and why would it be more appropriate than the one proposed? What costs would be involved for companies and accountants in complying with a new review standard? How should the Commission administer and enforce a different standard?

64. Section 4A(b)(1)(D)(iii) requires audited financial statements for offerings of more than $500,000 "or such other amount as the Commission may establish, by rule." Should we increase the offering amount for which audited financial statements would be required? If so, to what amount (*e.g.*, $600,000, $750,000, etc.)? Please provide a basis for any amount suggested. Should we identify additional criteria other than the offering amount, as one commenter suggested,[204] that could be used to determine when to require an issuer to provide audited financial statements? If so, what should those criteria be?

65. Should financial statements be required to be dated within 120 days of the start of the offering? If so, what standard should apply? Should those financial statements be reviewed or audited? Why or why not?

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204 *See* ABA Letter 1 (stating that revenue could be a criteria for determining when audited financial statements would be required).

66. Under Rule 502(b)(2)(B)(1)-(2) of Regulation D, if an issuer, other than a limited partnership, cannot obtain audited financial statements without unreasonable effort or expense, then only the issuer's balance sheet must be audited. Should we include a similar provision in the proposed rules? Why or why not? Should we provide any guidance as to what would constitute unreasonable effort or expense in this context? If so, please describe what should be considered to be an unreasonable effort or expense. If we were to require an issuer's balance sheet to be dated within 120 days of the start of the offering, should we allow the balance sheet to be unaudited? Why or why not?

67. As proposed, an issuer with a target offering amount greater than $500,000 could select between the auditing standards issued by the AICPA or the PCAOB. Should we instead mandate one of the two standards? If so, which standard and why? Alternatively, should we create a new audit standard for purposes of Section 4(a)(6)? If so, what would be an appropriate standard? What costs would be involved for companies and auditors in complying with a new audit standard?

68. Should we require that all audits be conducted by PCAOB-registered firms? Why or why not?

69. Should we consider the requirement to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors financial statements subject to a review to be satisfied if the review report includes modifications? Why or why not? Would your response differ depending on the nature of the modification? Please explain.

70. As proposed, an issuer receiving an adverse audit opinion or disclaimer of opinion would not satisfy its requirement to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors audited financial statements. Should an issuer receiving a qualified audit opinion be deemed to have satisfied this requirement? Should certain qualifications (*e.g.*, non-compliance with U.S. GAAP) result in the financial statements not satisfying the requirement to provide audited financial statements while other types of qualifications would be acceptable? If so, which qualifications would be acceptable and why?

71. Should we require that the certified public accountant reviewing or auditing the financial statements be in good standing for at least five years, as one commenter suggested?[205] Why or why not? Should we require that the public accountant be in good standing for a lesser period of time? If so, for how long? Would such a requirement restrict the pool of available public accountants? If so, by how much? Would such a requirement reduce investor protections? If so, how?

b. Progress Updates

Consistent with Section 4A(b)(1)(F), the proposed rules would require an issuer to prepare regular updates on its progress in meeting the target offering amount.[206] These updates would be filed with the Commission on EDGAR, under cover of Form C, provided to investors and the relevant intermediary and made available to potential investors. The issuer would check

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[205] *See* Philipose Letter 1.

[206] *See* proposed Rules 201(v) and 203(a)(3) of Regulation Crowdfunding.

the box for "Form C-U: Progress Update" on the cover of the Form C and provide the required update in the space provided. One commenter suggested that issuers should be exempted from issuing status updates and/or reports so long as the funding portal publicly displays the progress of the issuer in meeting the target offering amount.[207]

As proposed, the rules would require an issuer to file with the Commission and provide investors and the relevant intermediary regular updates regarding the issuer's progress in meeting the target offering amount no later than five business days after the issuer reaches particular intervals – *i.e.*, one-half and 100 percent – of the target offering amount.[208] If the issuer will accept proceeds in excess of the target offering amount, the issuer also would be required to file with the Commission and provide investors and the relevant intermediary a final progress update, no later than five business days after the offering deadline, disclosing the total amount of securities sold in the offering.[209] If, however, multiple progress updates are triggered within the same five-business-day period (*e.g.*, the issuer reaches one-half of the target offering amount on November 5 and 100 percent of the target offering amount on November 8), the issuer could consolidate such progress updates into one Form C-U, so long as the Form C-U discloses the most recent threshold that was met and the Form C-U is filed with the Commission and provided to investors and the relevant intermediary by the day on which the first progress update would be

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207 *See* RocketHub Letter 1 (also stating that if the Commission mandates the filing of status updates, it should not mandate a particular form of update).

208 *See* proposed Rule 203(a)(3) of Regulation Crowdfunding.

209 *Id.*

due.[210] The proposed rules also would require the intermediary to make these updates available to investors and potential investors through the intermediary's platform.[211]

We believe that this information would be important to investors by allowing them to gauge whether interest in the offer has increased gradually or whether it was concentrated at the beginning or at the end of the offering period. In addition, we believe that the final progress update would be necessary to inform investors of the total amount of securities sold by the issuer, especially in cases where an issuer may have sold more than the target offering amount. The proposed rules do not include an exemption from this requirement when progress updates are provided solely on the intermediary's platform. We believe that proposing to require that the progress updates be filed with the Commission would create a central repository for this information – information that otherwise might no longer be available on the intermediary's platform after the offering terminated. The progress updates filed with the Commission also would make data available that could be used to evaluate the effects of the Section 4(a)(6) exemption on capital formation.

Request for Comment

72. Views about what constitutes a "regular update" may vary, particularly when considering the length of the offering. Is the requirement to file an update when the issuer reaches one-half and 100 percent of the target offering amount appropriate? Is the proposed requirement to file a final update in offerings in which the issuer will accept proceeds in excess of the target offering amount appropriate? Why or why not? Should we require the progress updates to be

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210 *See* proposed Instruction 2 to paragraph (a)(3) of proposed Rule 203 of Regulation Crowdfunding.

211 *See* proposed Rule 303(a) of Regulation Crowdfunding and Section II.C.5.a below.

filed at different intervals (*e.g.*, one-third, two-thirds or some other intervals)? Why or why not? Alternatively, should the progress updates be filed after a certain amount of the offering time has elapsed (*e.g.*, weekly or monthly until the target or maximum is reached or until the offering closes)? Should the progress updates be based on reaching other milestones or on some other basis? If so, what milestones or other basis and why?

73. As proposed, issuers would have five business days from the time they reach the relevant threshold to file a progress update. Is this time period appropriate? Why or why not? If not, what would be an appropriate time period? Please explain. Should issuers be allowed to consolidate multiple progress updates into one Form C-U if multiple progress updates are triggered within a five-business-day period, as proposed? Why or why not?

74. Should issuers be required to certify that they have filed all the required progress updates prior to the close of the offering? Why or why not?

75. Should we exempt issuers from the requirement to file progress updates with the Commission as long as the intermediary publicly displays the progress of the issuer in meeting the target offering amount? Why or why not? If so, should the Commission establish standards about how prominent the display would need to be?

c. Amendments to the Offering Statement

We are proposing to require that an issuer amend its disclosure for any material change in the offer terms or disclosure previously provided to investors. The amended disclosure would be filed with the Commission on Form C, provided to investors and the relevant intermediary and

made available to potential investors.[212] The issuer would check the box for "Form C-A: Amendment" on the cover of the Form C and explain, in summary manner, the nature of the changes, additions or updates in the space provided. An issuer would determine whether changes in the offer terms or disclosure are material based on the facts and circumstances. Information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding whether or not to purchase the securities.[213] For example, we believe that a material change to financial condition or to the intended use of proceeds would require an amendment to an issuer's disclosure. Also, in those instances in which an issuer has previously disclosed only the method for determining the price, and not the final price, of the securities offered, we believe that determination of the final price would be considered a material change to the terms of the offer and would have to be disclosed. These are not, however, the only possible material changes that would require amended disclosure. In addition, as discussed further in Section II.C.6 below, if any change, addition or update constitutes a material change to information previously disclosed, the issuer shall check the box indicating that investors must reconfirm their investment commitments. Investors would have five business days to reconfirm their investment commitments, or the investment commitments would be cancelled.[214]

Issuers would be permitted, but not required, to amend the Form C to provide information with respect to other changes that are made to the information presented on the intermediary's platform and provided to investors and potential investors.[215] Issuers amending the Form C to

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212 *See* proposed Rule 203(a)(2) of Regulation Crowdfunding.

213 *See Basic Inc. v. Levinson*, 485 U.S. 224 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438 (1976)).

214 *See* proposed Rule 203(a)(2) of Regulation Crowdfunding.

215 *See* proposed Instruction to paragraph (a)(2) of proposed Rule 203 of Regulation Crowdfunding.

provide information that it considers not material would not check the box indicating that investors must reconfirm their investment commitments.

Request for Comment

76. Should we specify that an amendment to an offering statement must be filed within a certain time period after a material change occurs? Why or why not? What would be an appropriate time period for filing an amendment to an offering statement to reflect a material change? Why?

77. If an issuer amends its Form C, should the intermediary be required to notify investors? If so, should we specify the method of notification, such as via e-mail or other electronic means?

78. Should establishment of the final price be considered a material change that would always require an amendment to Form C and reconfirmation, as proposed? Would it be appropriate to require disclosure of the final price but not require reconfirmation? Should we consider any change to the information required by Section 4A(b)(1) to be a material change? Why or why not?

79. Should we require issuers to amend Form C to reflect all changes, additions or updates regardless of materiality so that the Form C filed with us would reflect all information provided to investors through the intermediary's platform? Why or why not?

2. Ongoing Reporting Requirements

Section 4A(b)(4) requires, "not less than annually, [the issuer to] file with the Commission and provide to investors reports of the results of operations and financial statements

of the issuer, as the Commission shall, by rule, determine appropriate, subject to such exceptions and termination dates as the Commission may establish, by rule."

One commenter suggested that the Commission should create a standardized form or template for this ongoing disclosure.[216] The same commenter suggested that this ongoing disclosure should be publicly available and shared with other regulators. Another commenter noted that the requirement to file reports not less than annually could be difficult to enforce and that it is unclear who would be responsible for enforcing the requirement.[217] The same commenter noted that this provision seems to presume the success of every business that raises capital through crowdfunding and questioned what would happen when an issuer goes out of business. One commenter suggested that financial statements included in an annual report should be required to be reviewed or audited only if the issuer's total assets exceeded a specified amount at the last day of the issuer's fiscal year.[218] One commenter suggested that annual reports should be required to be reviewed by a qualified accountant in good standing for at least five years.[219] Two commenters noted that compliance with the exemption would not be known at the time of the transaction if the annual reports are a condition to the exemption under Section 4(a)(6).[220] One commenter suggested that the Commission should require a failed business that

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216 *See* Commonwealth of Massachusetts Letter.

217 *See* Crowdfunding Offerings Ltd. Letter 5.

218 *See* ABA Letter 1 (suggesting that financial statements reviewed by an independent accountant be required only if the issuer's total assets as of the end of its fiscal year exceeded $300,000 and that audited financial statements be required only if the issuer's total assets exceeded $750,000 because (i) public reporting pursuant to Exchange Act Section 12(g) is based, in part, on an asset test and (ii) this would offer a reasonable predicate for balancing the relative costs to very small, early-stage issuers and the informational benefits to investors).

219 *See* Philipose Letter 2.

220 *See* Ohio Division of Securities Letter; Whitaker Letter (suggesting that the filing of the annual report should not be a condition to satisfying the exemption under Section 4(a)(6)).

issued securities pursuant to Section 4(a)(6) to file a final annual report, in the year of the failure, that provides final financial statements and discloses to investors the material reasons for the liquidation, dissolution, wind-down or bankruptcy.[221]

To implement the ongoing reporting requirement in Section 4A(b)(4), the proposed rules would require an issuer that sold securities in reliance on Section 4(a)(6) to file a report on EDGAR annually, no later than 120 days after the end of the most recent fiscal year covered by the report.[222] Although the statute provides that an "issuer who offers or sells securities" in reliance on Section 4(a)(6) shall provide ongoing reports, we do not believe the intent was to require ongoing reports from a company that has not completed a crowdfunding transaction and thus did not issue any securities.

To implement the statutory requirement that issuers provide the report to investors, we propose to require issuers to post the annual report on their websites.[223] We believe that investors in this type of Internet-based offering would be familiar with obtaining information on the Internet and that providing the information in this manner would be cost-effective for issuers. As discussed above, we believe Congress contemplated that crowdfunding would, by its very nature, occur over the Internet or other similar electronic media accessible to the public,[224] so we are not proposing to require issuers to provide physical copies of the report to investors. We also are not proposing to require issuers to provide a copy of the annual report, or refer investors to

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221 *See* Ohio Division of Securities Letter.

222 *See* proposed Rule 202(a) of Regulation Crowdfunding. *See also* proposed Rule 203(b) of Regulation Crowdfunding and proposed Instruction to paragraph (b)(1) thereof.

223 We are not proposing to require issuers to post the annual report on the intermediary's platform because issuers may not necessarily have an ongoing relationship with the intermediary following an offering. *See* discussion in Section II.C.4.b below.

224 *See* note 55.

the posting of the annual report, via e-mail because we believe that many issuers may not have e-mail addresses for the investors, especially after the shares issued pursuant to Section 4(a)(6) are traded by the original purchasers.[225] To the extent e-mail addresses for investors are available to issuers, an issuer could refer investors to the posting of the annual report via e-mail.

When filing the annual report with the Commission, an issuer would check the box for "Form C-AR: Annual Report" on the cover of the Form C. The issuer would be required to disclose information similar to the information required in the offering statement, including disclosure about its financial condition that meets the financial statement requirements that were applicable to its offering statement. The issuer also would be able to voluntarily provide financial statements that meet the requirements for a higher aggregate target offering amount than it was required to provide in its offering statement. If an issuer undertakes multiple offerings, which individually require different levels of financial statements, the issuer would be required to provide financial statements that meet the highest standard previously provided. We believe that investors who purchased on the basis of the higher level of financial statements should continue to receive that level of disclosure, and investors in other offerings of the issuer should receive the same information.[226] Although an issuer would not be required to provide the offering-specific information that it filed at the time of the offering (because the issuer will not

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225 We believe that in order for the issuer to have e-mail addresses for the investors, it would need to obtain those e-mail addresses from the intermediary, since it would be the intermediary that would collect that information when a potential investor opens an account. In order for the issuer to have e-mail addresses after the shares issued pursuant to Section 4(a)(6) are traded, an issuer would need to collect that information from each new investor in connection with any sale of the issuer's securities in a secondary market.

226 For example, if an issuer had previously completed an offering with a $200,000 target and an offering with a $700,000 target, the issuer would be required to provide audited financial statements rather than reviewed financial statements. This would be the case even if the $200,000 offering was conducted more recently than the $700,000 offering.

be offering or selling securities),[227] it would be required to disclose information about the company and its financial condition, as was required in connection with the offer and sale of the securities.[228] This should minimize the disclosure burden for issuers to the extent they would be able to use the offering materials as a basis to prepare the ongoing disclosure. Investors should benefit from receiving annual updates to the information they received when making the decision to invest in the issuer's securities, which should allow them to continue to be informed about issuer developments. Under the statute and the proposed rules, the securities will be freely tradable after one year and, therefore, this information also would benefit potential future holders of the issuer's securities and help them to make more informed investment decisions.

We are proposing to require issuers to file the annual report until one of the following events occurs: (1) the issuer becomes a reporting company required to file reports under Exchange Act Sections 13(a) or 15(d); (2) the issuer or another party purchases or repurchases all of the securities issued pursuant to Securities Act Section 4(a)(6), including any payment in full of debt securities or any complete redemption of redeemable securities; or (3) the issuer liquidates or dissolves its business in accordance with state law.[229] In these situations, we

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227 An issuer would not be required to provide information about: (1) the stated purpose and intended use of the proceeds of the offering; (2) the target offering amount and the deadline to reach the target offering amount; (3) whether the issuer will accept investments in excess of the target offering amount; (4) whether, in the event that the offer is oversubscribed, shares will be allocated on a pro-rata basis, first come-first served basis, or other basis; (5) the process to complete the transaction or cancel an investment commitment once the target amount is met; (6) the price to the public of the securities being offered; (7) the terms of the securities being offered; (8) the name, Commission file number and CRD number (as applicable) of the intermediary through which the offering is being conducted; and (9) the amount of compensation paid to the intermediary.

228 Issuers would be required to provide disclosure about its directors and officers, business, current number of employees, financial condition (including financial statements), capital structure, significant factors that make an investment in the issuer speculative or risky, material indebtedness and certain related-party transactions.

229 *See* proposed Rule 202(b) of Regulation Crowdfunding.

believe it is appropriate to terminate an issuer's reporting obligations because it will either be required by other provisions of the securities laws to provide investors with necessary information or it will no longer have investors. Any issuer terminating its annual reporting obligations would be required to file on EDGAR, within five business days from the date of the terminating event, a notice to investors and the Commission that it will no longer file and provide annual reports pursuant to the requirements of Regulation Crowdfunding.[230] The issuer would check the box for "Form C-TR: Termination of Reporting" on the cover of Form C.

Request for Comment

80. Should we require ongoing annual reports, as proposed? Why or why not? Should we require ongoing reporting more frequently than annually? Why or why not? If so, how often (*e.g.*, semi-annually or quarterly)?

81. Two commenters noted that compliance with the exemption would not be known at the time of the transaction if the annual reports are a condition to the exemption under Section 4(a)(6).[231] Should the requirement to provide ongoing annual reports be a condition to the exemption under Section 4(a)(6)? If so, for how long (*e.g.*, until the first annual report is filed, until the termination of an issuer's reporting obligations or some other period)? Please explain.

82. Should we require that the annual reports be provided to investors by posting the reports on the issuer's website and filing them on EDGAR, as proposed? Should we require issuers also to directly notify investors of the availability of the annual report, such as by e-mail or other electronic means? Should we

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230 *See* proposed Rule 203(b)(2) of Regulation Crowdfunding.

231 *See* Ohio Division of Securities Letter; Whitaker Letter.

instead require issuers to deliver the annual reports directly to investors? If so, should we specify the method of delivery (*e.g.*, e-mail or other electronic means, U.S. mail or some other method)? Would investors have an electronic relationship with the issuer after the offering terminates? If not, how would an issuer notify or deliver a copy of the annual report to the investor? Would issuers continue to have an ongoing relationship with intermediaries once the offering is completed? If so, should we also require that the issuer post its annual report on the intermediary's platform? Why or why not?

83. After completion of the offering, should we require that investors be represented by a nominee or other party who could help to facilitate physical delivery of the annual report to investors? Why or why not? Should the nominee or other party have other responsibilities, such as speaking on behalf of and representing the interests of investors (*e.g.*, when the issuer wishes to take certain corporate actions that could impact or dilute the rights of investors, distribution of dividend payments, etc.)? If a nominee or other party should be required, what structure should this arrangement take and why?

84. Are the proposed ongoing disclosure requirements appropriate? Why or why not? Should we modify or eliminate any of the proposed requirements?

85. Should the discussion of the issuer's financial condition address changes from prior periods? Why or why not? Should the number of years covered by the financial statements be the same as in the offering statement? Why or why not? If not, what should they be?

86. Should we require that reviewed or audited financial statements be provided only if the total assets of the issuer at the last day of its fiscal year exceeded a specified amount, as one commenter suggested?[232] Why or why not? If so, what level of total assets would be appropriate (*e.g.*, $1 million, $10 million, or some other amount)? Are there other criteria (other than total assets) that we should consider? Please explain.

87. The proposed rules would require any issuer terminating its annual reporting obligations to file on EDGAR, within five business days from the date of the terminating event, a notice to investors and the Commission that it will no longer file and provide annual reports. Is this approach appropriate? Why or why not? Should we require issuers to file the notice earlier (*e.g.*, within two business days of the event) or later (*e.g.*, within 10 business days of the event)? If so, what would be an appropriate amount of time after the event and why?

88. Should an issuer be able to terminate its annual reporting obligation in circumstances other than those provided in the proposed rules? For example, should an issuer be allowed to terminate its reporting obligation after filing a certain number of annual reports, as one commenter suggested,[233] so long as the issuer does not engage in additional transactions in reliance on Section 4(a)(6) (*e.g.*, after filing one annual report, two annual reports or some other number of annual reports)? Why or why not? If so, what would be an appropriate number of annual reports? Should all issuers be allowed to terminate their reporting

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232 *See* ABA Letter 1.

233 *See* Schwartz Letter.

obligations or only issuers that have not sold more than a certain amount of securities in reliance on Section 4(a)(6)? If so, what would be an appropriate amount of securities (*e.g.*, $100,000, $500,000, or some other amount)? Should an issuer be allowed to terminate its reporting obligation following the issuer's or another party's purchase or repurchase of a significant percentage of the securities issued in reliance on Section 4(a)(6) (including any payment of a significant percentage of debt securities or redemption of a significant percentage of redeemable securities), or receipt of consent to cease reporting from a specified percentage of the unaffiliated security holders? Why or why not? If so, what would be an appropriate percentage (greater than 50 percent, 75 percent or some other percentage)? Should an issuer be allowed to terminate its reporting obligation if the securities issued in reliance on Section 4(a)(6) are held by less than a specified number of holders of record, as suggested by a commenter?[234] Why or why not? If so, what would be an appropriate number of holders of record (less than 500, 300 or some other number)?

89. If an issuer files a petition for bankruptcy, what effect should that filing have on the issuer's reporting obligations? Please explain.

90. Should issuers be required to file reports to disclose the occurrence of material events on an ongoing basis? What events would be material and therefore require disclosure? Should we identify a list of material events that would

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[234] *See* ABA Letter 1.

trigger a report, similar to the list in Form 8-K[235] (such as changes in control, bankruptcy or receivership, material acquisitions or dispositions of assets, issuances of securities and changes to the rights of security holders)? Or should we require that all material events be reported without specifying any particular events? How many days after the occurrence of the material event should the issuer be required to file the report? Please explain.

91. We have the authority to include exceptions to the ongoing reporting requirements in Section 4A(b)(4). Should we consider excepting certain issuers from ongoing reporting obligations (*e.g.*, those raising a certain amount, such as $100,000 or less)? Should any exception always apply or only after a certain number of reports have been filed? Please explain.

3. Form C and Filing Requirements

Section 4A(b)(1) does not specify a format that issuers must use to present the required disclosures and file these disclosures with the Commission. Several commenters stated that the Commission should require the disclosure on a form modeled after, or require the use of NASAA's Small Company Offering Registration Form (U-7).[236] One commenter suggested using Form 1-A, which is used for securities offerings made pursuant to Regulation A,[237] as a

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235 17 CFR 249.308. Form 8-K is a report that public companies must file to announce major events that shareholders should know about on a more current basis. Form 8-K includes a specific list of the types of events that trigger a public company's obligation to file a current report, including matters relating to the company's business and operations, financial information, securities and trading markets, accountants and financial statements, corporate governance and management, asset-backed securities, exhibits and other matters that are not specifically called for by Form 8-K that the company considers to be of importance to security holders. Generally, a Form 8-K must be filed within four business days from the date of the event that triggered the report.

236 *See* Coan Letter; Liles Letter 1; Vim Funding Letter; NASAA Letter.

237 17 CFR 230.251 *et seq*.

model.[238] One commenter requested that we create a form for issuers that "simplifies the process and provides legal certainty for investors, intermediaries and issuers,"[239] while another commenter suggested that we adopt a "simple, uniform, easy-to-understand yet comprehensive template prospectus that is similar in principle to the mutual fund industry's summary prospectus."[240] Another commenter recommended that disclosure be simple, allow for standardization and take into account the size and stage of development of the issuer.[241] One commenter suggested we create a disclosure template that would allow issuers to complete certain fields by inserting the required disclosure.[242] Another commenter suggested we require a single offering document incorporating disclosures that intermediaries and issuers are required to make.[243]

We are proposing to require issuers to file the mandated disclosure on EDGAR using new Form C.[244] As proposed, Form C would require certain disclosures to be presented in a specified format, while allowing the issuer to customize the presentation of other disclosures required by Section 4A(b)(1) and the related rules. This approach should provide key offering information in

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238 *See* Commonwealth of Massachusetts Letter.

239 CFIRA Letter 2.

240 The Motley Fool Letter.

241 *See* 2012 SEC Government-Business Forum, note 29.

242 *See* ABA Letter 1.

243 *See* Ohio Division of Securities Letter.

244 An issuer that does not already have EDGAR filing codes, and to which the Commission has not previously assigned a user identification number, which we call a "Central Index Key (CIK)" code, would need to obtain the codes by filing electronically a Form ID [17 CFR 239.63; 249.446; 269.7 and 274.402] at https://www.filermanagement.edgarfiling.sec.gov. The applicant also would be required to submit a notarized authenticating document as a Portable Document Format (PDF) attachment to the electronic filing. The authenticating document would need to be manually signed by the applicant over the applicant's typed signature, include the information contained in the Form ID and confirm the authenticity of the Form ID. *See* 17 CFR 232.10(b)(2).

a standardized format and give issuers flexibility in the presentation of other required disclosures. We believe this flexibility is important given that we expect that issuers engaged in crowdfunding transactions in reliance on Section 4(a)(6) would encompass a wide variety of industries at different stages of business development.

We propose to require issuers to use an XML-based fillable form to input certain information.[245] This XML-based fillable form would support the assembly and transmission of those required disclosures to EDGAR on Form C.[246] It also would help the Commission to collect certain key information about each offering to monitor the implementation of the crowdfunding exemption under Section 4(a)(6). For example, the Commission could monitor the types of issuers using the exemption, including the issuers' size, location, securities offered and offering amounts and the intermediaries through which the offerings are taking place. Monitoring the implementation of the crowdfunding exemption also would give the Commission more information to evaluate whether the rules include appropriate investor protections and facilitate capital formation. Issuers could customize the presentation of the rest of their disclosures and file those disclosures as exhibits to the Form C. For example, an issuer could provide the required disclosures by uploading to EDGAR, as an exhibit to Form C, a text version

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245 *See* proposed Instruction to paragraph (a)(1) of proposed Rule 203 of Regulation Crowdfunding. Issuers would input in the proposed XML-based filing the following information: name, legal status and contact information of the issuer; name, Commission file number and CRD number (as applicable) of the intermediary through which the offering will be conducted; the amount of compensation paid to the intermediary to conduct the offering, including the amount of referral and other fees associated with the offering; type of security offered; number of securities offered; offering price; target offering amount and maximum offering amount (if different from the target offering amount); whether oversubscriptions will be accepted and, if so, how they will be allocated; deadline to reach the target offering amount; current number of employees of the issuer; and selected financial data for the prior two fiscal years.

246 The Commission would disseminate the information in a format that provides normal text for reading and XML-tagged data for analysis. Currently the Commission's OnlineForms website (https://www.onlineforms.edgarfiling.sec.gov) supports the assembly and transmission of XML filings required by Exchange Act Section 16 (15 U.S.C. 78p).

of the relevant information presented on the intermediary's platform, including a transcript of any video presentation and a description of any charts or graphs.

Under the proposed rules, Form C would be used for all of an issuer's filings with the Commission.[247] The issuer would check one of the following boxes on the cover of the Form C to indicate the purpose of the Form C filing:

- "Form C: Offering Statement" for issuers filing the initial disclosures required for an offering made in reliance on Section 4(a)(6);
- "Form C-A: Amendment" for issuers seeking to amend a previously-filed Form C for an offering;
- "Form C-U: Progress Update" for issuers filing a progress update required by Section 4A(b)(1)(H) and the related rules;
- "Form C-AR: Annual Report" for issuers filing the annual report required by Section 4A(b)(4) and the related rules; and
- "Form C-TR: Termination of Reporting" for issuers terminating their reporting obligations pursuant to Section 4A(b)(4) and the related rules.

We believe that the use of one form would be more efficient than requiring multiple forms and would simplify the filing process for issuers and their preparers. EDGAR would automatically provide each filing with an appropriate tag depending on which box the issuer checks so that investors could distinguish between the different filings.[248]

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247 *See* proposed Rule 203 of Regulation Crowdfunding.

248 EDGAR would tag the offering statement as "Form C," any amendments to the offering statement as "Form C-A," progress updates as "Form C-U," annual reports as "Form C-AR" and termination reports as "Form C-TR."

Section 4A(b)(1) requires issuers to file the offering information with the Commission, provide it to investors and the relevant intermediary and make it available to potential investors.[249] Under the proposed rules, issuers would satisfy the requirement to file the information with the Commission by filing the Form C: Offering Statement, including any amendments and progress updates, on EDGAR. To satisfy the requirement to provide the disclosures to the relevant intermediary, we propose that issuers provide to the relevant intermediary a copy of the disclosures filed with the Commission on EDGAR.[250] To satisfy the requirement to provide the disclosures to investors and make them available to potential investors, we propose that issuers provide the information to investors electronically by referring investors to the information on the intermediary's platform.[251] Issuers could refer investors through a posting on the issuer's website or by e-mail.[252] We believe that investors in this type of Internet-based offering would be familiar with obtaining information on the Internet and that providing the information in this manner would be cost-effective for issuers. As discussed above, we believe Congress contemplated that crowdfunding would, by its very nature, occur over the Internet or other similar electronic medium that is accessible to the public,[253] so we are not proposing to require issuers to provide physical copies of the information to investors. We

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249 Section 4A(b)(4) requires issuers to file with the Commission and provide to investors, not less than annually, reports of the results of operations and financial statements of the issuer. As discussed above in Section II.B.2, to satisfy this requirement, the proposed rules would require an issuer to post the annual report on its website and file it on EDGAR. *See* proposed Rule 202(a) of Regulation Crowdfunding.

250 *See* proposed Instruction 1 to paragraph (a) of proposed Rule 203 of Regulation Crowdfunding. We anticipate that issuers seeking to engage in an offering in reliance on Section 4(a)(6) may likely work with an intermediary to prepare the disclosure that would be provided on the intermediary's platform and filed on EDGAR. In some cases, intermediaries may offer, as part of their service, to file the disclosure on EDGAR on behalf of the issuer.

251 *See* proposed Instruction 2 to paragraph (a) of proposed Rule 203 of Regulation Crowdfunding.

252 *Id.*

253 *See* note 55.

propose to allow issuers to refer investors to the information on the intermediary's platform through a posting on the issuer website or by e-mail, rather than requiring e-mail, because we believe that many issuers may not have e-mail addresses for investors.[254]

Request for Comment

92. Should we require a specific format that issuers must use to disclose the information required by Section 4A(b)(1) and the related rules?

93. Should issuers be required to file the Form C with the Commission in electronic format only, as proposed? Alternatively, should we permit issuers to file the Form C in paper format? What are the relative costs and benefits of permitting the filing of the Form C in paper format? Should issuers be precluded from relying on the hardship exemptions in Rules 201 and 202 of Regulation S-T?[255] Why or why not?

94. In what format would the information about an issuer be presented on an intermediary's platform? Will there be written text, graphics, charts or graphs, or video testimonials by the founder or other key stakeholders? Will the information be presented in a way that would allow for the filing of the information as an exhibit to Form C on EDGAR? If not, how should the rules address these types of materials?

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254 *See* note 225. To the extent that intermediaries have the e-mail addresses of investors and potential investors (*e.g.*, as a result of investors and potential investors opening an account with the intermediary), intermediaries could provide an issuer's disclosures to investors and potential investors through e-mail.

255 17 CFR 232.201 and 232.202. These hardship exemptions allow filers, under certain conditions, to submit their filings and exhibits in paper form instead of electronically.

95. Should we require different forms for each type of required filing? Would the use of one form with different EDGAR tags for each type of filing create confusion among investors who review the issuer's filings? Would it create confusion for issuers that are filing the forms? Please explain.

96. Should we allow issuers to refer investors and potential investors to the information on the intermediary's platform? Are the proposed methods (website posting or e-mail) to refer investors effective and appropriate? Would issuers have access to the investors' e-mail addresses? Are there other methods we should consider? If so, what methods and why?

4. Prohibition on Advertising Terms of the Offering

Section 4A(b)(2) provides that an issuer shall "not advertise the terms of the offering, except for notices which direct investors to the funding portal or broker." We received a number of comments regarding this provision. One commenter stated that the inability to market an offering will prevent startups from reaching their desired goal.[256] One commenter suggested that we should allow issuers unrestricted use of advertising, both on the Internet and through conventional forms of advertising.[257] Another commenter suggested that communications between the issuer and investors should be limited to communication channels controlled by the intermediary and that direct communications between an issuer and investors should be discouraged.[258] Another commenter stated that it is unclear what constitutes a notice for these purposes and that issuers should be able to promote their offerings as long as investors register

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256 *See* VTNGLOBAL Letter.

257 *See* Loofbourrow Letter.

258 *See* CommunityLeader Letter.

with the intermediary and participate in the offering through that intermediary.[259] Another commenter suggested that issuers should be able to promote their offerings through "their own platforms" as long as all such notices include a link directly to the registered intermediary.[260] One commenter suggested that an issuer should be permitted to place a notice consisting of the basic terms of the offering on the issuer's website or at its place of business.[261] Alternatively, the commenter suggested an issuer should be permitted to include such notice in correspondence to its customers or mailing list subscribers.[262]

Another commenter stated that the advertising prohibition should not be read to restrict notices that: (1) alert the public to the issuer's project or company; (2) state that the public may participate in the fundraising; or (3) direct the public to the funding platform.[263] Another commenter suggested notices should be allowed to include: (1) the type of security being offered; (2) the offering amount; (3) the opening and closing date of the offering; and (4) the issuer's line of business or whether the offering will fund a new line of business.[264] One commenter suggested that, given the limitations on the number of characters allowed by some social media sites, we should allow notices that do not require lengthy legends or disclosure.[265] Another commenter suggested that we define the term "advertising" and provide a model form

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259 *See* Crowdfunding Offerings Ltd. Letter 5.

260 *See* CFIRA Letter 2.

261 *See* NCA Letter (stating that the Commission should clarify whether the rules will permit notices to state the offering period, whether investors may contact the issuer's management to discuss the offering or whether the notices may include names of accredited investors participating in the offering).

262 *Id.*

263 *See* RocketHub Letter 1.

264 *See* NSBA Letter.

265 *See* CFIRA Letter 1 (providing examples of notices varying in length from zero to 1,500 characters).

that can be used by issuers to direct investors to the intermediary.[266] Another commenter suggested that we require issuers to file all advertising and other materials that the issuers create relating to offerings made in reliance on Section 4(a)(6).[267] One commenter suggested that we allow advertising of non-financial elements of a transaction in the case of offerings conducted through an intermediary that is a community development financial institution.[268]

Under the proposed rules, an issuer could publish a notice advertising the terms of an offering in reliance on Section 4(a)(6), provided that the notice includes the address of the intermediary's platform on which additional information about the issuer and the offering may be found.[269] Consistent with Section 4A(b)(2), an issuer would not otherwise be permitted to advertise, directly or indirectly, the terms of an offering made in reliance on Section 4(a)(6). While we understand the importance that potential issuers likely will place on the ability to advertise, the statute specifically restricts the ability of issuers to advertise the terms of offerings made in reliance on Section 4(a)(6). Limiting the advertising of the terms of the offering to the information permitted in the notice is intended to direct investors to the intermediary's platform and to make investment decisions with access to the disclosures necessary for them to make informed investment decisions.

The proposed rules would allow notices advertising the terms of the offering to include no more than the following: (1) a statement that the issuer is conducting an offering, the name of the intermediary through which the offering is being conducted and a link directing the potential

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266 *See* CompTIA Letter.

267 *See* Commonwealth of Massachusetts Letter.

268 *See* City First Letter.

269 *See* proposed Rule 204 of Regulation Crowdfunding.

investor to the intermediary's platform; (2) the terms of the offering; and (3) factual information about the legal identity and business location of the issuer, limited to the name of the issuer of the security, the address, phone number and website of the issuer, the e-mail address of a representative of the issuer and a brief description of the business of the issuer.[270] Under the proposed rules, "terms of the offering" would include: (1) the amount of securities offered; (2) the nature of the securities; (3) the price of the securities; and (4) the closing date of the offering period.[271]

The permitted notices would be similar to the "tombstone ads" permitted under Securities Act Rule 134,[272] except that the notices would be required to direct investors to the intermediary's platform through which the offering is being conducted,[273] such as by including a link directing the potential investor to the platform.[274] We are not proposing to impose limitations on how the issuer distributes the notices. For example, issuers could place notices in newspapers or could post notices on social media sites. We believe this approach would allow issuers to leverage social media to attract potential investors, while at the same time protecting potential investors by limiting the ability of issuers to advertise the terms of the offering without providing the required disclosures.

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270 *See* proposed Rule 204(b) of Regulation Crowdfunding. While notices would not be required to include all of this information, they would be required to, at a minimum, direct investors and potential investors to the intermediary's platform on which additional information about the issuer and the offering may be found. *See* proposed Rule 204(a) of Regulation Crowdfunding.

271 *See* proposed Instruction to proposed Rule 204 of Regulation Crowdfunding.

272 17 CFR 230.134.

273 *See* proposed Rule 204(a) of Regulation Crowdfunding.

274 *See* proposed Rule 204(b)(1) of Regulation Crowdfunding.

The proposed rules also would allow an issuer to communicate with investors and potential investors about the terms of the offering through communication channels provided by the intermediary on the intermediary's platform, so long as the issuer identifies itself as the issuer in all communications. We believe that one of the central tenets of the concept of crowdfunding is that the members of the crowd decide whether or not to fund an idea or business after sharing information with each other. As part of those communications, we believe it is important for the issuer to be able to respond to questions about the terms of the offering or even challenge or refute statements made through the communication channels provided by the intermediary. Therefore, we have not proposed to restrict issuers from participating in those communications.

The proposed rules would not restrict an issuer's ability to communicate other information that does not refer to the terms of the offering. We believe that this is consistent with the statute because Section 4A(b)(2) only appears to impose a restriction on the advertising of the terms of the offer. To prohibit communications that do not refer to the terms of the offering would place a greater burden on issuers relying on Section 4(a)(6) than on issuers in registered offerings. For example, Securities Act Rule 169[275] permits non-Exchange Act reporting issuers engaged in an initial public offering to continue to publish, subject to certain exclusions and conditions, regularly released factual business information that is intended for use by persons other than in their capacity as investors or potential investors.[276] We believe that permitting issuers to continue to engage in communications that do not refer to the terms of the offering during the pendency of offering made in reliance on Section 4(a)(6) would increase the

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275 17 CFR 230.169.

276 *Id. See also Securities Offering Reform*, Release No. 33-8591 (July 19, 2005) [70 FR 44722 (Aug. 3, 2005)].

likelihood of the success of an issuer's business because the issuer could continue to advertise its products or services, so long as it does so without discussing the terms of the offering.

Request for Comment

97. Should we require issuers to file with the Commission or provide to the intermediary a copy of any notice directing investors to the intermediary's platform? Why or why not?

98. The proposed rules would define "terms of the offering" to include: (1) the amount of securities offered; (2) the nature of the securities; (3) the price of the securities; and (4) the closing date of the offering period. Is this definition appropriate? Why or why not? Should the definition be modified to eliminate or include other items? If so, which ones and why? Should we provide further guidance as to the meaning of "terms of the offering?" Please explain.

99. Should we restrict the media that may be used for the advertising of notices (*e.g.*, prohibit advertising via television, radio or phone calls)? If so, why and what media should we restrict? What media should we permit? Please explain.

100. Should we require a specific format for issuer notices? Should we provide examples of notices that would comply with the requirements?

101. Should we further restrict or specify the information that could be included in a notice of the offering? If so, how and why? Is the information that we have proposed to permit in notices sufficient to inform potential investors of an offering? Should we permit the issuer to include any additional information in the notice if, for example, the offering aims to promote a particular social cause, such as driving economic growth in underinvested communities, as one

commenter suggested?[277] If so, what information and why? Should we allow any additional information to be included in the notices for all offerings made in reliance on Section 4(a)(6)? Please explain. Should we impose restrictions on the timing or frequency of notices? Why or why not? If so, what restrictions would be appropriate?

102. Should we limit the issuer's participation in communication channels provided by the intermediary on the intermediary's platform? Why or why not? If so, what limitations would be appropriate?

103. The proposed rules would allow an issuer to communicate with investors and potential investors about the terms of an offering through communication channels provided by the intermediary on the intermediary's platform, so long as the issuer identifies itself as the issuer in all communications. Is this approach appropriate? Why or why not? If not, why not?

104. The proposed rules would not restrict an issuer's ability to communicate information that does not refer to the terms of the offering. Is this approach appropriate? Why or why not? If not, what limitations should we include on an issuer's communications that do not refer to the terms of the offering and why?

5. Compensation of Persons Promoting the Offering

Section 4A(b)(3) provides that an issuer shall "not compensate or commit to compensate, directly or indirectly, any person to promote its offerings through communication channels provided by a broker or funding portal, without taking such steps as the Commission shall, by

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[277] *See* City First Letter.

rule, require to ensure that such person clearly discloses the receipt, past or prospective, of such compensation, upon each instance of such promotional communication."

We received comments offering varying views on this provision. One commenter noted that it is unclear precisely what this provision attempts to prohibit or protect against.[278] Another commenter suggested the rules should distinguish between an issuer hiring an individual or entity for promotion, where investors may not be aware of the commercial relationship between the parties, and more standard web-based advertising, including through search engines or trending topics.[279] This commenter suggested that we should not adopt rules that may interfere with promotional compensation, but rather, we should require simple disclosure of a commercial relationship when it would not otherwise be apparent. One commenter suggested that the rules should provide that a clear statement of the compensation amount paid to promoters (or a formula for determining the same) in the disclosure document would satisfy this disclosure obligation.[280] Another commenter suggested that if the issuer will use any promoters in connection with the offering, the issuer should identify the promoters and disclose the amount and structure of promoter compensation.[281]

Consistent with the statute, the proposed rules[282] would prohibit an issuer from compensating, or committing to compensate, directly or indirectly, any person to promote the

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278 *See* Crowdfunding Offerings Ltd. Letter 5 (asking a number of questions about what constitutes direct or indirect compensation, whether it is acceptable to promote offerings if no compensation is paid and whether the provision covers third parties who may have an interest in the offering and who pay for the promotion).

279 *See* RocketHub Letter 1.

280 *See* Schwartz Letter.

281 *See* Commonwealth of Massachusetts Letter.

282 *See* proposed Rule 205 of Regulation Crowdfunding. *See also* proposed Rule 303(c)(4) and the discussion in Section II.C.5.c below for requirements on intermediaries as they relate to disclosure in intermediary-provided communication channels of certain compensation and promotional activities.

issuer's offering through communication channels provided by the intermediary unless the issuer takes reasonable steps to ensure that the person clearly discloses the receipt (both past and prospective) of compensation each time the person makes a promotional communication.[283] In this regard, we anticipate that an issuer could, for example, contractually require any promoter to include the required statement about receipt of compensation, confirm that the promoter is adhering to the intermediary's terms of use that require promoters to affirm whether or not they are compensated by the issuer, monitor communications made by such persons and take the necessary steps to have any communications that do not have the required statement removed promptly from the communication channels, or retain a person specifically identified by the intermediary to promote all issuers on its platform. We anticipate that communication channels provided by the intermediary would provide a forum through which potential investors could share information to help the members of the crowd decide whether or not to fund the issuer.

We believe that it would be important for potential investors to know whether persons using these communication channels are the issuer, persons acting on behalf of the issuer or persons receiving compensation from the issuer to promote the issuer's offering because of the potential for self-interest or bias in communications by these persons. As such, the proposed rules would apply broadly to persons acting on behalf of the issuer, regardless of whether or not

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283 The receipt of transaction-based compensation in connection with the offer and sale of a security could cause a person to be a broker required to register with us under Exchange Act Section 15(a)(1) [15 U.S.C. 78*o*(a)(1)]. Issuers also would need to consider the application of Securities Act Section 17(b) [15 U.S.C. 77q] to these activities. Section 17(b) provides that "[i]t shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof."

they are compensated or they receive compensation specifically for the promotional activities. For example, the proposed rules would apply to persons hired specifically to promote the offering, as well as to individuals who are otherwise employed by the issuer or who undertake promotional activities on behalf of the issuer. A founder or an employee of the issuer who engages in promotional activities on behalf of the issuer through the communication channels provided by the intermediary would be required to disclose, with each posting, that he or she is engaging in those activities on behalf of the issuer.

The proposed rules also would specify that the issuer shall not compensate or commit to compensate, directly or indirectly, any person to promote its offerings outside of the communication channels provided by the intermediary, unless the promotion is limited to notices that comply with the advertising rules discussed above in Section II.B.4.[284] This prohibition should prevent issuers from circumventing the restrictions on advertising by compensating a third party to do what the issuer cannot do directly.

Request for Comment

105. The proposed rules would prohibit an issuer from compensating or committing to compensate, directly or indirectly, any person to promote its offering outside of the communication channels provided by the intermediary, unless the promotion is limited to notices that direct investors to the intermediary's platform. Is this approach appropriate? Why or why not?
106. The proposed rules would require issuers to take reasonable steps to ensure that persons promoting the issuer's offering through communication channels

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284 *See* proposed Rule 205(b) of Regulation Crowdfunding.

provided by the intermediary disclose the receipt (both past and prospective) of direct or indirect compensation each time they make a promotional communication. Is this an appropriate approach to the statutory requirement for issuers to ensure that promoters make the required disclosures? If not, what standard should we apply and why?

107. Should we require that any person who receives compensation from the issuer to promote an issuer's offering through communication channels provided by the intermediary register with, or otherwise provide notice to, the intermediary? If so, should we require that person to disclose the amount of the compensation and the structure of the compensation arrangement to the intermediary? Why or why not? If so, what would be the purpose of such a requirement?

108. Should the issuer provide disclosure of any person who receives compensation from the issuer to promote an issuer's offering? Why or why not?

6. Other Issuer Requirements

Some commenters addressed issues relating to oversubscriptions, the offering price, the type of securities that may be offered and how those securities should be valued.[285]

a. Oversubscriptions

Two commenters suggested that we should permit an issuer to raise capital in excess of the target offering amount, subject to certain conditions.[286] The proposed rules would not limit

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285 Securities Act Section 4A(b)(5) states that issuers shall "comply with such other requirements as the Commission may, by rule, prescribe, for the protection of investors and in the public interest."

286 *See* ABA Letter 1 (stating that if the maximum amount exceeds the target offering amount, the issuer should be required to disclose: (1) the maximum amount that it could raise; (2) the total amount of securities that would be issued should the maximum amount be raised; (3) the anticipated use of proceeds should the maximum amount be raised; and (4) financial statements that would have been required had the

an issuer's ability to accept investments in excess of the target offering amount, subject to the $1 million annual limitation.[287] Issuers, however, would be required to provide disclosure to investors concerning this possibility.[288] Some commenters suggested that the rules require a defined range for permissible oversubscriptions.[289] We believe, however, that limits on oversubscriptions are not necessary if an issuer discloses how much it would be willing to accept in oversubscriptions, how the oversubscriptions would be allocated and the intended purpose of those additional funds.[290] We believe that this approach would provide investors, prior to the sale, with useful information to make an informed investment decision about an issuer that is seeking investments in excess of the target offering amount.

Request for Comment

109. Should we require that oversubscribed investments be allocated using a pro-rata, first-come, first-served or other method, rather than leaving that decision up to the issuer? Please explain.

110. Should we limit the maximum oversubscription amount to a certain percentage of the target offering amount? If so, what should the limit be and why?

111. Should we allow issuers to accept commitments in excess of the $1 million limitation so that if an investor withdraws his or her investment commitment

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target offering amount been equal to the maximum amount); Hutchens Letter (stating that issuers should be allowed to raise capital in excess of the target offering amount so long as the amount raised does not fall within a higher tier of financial statement requirements).

287 *See* proposed Rule 201(h) of Regulation Crowdfunding.

288 *Id.* Issuers also would need to allow investors to cancel the commitment to purchase the securities in the same way as it would have done had it not accepted oversubscriptions. *See* Section II.C.6 below for a discussion of the right to cancel the purchase commitment.

289 *See* RocketHub Letter 1; CFIRA Letter 5; Hutchens Letter.

290 *See* Section II.B.1.a.i(d) above for a discussion of the disclosure requirements if the issuer will accept investments in excess of the target offering amount.

prior to the closing of the offering, the issuer would still be able to raise $1 million? If so, should we require that investments in excess of $1 million be allocated using a pro-rata, first-come, first-served or other method, or should we leave that decision up to the issuer? Please explain.

b. Offering Price

One commenter suggested that the Commission should require issuers to set a fixed price for the offering and prohibit any dynamic pricing (*e.g.*, pricing per share that increases with the passage of time) because dynamic pricing schemes may apply time pressure on the investment decision.[291] We are not proposing to require issuers to set a fixed price or prohibit dynamic pricing because we believe that the statute contemplated flexible pricing by providing that issuers may disclose the method for determining the price provided that the final price and required disclosures are provided to each investor prior to the sale. We also believe that the proposed cancellation rights would address the concerns about time pressure on the investment decision because investors would have a reasonable opportunity to cancel the investment commitment after the price is fixed.[292]

Request for Comment

112. Should we require issuers to set a fixed price at the commencement of an offering or prohibit dynamic pricing? Why or why not?

c. Types of Securities Offered and Valuation

We received comments about the types of securities that could be offered and the valuation of securities offered. One commenter suggested that the Commission should not

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[291] *See* Spinrad Letter 1.

[292] *See* Section II.C.6 below for a discussion of cancellation rights.

prescribe eligible types of securities because markets and securities may evolve.[293] Instead, the commenter urged the Commission to set forth minimum disclosure requirements for issuers and intermediaries to use when communicating the price and structure of offered securities. Another commenter suggested that the Commission require issuers to disclose their valuation and the factors they considered when determining such valuation.[294] Another commenter suggested that the Commission should prescribe a maximum valuation and ban certain dilution practices.[295] Another commenter suggested that if an offering exceeds certain valuation limitations (based, for instance, on company financial ratios), then the Commission should require that the shares held by company insiders be subject to a lock-up that would terminate after a period of time or after the company meets certain financial benchmarks.[296] Another commenter indicated that there are significant costs to properly ascertaining future valuations and that such a requirement could only be applied to corporations.[297]

The proposed rules would neither limit the type of securities that may be offered in reliance on Section 4(a)(6) nor prescribe a method for valuing the securities. In this regard, we note that the statute refers to "securities" and does not limit the types of securities that could be offered pursuant to the exemption. In addition, the statute does not require the use of a specific

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293 *See* RocketHub Letter 1.

294 *See* Sjogren Letter.

295 *See* The Motley Fool Letter (stating that the Commission should specify a maximum valuation for issuers, perhaps at two, five, or 10 times the aggregate issue limit and should implement a rule to protect investors from issuers that might sell a special class of shares to the crowdfunding public that they eventually dilute in future offerings).

296 *See* Commonwealth of Massachusetts Letter (stating that the Commission should require disclosure about the risks of buying securities of an early-stage company at a high valuation).

297 *See* CrowdFund Connect Letter (stating that the Commission should clarify that an issuer would satisfy the requirement to describe how the securities being offered are being valued by providing an operating and management statement that clearly defines capital distributions).

valuation method or ban any dilution practices. Issuers would be required to describe the terms of the securities and the valuation method in their offering materials.[298] We believe this approach is consistent with the statute and will provide flexibility to issuers to determine the types of securities that they offer to investors and how those securities are valued, while providing investors with the information they need to make an informed investment decision.

The proposed rules do not limit the types of securities that may be offered in reliance on Section 4(a)(6), and thus, debt securities may be offered and sold in crowdfunding transactions. In general, the issuance of a debt security raises questions about the applicability of the Trust Indenture Act of 1939 ("Trust Indenture Act").[299] The Trust Indenture Act applies to any debt security sold through the use of the mails or interstate commerce, including debt securities sold in transactions that are exempt from Securities Act registration. A debt security sold in reliance on Section 4(a)(6) would need to be issued under a qualified indenture[300] or under an indenture that is exempt from qualification.[301] The Trust Indenture Act and related rules provide exemptions in some circumstances. For example, Trust Indenture Act Section 304(b) provides an exemption for any transaction that is exempted from the provisions of Securities Act Section 5 by Section 4 thereof.[302] We believe an issuer offering debt securities in reliance on Section 4(a)(6) would be able to rely on this exemption.[303] Based on the availability of this

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298 *See* proposed Rule 201(m) of Regulation Crowdfunding.

299 15 U.S.C. 77aaa *et seq*.

300 *See* Trust Indenture Act Section 309 [15 U.S.C. 77iii].

301 *See* Trust Indenture Act Section 304 [15 U.S.C. 77ddd].

302 15 U.S.C. 77ddd(b).

303 Trust Indenture Act Section 304(a)(8) [15 U.S.C. 77ddd(a)(8)] and Rule 4a-1 [17 CFR 260.4a-1] also provide an exemption to issue up to $5 million of debt securities without an indenture in any 12-month period.

exemption from the requirements of the Trust Indenture Act, we are not proposing a specific exemption from the requirements of the Trust Indenture Act for offerings of debt securities made in reliance on Section 4(a)(6).

Request for Comment

113. Should we limit the types of securities that may be offered and sold in reliance on Section 4(a)(6) (*e.g.,* should the exemption be limited to offers and sales of equity securities)? If so, to what securities should crowdfunding be limited and why? Should we create a separate exemption for certain types of offerings of limited types of securities, as one commenter proposed?[304]

114. Is it anticipated that issuers may want to conduct crowdfunding offerings of securities under Section 4(a)(6) alongside non-securities-based crowdfunding, such as a crowdfunding campaign for donations or rewards? If so, please describe how these offerings may be structured. Are there any issues in particular that our rules should address in the context of such simultaneous crowdfunding offerings? Please explain.

115. Should we require or prohibit a specific valuation methodology? If so, what method and why? Should we specify a maximum valuation allowed as suggested by one commenter?[305] Why or why not?

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304 *See* City First Letter.

305 *See* The Motley Fool Letter.

C. Requirements on Intermediaries

1. Brokers and Funding Portals

Securities Act Section 4(a)(6)(C) requires a crowdfunding transaction to be conducted through a broker or funding portal that complies with the requirements of Securities Act Section 4A(a). The term "broker" is generally defined in Exchange Act Section 3(a)(4) as any person that effects transactions in securities for the account of others. Exchange Act Section 3(a)(80),[306] as added by Section 304 of the JOBS Act, defines the term "funding portal" as any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to Securities Act Section 4(a)(6), that does not: (1) offer investment advice or recommendations; (2) solicit purchases, sales or offers to buy the securities offered or displayed on its platform or portal; (3) compensate employees, agents or other person for such solicitation or based on the sale of securities displayed or referenced on its platform or portal; (4) hold, manage, possess or otherwise handle investor funds or securities; or (5) engage in such other activities as the Commission, by rule, determines appropriate.

Because a funding portal would be engaged in the business of effecting securities transactions for the accounts of others through crowdfunding, it would meet the Exchange Act definition of broker.[307] The proposed rules would define "funding portal" consistent with the statutory definition of "funding portal," substituting the word "broker" for the word "person,"[308] to state explicitly and make clear that funding portals are brokers under the federal securities laws. We are not proposing at this time to exercise our discretion under Section 3(a)(80)(E) to

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306 The JOBS Act inadvertently created two Sections 3(a)(80) in the Exchange Act, the other being the definition of "emerging growth company" (added by Section 101(b) of Title I of the JOBS Act).

307 *See* discussion in Section II.D.2 below.

308 *See* proposed Rule 300(c)(2) of Regulation Crowdfunding.

prohibit any activities in which a funding portal may engage, other than those identified in the statute.[309]

The proposed rules would not only apply to funding portals, but also to their associated persons in many instances. The proposed rules would define the term "person associated with a funding portal or associated person of a funding portal" to mean any partner, officer, director or manager of a funding portal (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling or controlled by a funding portal, or any employee of a funding portal, but would exclude any persons whose functions are solely clerical or ministerial.[310] The rules would provide, however, that excluded persons nevertheless would be subject to our authority under Exchange Act Sections 15(b)(4) and 15(b)(6) because they are associated with a broker.[311] This definition is consistent with, and modeled on, the definition of "person associated with a broker or dealer or associated person of a broker or dealer" under Exchange Act Section 3(a)(18).[312]

Request for Comment

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309 In proposing Regulation Crowdfunding, we propose requirements that are tailored to the limited brokerage activities in which funding portals may engage. Even where requirements proposed for funding portals are the same as those imposed on brokers, such as the AML requirements discussed in Section II.D.4 below, due to the limited nature of funding portals' activities, the compliance burden on funding portals should be less extensive than those applicable to full service brokers under the existing regulatory regime for broker-dealers.

310 *See* proposed Rule 300(c)(1) of Regulation Crowdfunding.

311 Exchange Act Section 15(b)(4) (15 U.S.C. 78*o*(b)(4)) authorizes the Commission to bring administrative proceedings against a broker when the broker violates the federal securities laws (and for other misconduct) and provides for the imposition of sanctions, up to and including the revocation of a broker's registration. Exchange Act Section 15(b)(6) (15 U.S.C. 78*o*(b)(6)) provides similar enforcement authority against the persons associated with a broker, including barring persons from associating with any Commission registrant. *See* note 559.

312 15 U.S.C. 78c(a)(18).

116. Are there other funding portal activities, other than those in Exchange Act Section 3(a)(80), that we should prohibit? If so, which activities and why? Are there any prohibitions that should be modified or removed? If so, which ones and why?

117. Do we need to provide further guidance concerning which provisions of the Exchange Act and the rules and regulations thereunder would apply to funding portals? If so, what further guidance is necessary and why?

2. Requirements and Prohibitions

a. Registration and SRO Membership

Securities Act Section 4A(a)(1) requires that a person acting as an intermediary in a crowdfunding transaction register with the Commission as a broker or as a funding portal. The proposed rules would implement this requirement by providing that a person acting as an intermediary in a transaction involving the offer or sale of securities made in reliance on Section 4(a)(6) must be registered with the Commission as a broker under Exchange Act Section 15(b) or as a funding portal pursuant to Securities Act Section 4A(a)(1) and proposed Rule 400 of Regulation Crowdfunding.[313]

One commenter requested transparency in the registration process, stating that intermediaries' completed registration materials should be accessible to the public.[314] Brokers currently register with the Commission using Form BD. Information on that form regarding the

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313 *See* proposed Rule 300(a)(1) of Regulation Crowdfunding.

314 *See* Commonwealth of Massachusetts Letter. *See also* Schwartz Letter (stating that the registration document should be made public because it would likely include many relevant disclosures, which would make it possible for the intermediary to file a single document to satisfy both the registration and disclosure requirements).

broker's credentials, including current registrations or licenses and employment and disciplinary history, is publicly available on FINRA's BrokerCheck.[315] As discussed below, we are proposing to make the information that a funding portal provides on proposed Form Funding Portal, other than personally identifiable information or other information with a significant potential for misuse, accessible to the public.[316] One commenter urged the Commission to grant funding portals a one-year moratorium from having to register.[317] We are not proposing such a moratorium because the statute clearly states that a person acting as an intermediary in a crowdfunding transaction made in reliance on Section 4(a)(6) must be registered with the Commission either as a broker or as a funding portal.

Another commenter requested clarification on whether a person acting as an intermediary in a transaction under Section 4(a)(6) would be required to register with us as an exchange, as defined in Exchange Act Section 3(a)(1), or as an alternative trading system.[318] As discussed above, Section 4A(a)(1) requires an intermediary that facilitates crowdfunded issuances of securities to register with us either as a broker or as a funding portal. Facilitating crowdfunded transactions alone would not require an intermediary to register as an exchange or as an alternative trading system (*i.e.*, registration as a broker-dealer subject to Regulation ATS). To the extent that an intermediary facilitates secondary market activity in securities issued in reliance on Section 4(a)(6), the intermediary would be required to register as an exchange or as

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315 *See* FINRA, note 142.

316 *See* discussion in Section II.D.1 below.

317 *See* Loofbourrow Letter.

318 *See* ABA Letter 1.

an alternative trading system if it met the criteria in Exchange Act Rule 3b-16.[319] We note, however, that a funding portal, by definition, is limited to acting as an intermediary in transactions involving the offer or sale of securities for the account of others solely pursuant to Section 4(a)(6),[320] which are primary issuances of securities. Thus, a funding portal could not effect secondary market transactions in securities.

Exchange Act Section 4A(a)(2) requires an intermediary to register with any applicable self-regulatory organization ("SRO"), as defined in Exchange Act Section 3(a)(26).[321] Exchange Act Section 3(h)(1)(B) separately requires, as a condition of the exemption from broker registration, a funding portal to be a member of a national securities association that is registered with the Commission under Exchange Act Section 15A. The proposed rules would implement these provisions by requiring an intermediary in a transaction involving the offer or sale of securities made in reliance on Section 4(a)(6) to be a member of FINRA or any other national securities association registered under Exchange Act Section 15A.[322] Today, FINRA is the only registered national securities association.

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319 *See* 17 CFR 240.3b-16 (subject to the exceptions provided in part (b) of the rule, an organization, association or group of persons would generally be considered a market place or facility for bringing together purchasers and sellers of securities or for otherwise performing, with respect to securities, the functions commonly performed by a stock exchange, "if such organization, association, or group of persons (1) Brings together the orders for securities of multiple buyers and sellers; and (2) Uses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade.").

320 *See* Section II.C.1 above.

321 15 U.S.C. 78c(a)(26). Exchange Act Section 3(a)(26) defines an "SRO" to mean "any national securities exchange, registered securities association, or registered clearing agency, or (solely for the purposes of [S]ections [19(b), 19(c), and 23 of the Exchange Act]) the Municipal Securities Rulemaking Board established by [S]ection [15B of the Exchange Act.]" *Id.*

322 *See* proposed Rule 300(a)(2) of Regulation Crowdfunding. We have proposed definitions for the terms "intermediary" and "SRO" in proposed Rule 300(c)(3) and 300(c)(5) of Regulation Crowdfunding, respectively. Intermediary would mean a broker registered under Section 15(b) of the Exchange Act or a funding portal registered under proposed Rule 400 and would include, where relevant, an associated person of the registered broker or registered funding portal. SRO is proposed to have the same meaning as in

One commenter generally objected to the requirement for an intermediary to be a member of a registered national securities association.[323] As we noted above, the statute clearly requires a funding portal to be a member of a registered national securities association. Likewise, under Section 15(b)(8) of the Exchange Act, a broker-dealer that is engaged in crowdfunding activities must be a member of a national securities association.[324] We believe that requiring intermediary membership in a registered national securities association should help to ensure consistent regulation of intermediaries with fewer opportunities for regulatory gaps. In regulating broker-dealers that effect securities transactions with members of the public, FINRA has the most members and is responsible for conducting broker-dealer examinations of its members, mandating disclosures by its members, writing rules governing the conduct of its members and associated persons[325] and informing and educating the investing public.[326] FINRA investigates and brings enforcement actions against FINRA members and their associated persons who are suspected of violating its rules and the federal securities laws.[327] While FINRA has primary responsibility for examining its members,[328] the Commission staff generally examines broker-dealers if specific firm or industry risks have been identified or when fraud and rule violations may have occurred. Because the statute requires a national securities association

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Section 36(a)(26) of the Exchange Act. *See also* Section II.D.1 below for a discussion regarding proposed Rule 400 of Regulation Crowdfunding, which addresses registration requirements for funding portals.

323 *See* Priore Letter.

324 The statute also permits brokers-dealers to be members of a national securities exchange if the broker-dealer effects transactions in securities solely on that exchange.

325 15 U.S.C. 78*o*-3.

326 FINRA, Inc., http://www.finra.org/AboutFINRA/P125239 (last visited Oct. 15, 2012).

327 *See, e.g.*, 15 U.S.C. 78*o*-3(b)(2); Testimony Before the Senate Subcommittee on Securities, Insurance, and Investment Committee on Banking, Housing, and Urban Affairs, 111th Cong. 8 (2010) (testimony of Stephen Luparello, Vice Chairman, FINRA).

328 15 U.S.C. 78*o*-3.

to write rules expressly for funding portals,[329] we anticipate that funding portals would be subjected to requirements targeted to their limited business model and not the more comprehensive requirements applicable to brokers. We anticipate that the regulatory framework FINRA creates for funding portals would play an important role in the oversight of these entities and, through the information that FINRA shares with the Commission, the Commission's ability to effectively regulate registered funding portals' activities.[330]

In response to commenters' requests that we clarify the applicable SRO for crowdfunding intermediaries, and to address any confusion about which entity or entities may serve as an SRO for crowdfunding brokers and funding portals, we are expressly identifying FINRA as a registered national securities association within the meaning of the statute.[331] While FINRA currently is the only registered national securities association, we are not foreclosing the possibility that another national securities association could register with us in the future. In that event, the proposed rule would permit funding portals to become members of the new association (should one become established in the future) instead of, or in addition to, FINRA.[332]

FINRA currently provides licensing and qualification requirements for associated persons of brokers. While we are not proposing any such requirement for persons associated with a funding portal, FINRA (or any other registered national securities association) could propose such requirements, as well as requirements dealing with supervision of funding portal personnel

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329 *See* Exchange Act Section 3(h)(2) [15 U.S.C. 78c(h)(2)].

330 *Id.*

331 *See* NCA Letter; NSBA Letter.

332 For requirements to register as a national securities association, *see* Exchange Act Section 15A [15 U.S.C. 78*o*-3].

and appropriate compliance structures.[333] FINRA, like all SROs, is required to file all proposed rules with us under Exchange Act Section 19(b)[334] and Rule 19b-4.[335] In general, the Commission reviews proposed SRO rules and rule changes, publishes them for comment, approves or disapproves them, or the rules become effective immediately or by operation of law.

Request for Comment

118. We have named FINRA expressly in the proposed rules as an applicable registered national securities association for crowdfunding intermediaries. Is this helpful? Is this appropriate? Why or why not? Are there other entities considering applying to become registered national securities associations?

119. The proposed rules would require that an intermediary be a member of FINRA or of any other applicable national securities association. Is this an appropriate approach? At present, FINRA is the only registered national securities association. If we were in the future to approve the registration of another national securities association under Exchange Act Section 15A, would it be appropriate for us to require membership in both the existing and new association? Why or why not?

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333 Exchange Act Section 15(b)(7) (15 U.S.C. 78*o*(b)(7)) requires that natural persons associated with brokers and dealers that are registered under Exchange Act Section 15(a)(1) (15 U.S.C. 78*o*(a)(1)) meet such standards of training, experience, competence and such other qualifications as the Commission finds necessary or appropriate in the public interest. The Commission historically has not exercised this authority but instead has relied on and deferred to the "substantive content of the SROs' entry requirements imposed on securities personnel in the various qualification categories." *See Requirement of Broker-Dealers to Comply with SRO Qualification Standards*, Release No. 34-32261 (May 4, 1993). *See also* Sections II.D.1 and II.D.2 below for a discussion regarding proposed Rules 400 and 401 of Regulation Crowdfunding.

334 15 U.S.C. 78s(b).

335 17 CFR 240.19b-4.

120. No intermediary can engage in crowdfunding activities without being registered with the Commission and becoming a member of FINRA or another registered national securities association. We recognize that while there is an established framework for brokers to register with the Commission and become members of FINRA, no such framework is yet in place for funding portals. We do not intend to create a regulatory imbalance that would unduly favor either brokers or funding portals.[336] Are there steps we should take to ensure that we do not create a regulatory imbalance?[337] Please explain.

121. The proposed rules do not independently establish licensing or other qualification requirements for intermediaries and their associated persons. The applicable registered national securities associations may or may not seek to impose such requirements. Should the Commission consider establishing these requirements? Should the Commission consider establishing requirements only if the associations do not? Would licensing or other qualifications for intermediaries and their associated persons be necessary, for example, to provide assurances that those persons are sufficiently knowledgeable and qualified to

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336 We note, however, that a registered broker could nonetheless have a competitive advantage to the extent it would be able to provide a wider range of services than a registered funding portal could provide in connection with crowdfunding transactions made in reliance on Section 4(a)(6). Unlike a funding portal, a registered broker-dealer could make recommendations, engage in solicitations and handle investor funds and securities. In addition, a registered broker-dealer, but not a funding portal, could potentially facilitate a secondary market for securities sold pursuant to Section 4(a)(6). *See* Exchange Act Section 3(a)(80) [15 U.S.C. 78c(a)(80)] (providing that a funding portal may act as an intermediary solely in securities transactions effected pursuant to Securities Act Section 4(a)(6), which are offerings by issuers and not resales).

337 *See* NCA Letter (stating that registered brokers should not be permitted to engage in crowdfunding activities until funding portals also become registered with, and members of, SROs).

operate a funding portal? Why or why not? If so, what types of licensing or other qualifications should we consider?

b. Financial Interests

Exchange Act Section 4A(a)(11) requires an intermediary to prohibit its directors, officers or partners (or any person occupying a similar status or performing a similar function) from having any financial interest in an issuer using its services. The proposed rules would implement this prohibition by importing the language of the statute, and also by extending this prohibition to the intermediary itself. The proposed rules would add that these persons are not only prohibited from having any financial interest in an issuer using its services, but also would specifically be prohibited from receiving a financial interest in the issuer as compensation for services provided to, or for the benefit of, the issuer, in connection with the offer and sale of its securities.[338] The proposed rules would interpret "any financial interest in an issuer," for purposes of Securities Act Section 4A(a)(11), to mean a direct or indirect ownership of, or economic interest in, any class of the issuer's securities.

One commenter sought clarification of whether Section 4A(a)(11) prohibits an intermediary – as an entity – from accepting equity from an issuer as compensation for its services.[339] In the commenter's view, Section 4A(a)(11) should be interpreted as prohibiting an intermediary from having a financial interest in an issuer only at the time of the offering and not thereafter. Another commenter stated that permitting a funding portal to have a financial interest in an issuer would align the funding portal's interests with those of potential investors and that

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338 *See* proposed Rule 300(b) of Regulation Crowdfunding.

339 *See* NCA Letter.

full disclosure of any financial interest should quell any potential concerns.[340] Another commenter stated that Section 4A(a)(11) does not expressly prohibit an intermediary, as an entity, from having a financial interest in an issuer and that this should be permitted under certain circumstances.[341]

We believe the prohibition in Section 4A(a)(11) is designed to protect investors from the conflicts of interest that may arise when the persons facilitating a crowdfunding transaction have a financial stake in the outcome. The proposed rules would extend the prohibition on holding a financial interest to the intermediary itself,[342] because we believe that the same concerns apply to the intermediary as to its directors, officers or partners (or any person occupying a similar status or performing a similar function). The existence of a financial interest in an issuer may create an incentive to advance that issuer's fundraising efforts over those of other issuers, which could potentially adversely affect investors. For similar reasons, the proposed rules also would prohibit receipt of a financial interest in an issuer as compensation for services provided to or on

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340 *See* Dex Offshore Letter 1. *See also* Dex Offshore Letter 2 (stating that allowing funding portals to have an equity interest in an issuer would align the funding portals with investors, much like venture capital or private equity models, and that transparent disclosure would quell any concerns related to portals maintaining equity interests in issuers).

341 *See* EarlyShares Letter 2 (stating that the following principles should govern a funding portal's financial interest in an issuer: first, to prevent any potential unfair advantage, an intermediary should only be able to invest on the same terms under which the crowd invests; second, any material nonpublic information that the intermediary (or any person acting on behalf of the intermediary) possessed prior to and/or after taking a financial interest in an issuer must be disclosed on the platform in a secure manner, consistent with the disclosure of other material nonpublic information that investors will receive through the issuer's profile page on an intermediary's platform; third, because under Securities Act Section 4A(e), an intermediary will be bound by the same one-year restriction on sales period as any other investor, there would be no risk that investors would be misled by a "false start" or "pump-and-dump" scheme; and finally, an intermediary's interest should remain anonymous throughout the investment campaign, to avoid having the intermediary's interest be considered "investment advice or recommendations," in violation of the prohibitions in the definition of funding portal).

342 *See* proposed Rule 300(b) of Regulation Crowdfunding. *See also* Securities Act Section 4A(a)(12) (granting us discretionary authority to include other requirements on intermediaries for the protection of investors and the public interest).

behalf of an issuer.[343] The proposed rules would define "financial interest in an issuer" to mean a direct or indirect ownership of, or economic interest in, any class of the securities of an issuer.[344]

As discussed above, one commenter suggested that an investor's and intermediary's interests may be aligned if an intermediary were allowed to take a financial interest in an issuer. We are concerned that the promise of a financial stake in the outcome could give an intermediary an incentive to ensure the success of its own investment in the issuer, to the disadvantage of investors and other issuers using the intermediary's platform, particularly if the financial interest is provided to the intermediary on different terms than to other investors.

Request for Comment

122. Should we permit an intermediary to receive a financial interest in an issuer as compensation for the services that it provides to the issuer? Why or why not? If we were to permit this arrangement, the proposed rules on disclosure requirements for issuers would require the arrangement to be disclosed to investors in the offering material. Are there other conditions that we should require? If so, please identify those conditions and explain.

123. If an intermediary receives a financial interest in an issuer, should it be permitted to provide future services as long as it retains the interest? Why or why not?

124. One commenter suggested that an intermediary should be able to receive a financial interest under the same terms as other investors participating in an

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343 *See id.*

offering made in reliance on Section 4(a)(6).[345] We request comment on this suggestion. How could an intermediary address potential conflicts of interest that may arise from this practice? Would disclosure of the arrangement be sufficient? Please explain.

125. The proposed rules define "financial interest in an issuer," for purposes of Securities Act Section 4A(a)(11), to mean a direct or indirect ownership of, or economic interest in, any class of the issuer's securities. Should we define the term more broadly to include other potential forms of a financial interest? For example, should the term include a contract between an intermediary and an issuer or the issuer's directors, officers or partners (or any person occupying a similar status or performing a similar function), for the intermediary to provide ancillary or consulting services to the issuer after the offering? Should it include an arrangement under which the intermediary is a creditor of an issuer? Should it include any carried interest or other arrangement that provides the intermediary or its associated persons with an interest in the financial or operating success of the issuer, other than fixed or flat-rate fees for services performed? Should any other interests or arrangements be specified in the term "financial interest in an issuer?" If so, what are they and what concerns do they raise?

126. In light of the reasons for the prohibition, should there be a *de minimis* exception? Why or why not? If so, what would be an appropriate *de minimis*

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345 *See* EarlyShares Letter 2.

amount? For example, would a one percent holding be an appropriate amount? Would another amount be more appropriate? Please explain. Should there be disclosure requirements for any *de minimis* exception? Why or why not?

127. Should we impose any other requirements or prohibitions on intermediaries? If so, what requirements or prohibitions and why?

3. Measures to Reduce Risk of Fraud

Securities Act Section 4A(a)(5) requires an intermediary to "take such measures to reduce the risk of fraud with respect to [transactions made in reliance on Section 4(a)(6)], as established by the Commission, by rule, including obtaining a background and securities enforcement regulatory history check on each officer, director, and person holding more than 20 percent of the outstanding equity of every issuer whose securities are offered by such person." The proposed rules would implement this provision by requiring an intermediary to have a reasonable basis for believing that the issuer is in compliance with relevant regulations and has established means to keep accurate records of holders of the securities it offers, and by requiring that the intermediary deny access if it believes the issuer or its offering would present a potential for fraud.[346]

Specifically, the proposed rules would require an intermediary to have a reasonable basis for believing that an issuer seeking to offer and sell securities in reliance on Section 4(a)(6), through the intermediary's platform, complies with the requirements in Securities Act Section 4A(b) and the related requirements in Regulation Crowdfunding.[347] While an issuer has an independent obligation to comply with these requirements, we believe it would help to reduce

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346 *See* proposed Rule 301 of Regulation Crowdfunding.

347 *See* proposed Rule 301(a) of Regulation Crowdfunding.

the risk of fraud if an intermediary were to also have an obligation to have a reasonable basis to believe that the issuer is in compliance.[348] The proposed rules would permit intermediaries to reasonably rely on representations of the issuer, absent knowledge or other information or indications that the representations are not true. While we do not propose to specify particular actions an intermediary must take in satisfying this requirement, we anticipate that in the course of its interactions with potential issuers, an intermediary may determine whether it could in fact reasonably rely on an issuer's representations and have a reasonable basis to believe the issuer is in compliance.

The proposed rules also would require an intermediary to have a reasonable basis for believing that an issuer has established means to keep accurate records of the holders of the securities it would offer and sell through the intermediary's platform.[349] The ability to keep track of the ownership of an issuer's securities is necessary to protect investors and critical for maintaining the integrity of securities transactions made in reliance on Section 4(a)(6), both with respect to the initial offering and any subsequent transfers of the securities. The statute does not assign responsibility in this regard but intermediaries would be well-positioned to make this determination, given that they would be interacting with the issuer, and particularly if they are advising the issuer to some extent about the offering.[350] One commenter stated that a direct registration system provides the best solution to policing transfers at a low cost and that, to the

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348 *See* Section II.E.5 below for a discussion relating to intermediaries' potential statutory liability for statements made by issuers and intermediaries' policies and procedures. Proposed Rule 403(a) of Regulation Crowdfunding would require funding portals to have policies and procedures designed to achieve compliance with federal securities laws, while intermediaries that are brokers would be subject to FINRA rules requiring similar policies and procedures. *See* discussion in Section II.D.4 below.

349 *See* proposed Rule 301(b) of Regulation Crowdfunding.

350 *See* discussion in Section II.D.3 below relating to proposed Rule 402(b)(5) of Regulation Crowdfunding.

extent physical certificates are issued, they should include legends similar to those required for restricted securities.[351]

Another commenter suggested that the Commission should require the use of registered transfer agents, which are already subject to SEC regulations and examinations, to maintain records of share ownership and transfers in connection with crowdfunding transactions.[352] This commenter stated that small issuers may not have the resources to properly execute the routine services that registered transfer agents provide, including procedures to: record and balance registered shareowner positions; follow shareholder instructions (and retain records of the instruction) to change an address or transfer their interests as a result of death, divorce or sale (including signature guarantees where necessary); escheat unclaimed assets under state laws; or address lost or stolen certificates.

We are not proposing to require a particular form or method of recordkeeping of securities, nor are we proposing to require that an issuer use a transfer agent or any other third party. We recognize the importance of accurate recordkeeping for investors and issuers, and that the failure to accurately record or maintain shareholder records of an issuer, or to prevent fraudulent transfers, can have significant negative impacts for both investors and issuers.[353] Among other things, investors without accurate records of their ownership of shares can find it difficult to prove such ownership in connection with a sale of their shares or execution of a corporate transaction. We believe that accurate recordkeeping can be accomplished by diligent issuers or through a variety of third parties. Accordingly, under the proposed rules, the

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351 *See* RocketHub Letter 1. *See also* STA Letter.

352 *See* STA Letter.

353 *See*, *e.g.*, STA Letter.

recordkeeping function may be provided by the issuer, a broker, a transfer agent or some other (registered or unregistered) person.[354] In certain business models, for example, it may be possible for other regulated entities, such as banks, to provide this function.[355]

Requiring a direct registration system to monitor transfers could create additional costs to implement that we have not required in connection with any types of securities offerings, and thus we are not proposing to require it here. Similarly, we are not proposing to require the use of a registered transfer agent. While requiring a registered transfer agent to be involved after the offering could introduce a regulated entity with experience in maintaining accurate shareholder records, a transfer agent is not necessary for accurate recordkeeping. Issuers and other third parties can also be well-positioned to keep accurate records of the holders of the securities an issuer would offer and sell through an intermediary's platform.[356]

In satisfying this requirement that an intermediary have a reasonable basis to believe that an issuer has established means to keep accurate records of the securities it would offer and sell through the intermediary's platform, the intermediary may rely on an issuer's representations concerning the means it has established, unless the intermediary has reason to question the

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354 An intermediary that is a funding portal could not provide these services, however, because by statute, it cannot "hold, manage, possess, or otherwise handle investor funds or securities." *See* Exchange Act Section 3(a)(80)(D) [15 U.S.C. 78c(a)(80)].

355 *See* City First Letter (indicating that there was interest in leveraging resources of Community Development Financial Institutions, which are certified by the U.S. Department of Treasury and include community development banks, credit unions, loan funds, and venture capital funds, with crowdfunded capital).

356 Transfer agent registration is required with respect to securities registered under Exchange Act Section 12 (15 U.S.C. 78*l*). Because securities issued pursuant to a transaction relying on Section 4(a)(6) will not be registered under Exchange Act Section 12, as explained above, we are not proposing to require the use of transfer agents on the transfers of these securities. Nevertheless, issuers relying on Section 4(a)(6) could choose to engage a registered transfer agent to provide these services. *See* Exchange Act Section 17A(c)(1) [15 U.S.C. 78q-1]. *See also id.*

reliability of the representations.[357] To keep accurate records, an issuer may need to have established means to perform a range of functions with respect to shareholder records. The precise scope of the needed functions will depend on the nature of the issuer and its securities. Such functions could include, for example, the ability to (1) monitor the issuance of the securities the issuer would offer and sell through the intermediary's platform, (2) maintain a master security holder list reflecting the owners of those securities, (3) maintain a transfer journal or other such log recording any transfer of ownership, (4) effect the exchange or conversion of any applicable securities, (5) maintain a control book demonstrating the historical registration of those securities, and (6) countersign or legend physical certificates of those securities. For some issuers, not all of these functions may be needed.

There are a number of ways by which an issuer could demonstrate or represent that it has established the necessary recordkeeping means. The issuer itself may have capabilities to maintain accurate records of its securities and, as noted above, may represent such capabilities to the intermediary. The intermediary also may be able to establish a reasonable belief, for example, if the issuer has engaged a broker, transfer agent, or other third party that can provide the requisite recordkeeping services, including a third party providing such services tailored to crowdfunding issuers.

The proposed rules would require an intermediary to deny access to its platform, if the intermediary has a reasonable basis for believing that an issuer, or any of its officers, directors (or any person occupying a similar status or performing a similar function) or 20 Percent Beneficial Owners, is subject to a disqualification under the proposed rules or if the intermediary

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357 *See* proposed Rule 301(b) of Regulation Crowdfunding.

believes that the issuer or the offering presents the potential for fraud or otherwise raises concerns regarding investor protection.[358] The rules would require an intermediary to conduct a background and securities enforcement regulatory history check on each issuer whose securities are to be offered by the intermediary, as well as on each of its officers, directors (or any person occupying a similar status or performing a similar function) and 20 Percent Beneficial Owners. While the statute requires that these checks be conducted on persons holding *more than* 20 percent of the outstanding equity of the issuer, the proposed rules would extend this requirement to apply to the 20 Percent Beneficial Owners. This proposed requirement is consistent with the issuer disclosure requirements and with the issuer disqualification provisions.[359] Using the same standard here would be consistent with and reinforce the disclosure requirements and disqualification provisions applicable to issuers and would provide investors with protections and additional comfort when making investment decisions. At this time, we believe that requiring these background checks would be sufficient to meet the aims of Section 4A(a)(5) without imposing an undue burden, which could in turn discourage the use of the exemption provided in Section 4(a)(6).

A number of commenters requested guidance on the acceptable scope of background and securities enforcement regulatory history checks that an intermediary would be required to conduct.[360] One commenter suggested that the background check should consist of: a review of credit reports, verification of necessary business or professional licenses, evidence of corporate

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358 *See* proposed Rule 301(c) of Regulation Crowdfunding.

359 *See* proposed Rules 201 and 503 of Regulation Crowdfunding, as well as the discussion in Section II.B.1 above and Section II.E.6 below.

360 *See* CompTIA Letter; NASAA Letter; CrowdFund Connect Letter.

good standing, uniform commercial code checks and a CRD[361] snapshot report.[362] Another stated that the scope of the background and securities enforcement regulatory history check should be commensurate with the size of the transaction and that we should establish a minimum level of diligence that an intermediary must undertake to promulgate an effective mechanism against fraud.[363] The commenter further stated that such minimum level should be below that required of registered broker-dealers.[364] Other commenters requested guidance on the actions that an intermediary should take with respect to information uncovered during a background check.[365]

We are not proposing to establish specific procedures for intermediaries to follow to reduce the risk of fraud beyond conducting the prescribed background and securities enforcement regulatory history checks. We believe that this proposed approach would allow an intermediary to use its experience and judgment, as well as its concern for the reputational integrity of its platform and crowdfunding pursuant to Section 4(a)(6) in general, to design systems and processes to help reduce the risk of fraud in securities-based crowdfunding. In this

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361 CRD is a central licensing and registration system for the U.S. securities industry and its regulators. It includes a computerized database of registration records, as well as qualification, employment and complaint histories.

362 *See* NASAA Letter (stating that these types of checks and reviews are necessary to ensure bad actors are not permitted to raise money in lightly regulated public offerings). *Compare* RocketHub Letter 1 (stating that intermediaries should query commonly-used databases for criminal background checks, bankruptcy filings and tax liens, as well as cross reference against the Department of Treasury's ("Treasury") Office of Foreign Asset Control sanctions lists and Specially Designated Nationals and Blocked Persons lists).

363 *See* CFIRA Letter 2 (stating that because there is no mandated infrastructure that intermediaries are required to use, each intermediary should utilize an infrastructure that incorporates some type of fraud deterrence and fraud detection system, whether proprietary or licensed through a third party; that, in order to deter fraud, funding portals should have a video interface "whereby each issuer is required to give a short presentation on their business which is capable of being viewed live and saved for later viewing at any time by a potential investor;" and that in terms of detecting fraud, we should require intermediaries to build certain fraud detection systems into the functionality of their platforms).

364 *See id.*

365 *See* NSBA Letter; Arctic Island Letter.

regard, the proposed rules would require an intermediary to deny access to an issuer if it has information that is not necessarily the basis for a disqualification under proposed rules, but that the intermediary nevertheless believes presents the potential for fraud or otherwise raises concerns regarding investor protection.[366] For this particular proposed requirement to deny access, the intermediary would not be required to have a reasonable basis for its belief. This is because we believe it is important to provide intermediaries discretion in taking steps to reduce the risk of fraud as Congress intended, which would strengthen investor protection. The proposed rules also require that if this information becomes known to the intermediary after it has granted the issuer access to its platform, the intermediary must promptly remove the offering from its platform, cancel the offering and return to investors any funds they may have committed. Under the proposed rules, an intermediary would also be required to deny access to an issuer if it believes that it is unable to adequately or effectively assess the risk of fraud of the issuer or its potential offering. For example, if certain officers of the issuer reside in a jurisdiction where background checks and securities enforcement regulatory history checks are not readily available to the intermediary, the intermediary may determine that it is unable to assess the risk of fraud of the issuer, and thus must deny the issuer access to its platform.

Some commenters stated that background checks could help reduce fraud if intermediaries were required to prominently display the results of the background checks on their

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366 For example, in conducting the background checks on the officers and directors of an issuer, an intermediary may learn that an officer or director misrepresented his or her experience or background. In this situation, an intermediary may determine that the misrepresentation was intentional or material (*e.g.,* it was not the result of an inadvertent clerical error) and is an indication that an offering by the issuer would present potential for fraud or otherwise raises concerns regarding investor protection. The intermediary would then be required to deny access to its platform to the issuer.

platforms.[367] We believe that requiring intermediaries to conduct the checks and deny access to persons subject to disqualification satisfies the statutory requirement and achieves the underlying goal of the provision, which is to restrict the ability of certain parties to use the exemption. We do not believe it would be necessary to make publicly available the results of the background checks, especially as such a requirement could add to the cost of administration and could expose the individuals in question to harm, for example, if there were errors in the information made publicly available. Therefore, we are not proposing to require intermediaries to make publicly available the results of background checks. Other commenters suggested creating an online database of securities law violators,[368] or otherwise making certain information available so that investors could conduct their own background checks on officers and directors of an issuer,[369] which could help lower costs on intermediaries and, indirectly, on issuers, associated with conducting an offering pursuant to Section 4(a)(6). We are not persuaded at this time that the administrative costs of posting the information, which the intermediary might not be able to verify, would be justified.

Some commenters expressed concern over the costs and burdens associated with conducting background and securities enforcement regulatory history checks.[370] One commenter stated that it is important to control the expense of background checks to avoid making the cost

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367 *See* Arctic Island Letter; The Motley Fool Letter (stating the information should be displayed insofar as it bears on the honesty of the individual checked).

368 *See* CrowdFund Connect Letter.

369 *See* Cera Technology Letter.

370 *See* CrowdFund Connect Letter; Cera Technology Letter; Schwartz Letter (stating that the Commission should not add to the costs of background and securities enforcement regulatory history checks by tacking on additional antifraud measures).

of raising capital prohibitive to the issuer.[371] While we are mindful of the costs associated with conducting these checks, the statutory requirement is clear. To help mitigate the costs, however, the proposed rules provide intermediaries with flexibility in how they would meet this requirement, while still helping to reduce the risk of fraud.

We anticipate that an intermediary may use the services of a third party to gather the information to conduct the required background and regulatory checks on issuers and their control persons.[372] The intermediary, of course, would remain responsible for compliance with the requirements of Section 4A(a)(5) and proposed Rule 301(c).[373]

Request for Comment

128. We are not proposing to require that an issuer relying on Section 4(a)(6) engage a transfer agent due, in part, to the potential costs we believe such a requirement would impose on issuers. What would be the potential benefits and costs associated with having a regulated transfer agent for small issuers? Are there other less costly means by which an issuer could rely on a qualified third party to assist with the recordkeeping related to its securities?

129. The proposed rules incorporate a "reasonable basis" standard for intermediaries to determine whether issuers comply with the requirements in Securities Act

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371 *See* CrowdFund Connect Letter (further stating that the requirement should be worded in a way "as to be compatible with the numerous online sites that currently provide criminal background checks and that only felonies be reported").

372 *See* discussion in Sections III.B.4 and IV.C below.

373 An intermediary should investigate and understand the procedures used by the third party to determine the reasonableness of the reliance on a third party. Furthermore, depending on how an arrangement is structured or the services provided, a third-party service provider could come within the meaning of the term associated person of a broker or dealer in Exchange Act Section 3(a)(18) (15 U.S.C. 78c(a)(18)). *See also* National Association of Securities Dealers ("NASD" n/k/a FINRA), *Outsourcing,* Notice to Members 05-48 (July 2005), *available at* http://www.finra.org/Industry/Regulation/Notices/2005/p014736.

Section 4A(b) and the related requirements of Regulation Crowdfunding, as well as for satisfying the requirement that the issuer has established means to keep accurate records of the holders of the securities it would offer and sell through the its platform.[374] Is a "reasonable basis" the appropriate standard for intermediaries making such determinations? Why or why not? Is it appropriate for one determination but not the other? If so, please explain which one and why. What other standard would be more appropriate, and why? What circumstances in the crowdfunding context should not be considered to constitute a reasonable basis? Should we permit an intermediary to reasonably rely on the representation of an issuer with respect to one or both determinations?

130. The proposed rules incorporate a "reasonable basis" standard for intermediaries to determine whether an issuer would be subject to a disqualification. In contrast, there is no reasonableness standard for intermediaries' requirement under the proposed rules to deny access to an issuer if it believes the issuer or the offering presents potential for fraud or otherwise raises concerns regarding investor protection. Is it appropriate to have these two different standards under the proposed rules? Why or why not? If one of these standards is not appropriate, please explain what would be a more appropriate standard and why.

131. The proposed rules would implement Section 4A(a)(5) by requiring the intermediary to conduct a background and securities enforcement regulatory

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374 *See* proposed Rule 301(a) of Regulation Crowdfunding.

history check aimed at determining whether an issuer or any of its officers, directors (or any person occupying a similar status or performing a similar function) or 20 Percent Beneficial Owners is subject to a disqualification, presents potential for fraud or otherwise raises concerns regarding investor protection. Is this approach appropriate? Why or why not? If not, why not? Would another approach be more appropriate? Why or why not?

132. Should we require intermediaries to make the results of the proposed background checks publicly available? Why or why not? Would doing so raise privacy concerns?

133. Should we specify the steps that an intermediary must take in obtaining background and securities enforcement regulatory history checks on the issuer and its officers, directors (or any person occupying a similar status or performing a similar function) and 20 Percent Beneficial Owners? Should we require, for example, an intermediary to check publicly-available databases, such as FINRA's BrokerCheck and the Commission's Investment Adviser Public Disclosure program? Why or why not? Are there third parties who would be in a position to provide these types of services? Please discuss.

134. Should we require intermediaries to conduct specific checks or other steps (such as a review of credit reports, verification of necessary business or professional licenses, evidence of corporate good standing, Uniform Commercial Code checks or a CRD snapshot report)? Why or why not? Separately, should we specify a minimum or baseline level of due diligence to help establish a reasonable basis? Why or why not? If so, what should that level include? For

instance, should it include a review or a verification of certain publicly available information about an issuer and its officers, directors (or any person occupying a similar status or performing a similar function) and 20 Percent Beneficial Owners? Should it include searches related or tailored to their location or place of incorporation, assets including real property and liens on those assets? Are there items it should or should not include? Please explain.

135. Are there resources available to an intermediary that enable it to collect the information necessary for making a determination regarding disqualification or the potential for fraud or potential concerns as to investor protection? If so, which resources? Are there aspects of the proposed issuer disqualification rule that would make it difficult for an intermediary to assess whether the issuer is subject to a disqualification? If so, please explain. Are there additional events or factors relevant to reducing the risk of fraud that intermediaries should be required to check? Please explain.

136. Section 4A(a)(5) authorizes the Commission to specify measures to reduce the risk of fraud, in addition to background checks. Are there other risks of fraud which are not contemplated by the proposed rules? Are there any additional measures that we should specifically require? Please discuss any suggested measures, and explain. For example, should we require intermediaries to monitor investment commitments and cancellations or take any other actions to detect potential attempts to promote an issuer's securities? If so, which actions and why?

137. Should the intermediary be required to report to the Commission (or another agency) issuers that are denied access? Why or why not?

4. Account Opening

Under the proposed rules, an investor seeking to invest in an offering conducted in reliance on Section 4(a)(6) would need to open an account with an intermediary and provide consent to electronic delivery of materials. The intermediary also would be required to deliver to the investor educational materials, as discussed below.

a. Accounts and Electronic Delivery

The proposed rules would prohibit an intermediary or its associated persons from accepting an investment commitment unless the investor has opened an account with the intermediary and the intermediary has obtained from the investor consent to electronic delivery of materials.[375] We are not proposing to specify any particular type or form of information that an intermediary must obtain from an investor in order to open an account; however, we anticipate that at a minimum the intermediary would obtain basic identifying and contact information, such as full name, physical address and e-mail address.[376] Because we believe that Congress contemplated that crowdfunding would, by its very nature, occur exclusively through electronic media, the proposed rules require that investors consent to electronic delivery.[377]

The proposed rules also would require an intermediary to provide all information it is required to provide under Subpart C, such as educational materials, notices and confirmations,

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375 *See* proposed Rule 302(a)(1) of Regulation Crowdfunding.

376 Intermediaries also are subject to anti-money laundering obligations, including those relating to customer identification. *See* discussion in Section II.D.4 below regarding proposed Rule 403(b) of Regulation Crowdfunding.

377 *See Use of Electronic Media*, note 60 (citing *Use of Electronic Media for Delivery Purposes*, Release No. 34-36345 (Oct. 6, 1995) [60 FR 53548, 53454 (Oct. 13, 1995)]).

through electronic means.[378] We also propose to require that, unless otherwise permitted, an intermediary must provide the information through an electronic message that contains the information, through an electronic message that includes a specific link to the information as posted on the intermediary's platform, or through an electronic message that provides notice of what the information is and that it is located on the intermediary's platform or on the issuer's website. The proposed rules would state that electronic messages include, but are not limited to, e-mail messages. According to the proposed rule, for example, in complying with requirements to provide notices to investors under proposed Rule 304(b), the intermediary must provide those notices electronically to investors, such as through an e-mail message containing or attaching the notice. With respect to the provision of issuer materials as required under proposed Rule 303(a), however, the proposed rule specifies that the intermediary must make the information publicly available on its platform. Therefore, the intermediary would only need to post the information on its platform in a manner complying with proposed Rule 303(a) and would not be required to send any electronic messages with regard to its posting.

We believe that requiring consent to electronic delivery of documents relating to the offering, and requiring that intermediaries provide information electronically, would facilitate the ability of the investor, intermediary and issuer to comply with, and act in a timely manner, with respect to certain proposed requirements of Regulation Crowdfunding (such as the requirement for investors to reconfirm investment commitments within five business days of receiving notice of material changes).[379] As such, under the proposed rules, offerings made in reliance on Section

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378 *See* proposed Rule 302(a)(2) of Regulation Crowdfunding.

379 *See* discussion in Section II.C.6 below and proposed Rule 304(c) of Regulation Crowdfunding. We also note that, to the extent intermediaries are required to provide notices or other material to investors, it would

4(a)(6) would be "electronic-only," such that all information to be provided by intermediaries must be provided electronically, and investors would be permitted to participate only if they agree to accept electronic delivery of all documents in connection with the offering.[380]

Request for Comment

138. Should we specify the types of information that an intermediary must obtain from an investor as part of the account-opening process? If so, what information and why? How would this information differ from what intermediaries would be required to obtain to fulfill their anti-money laundering obligations?[381]

139. Should we permit any exceptions to the proposed requirements to obtain consent to electronic delivery? If so, why and under what circumstances? If an investor does not receive materials electronically, how would he or she be able to participate fully in an offering made in reliance on Section 4(a)(6)?

140. Are there any other means of providing information electronically by an intermediary that are not covered in the proposed rules but that should be covered? Are there any means proposed to be included that should be eliminated or modified? If so, what means are they? For example, should intermediaries be permitted to post information in an investor's account on its

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not be sufficient for the intermediary simply to make the notice or material available for investors to access, such as by posting it on its platform or through social media sites; rather, the intermediary would need to deliver the notice or material to the investor, such as by e-mail or other electronic delivery methods. *See Use of Electronic Media,* note 60 at 25853 (discussing the "access equals delivery" concept).

380 *See* proposed Rule 100(a)(3) of Regulation Crowdfunding. *See also* discussion in Section II.A.4 above, particularly the text accompanying note 55, regarding the requirement that crowdfunding transactions made in reliance on Section 4(a)(6) be conducted exclusively through an intermediary's platform. *See also Use of Electronic Media*, note 60 (citing *Use of Electronic Media for Delivery Purposes*, Release No. 34-36345 [60 FR 53548, 53454 (Oct. 13, 1995)]).

381 *See* Section II.D.4.b below for a discussion of the anti-money laundering provisions applicable to intermediaries.

platform, without sending a notification that it is posted there? Why or why not? Should different types of information be required to be provided through different means? Please explain.

b. Educational Materials

Section 4A(a)(3) states that an intermediary must "provide such disclosures, including disclosures related to risks and other investor education materials, as the Commission shall, by rule, determine appropriate," but it does not elaborate on the scope of this requirement. As described in further detail below, the proposed rules would require the intermediary to deliver to investors, at account opening, educational materials that are in plain language and otherwise designed to communicate effectively specified information. Intermediaries also would be required to make the current version of the educational materials available on their platforms and to make revised materials available to all investors before accepting any additional investment commitments or effecting any further transactions in securities offered and sold in reliance on Section 4(a)(6).[382]

The proposed rules would require the materials to include:

- the process for the offer, purchase and issuance of securities through the intermediary;
- the risks associated with investing in securities offered and sold in reliance on Section 4(a)(6);

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382 *See* proposed Rule 302(b) of Regulation Crowdfunding.

- the types of securities that may be offered on the intermediary's platform and the risks associated with each type of security, including the risk of having limited voting power as a result of dilution;
- the restrictions on the resale of securities offered and sold in reliance on Section 4(a)(6);
- the types of information that an issuer is required to provide in annual reports, the frequency of the delivery of that information, and the possibility that the issuer's obligation to file annual reports may terminate in the future;
- the limitations on the amounts investors may invest, as set forth in Section 4(a)(6)(B);
- the circumstances in which the issuer may cancel an investment commitment;
- the limitations on an investor's right to cancel an investment commitment;
- the need for the investor to consider whether investing in a security offered and sold in reliance on Section 4(a)(6) is appropriate for him or her; and
- that following completion of an offering, there may or may not be any ongoing relationship between the issuer and intermediary.

The proposed disclosures relating to the risks of investing in securities offered and sold in reliance on Section 4(a)(6), investors' cancellation rights, resale restrictions and issuer reporting are generally drawn from the statutory requirements.[383] These items of information are basic terms, relevant to transactions conducted in reliance on Section 4(a)(6), of which all investors should be aware before making an investment commitment. The circumstances in which an investor can cancel an investment commitment and obtain a return of his or her funds are

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[383] *See* Securities Act Sections 4A(a)(4), 4A(a)(7), 4A(e), and 4A(b)(4).

particularly important to an investor's understanding of the investment process. Information on resale restrictions could affect an investor's decision to consider any offerings made pursuant to Section 4(a)(6).

We are proposing to require intermediaries to provide educational material about the types of securities available for purchase on their platforms and the risks associated with each type of security, including the risk of having limited voting power as a result of dilution.[384] As one commenter noted, some forms of securities may have limited rights with respect to voting, input into management decisions or redemption, among others, and also may be subject to dilution.[385] Because we are not restricting the types of securities that an issuer may offer through Section 4(a)(6) transactions, this requirement would help investors understand the various types of securities that could be available on the platform and their associated risks.

We also are proposing to require intermediaries to provide educational material regarding the limitation on the amounts investors may invest pursuant to Section 4(a)(6)(B) and the proposed rules.[386] We believe it is important that investors are made aware of and understand the limits to which they would be subject, prior to making any investment commitments. As noted above, we are proposing to permit intermediaries to reasonably rely on investors' representations concerning compliance with the investment limitation requirements.[387] We

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384 *See* proposed Rule 302(b)(1)(ii) of Regulation Crowdfunding.

385 *See* Commonwealth of Massachusetts Letter (stating that the investor education materials and other disclosures should make clear to investors the risks of their crowdfunding investments, including that investors may not have any meaningful voting power as minority shareholders and that their investment may not be readily liquid). *See also* 2012 SEC Government-Business Forum, note 29 (recommending that certain investor education materials, such as those relating to dilution, may need to be mandated by the Commission).

386 *See* proposed Rule 100(a)(2) of Regulation Crowdfunding.

387 *See* proposed Rule 303(b)(1) of Regulation Crowdfunding.

believe providing these educational materials should enhance the accuracy of investor representations, because an investor may be less likely to inadvertently make an inaccurate representation that he or she complies with the investment limits after being presented with an explanation of what those limits are, how they apply and how they are calculated.

In addition, we are proposing to require that intermediaries provide, in the educational materials, a notice that the intermediary may or may not continue to have a relationship with the issuer following completion of the offering.[388] We believe that persons opening an account with an intermediary, for instance because they are interested in the offering of a particular issuer, could mistakenly assume that the intermediary will have an ongoing relationship with the issuer. Such persons also could assume that, following an offering conducted through the intermediary's platform through which they purchased securities, the intermediary would be the primary contact for investors wishing to obtain information about, or wishing to communicate with, the issuer or wishing to participate in secondary trading of the issuer's securities. Because intermediaries may not necessarily have an ongoing relationship with the issuer following an offering, and funding portals would not be permitted to be involved in secondary trading, we believe it would be helpful to require intermediaries to alert investors about this limitation the time they open accounts.

One commenter suggested that the user experience for investors engaging in crowdfunding transactions should be a "painless process" and that investors should be subject to mandatory investor education prior to investing.[389] Another commenter suggested that, in order to protect investors, intermediaries should be required to provide a glossary explaining each type

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388 *See* proposed Rule 302(b)(1)(viii) of Regulation Crowdfunding.

389 *See* Vim Funding Letter.

of security available for purchase in each of the offerings on its portal.[390] We are proposing to require intermediaries to provide educational material about the types of securities available for purchase on their platforms and the risks associated with each type of security; however, in order to provide intermediaries with flexibility in how they present or format this information, we are not proposing to require that it be presented as a glossary. One commenter suggested that a warning on the front page of an issuer's offering materials should suffice for the purposes of Section 4A(a)(3).[391] We do not believe that a disclaimer in isolation would be sufficient information to satisfy the statutory educational requirement.[392]

Other commenters requested that the Commission prepare and make available investor educational material or model text for use by intermediaries.[393] Other commenters requested that the Commission clarify whether educational materials may be provided to investors through electronic means, such as through the Internet or e-mail.[394] One commenter requested that intermediaries be given "wide latitude" to experiment with different methods of investor education.[395] We are not proposing to require a particular format or manner of presentation,

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390 *See* CFIRA Letter 2.

391 *See* InitialCrowdOffering Letter (stating that the following type of language should be used: "you should purchase these shares only if you can afford a complete loss of your investment").

392 *See also* discussion in Section II.C.5.b below and proposed Rule 303(b)(2)(i) of Regulation Crowdfunding.

393 *See, e.g.*, NASAA Letter (providing model language for use in investor education material and recommending that the material state that: (1) investments in small businesses and start-up companies are often risky; (2) according to the U.S. Small Business Administration, half of all new businesses fail within five years; (3) because of these risks, investors should only invest if they can afford to lose the entire investment; and (4) an investor should not invest if the investor has an immediate need for the return of the funds). *See also* Tri Valley Law Letter; NSBA Letter. *But see* 2012 SEC Government-Business Forum, note 29 (recommending that while some investor education materials may need to be mandated by the Commission, the industry should work together to standardize educational materials).

394 *See* RocketHub Letter 1; Spinrad Letter 1.

395 *See* Schwartz Letter.

other than the requirement that the materials be provided electronically.[396] Rather than requiring specific text or a particular format or presentation, we believe that the better approach is to provide each intermediary with sufficient flexibility to prepare educational materials in a manner reasonably designed to provide the required information, based on the types of offerings on the intermediary's platform and the types of investors drawn to its platform.[397] Under the proposed rules, the educational materials may be in any electronic format, including electronic and video format, that the intermediary determines is effective in communicating the contents of the educational material.[398]

Because the proposed rules require that the educational materials convey the specified pieces of information accurately, an intermediary would be required to update these materials over time as, for instance, the types of offerings on its platform change. For example, if an intermediary decides to expand the types of securities it offers through its platform, the intermediary would be required to update its educational materials. Similarly, an intermediary would be required to periodically review and update other aspects of its educational materials, such as the discussion of risk factors, as necessary. The proposed rules would require an intermediary to keep its educational materials accurate and thus current, which would require it to make the most current version of its educational materials available on its platform. In addition, to the extent an intermediary makes a material revision to its educational materials, it would be required to make the revised educational materials available to all investors before

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396 *See* proposed Rule 302(a)(2) of Regulation Crowdfunding and discussion in Section II.C.4.a above.

397 *See* 2012 SEC Government-Business Forum, note 29 (recommending that the market for transactions in reliance on Section 4(a)(6) should be permitted to develop best practices wherever possible).

398 As discussed in Section II.C.3 above, proposed Rule 302(a) of Regulation Crowdfunding would require that an intermediary obtain an investor's consent to such electronic delivery.

accepting any investment commitments.[399] We believe that this requirement is consistent with the Internet-based nature of crowdfunding. We also believe that this requirement would benefit investors, by helping to ensure that they have information about key aspects of investing through the intermediary's platform that may have changed since the last time they received the materials, prior to making investment commitments, as those key aspects could influence their investment decisions. Because these materials must be accurate, and thereby current, a change in the types of offerings conducted on an intermediary's platform would trigger an update. We believe requiring intermediaries to provide updated material on this basis, rather than at any regular intervals, should help to minimize the ongoing burden on intermediaries.

Request for Comment

141. Is the scope of information proposed to be required in an intermediary's educational materials appropriate? Why or why not? Is there other information that we should require an intermediary to provide as part of the educational materials? If so, what information and why?
142. Should any of the proposed requirements be modified or deleted, and if so, which requirements and why?
143. Should we prescribe the text or content of educational materials for intermediaries to use? Why or why not? Should we provide models that intermediaries could use? Why or why not?

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[399] Pursuant to proposed Rule 303(b)(2)(i) of Regulation Crowdfunding, the intermediary would be required to obtain, from each investor, a representation that the investor has reviewed these educational materials before accepting an investment commitment from the investor.

144. Should we specifically prohibit certain types of electronic media from being used to communicate educational material? If so, which ones and why?

145. Should we require intermediaries to submit the educational materials to us or FINRA (or other applicable national securities association) for review? Why or why not? If we should require submission of materials, should we require submission before or after use, when they are first used, when the intermediary changes them or at some other point(s) in time? Please explain.

146. Should we require intermediaries to provide educational material at additional or different specified points in time, rather than only when the investor begins to open an account or make an investment commitment? Why or why not? If so, why would that be preferable to requiring updates on an as-needed basis? For example, should educational material be provided on a quarterly, semi-annual, or annual basis? Should this material be provided again to investors who have not logged onto or accessed an intermediary's platform for a specified period of time? Why or why not? If so, what should that period of time be?

c. Promoters

Section 4A(b)(3) provides that an issuer shall "not compensate or commit to compensate, directly or indirectly, any person to promote its offerings through communication channels provided by a broker or funding portal, without taking such steps as the Commission shall, by rule, require to ensure that such person clearly discloses the receipt, past or prospective, of such

compensation, upon each instance of such promotional communication." As discussed above, the proposed rules would include this prohibition.[400]

We also propose to require the intermediary to inform investors, at the account opening stage, that any person who promotes an issuer's offering for compensation, whether past or prospective, or who is a founder or an employee of an issuer that engages in promotional activities on behalf of the issuer on the intermediary's platform, must clearly disclose in all communications on the platform the receipt of the compensation and the fact that he or she is engaging in promotional activities on behalf of the issuer.[401] We believe that requiring intermediaries to inform investors about these disclosure obligations at the outset of their relationship should help to ensure and monitor issuers' compliance with Section 4A(b)(3) and the proposed rules, as it would alert investors that information about the participation of issuers or representatives of issuers would have to be disclosed at a later time. Promoters also would need to disclose this information[402] each time they post a comment in the communication channels on the platform.[403]

Request for Comment

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400 *See* proposed Rule 205 of Regulation Crowdfunding and the discussion in Section II.B.5 above.

401 *See* proposed Rule 302(c) of Regulation Crowdfunding.

402 In addition to the information proposed Rule 302(c) requires, promoters would also be required to disclose the amount of compensation pursuant to Section 17(b) of the Securities Act (15 U.S.C. 77q(b)).

403 *See* proposed Rule 303(c)(4) of Regulation Crowdfunding. We recognize that after opening an account, an investor may come to be compensated by, or become an employee of, an issuer or potential issuer. For this reason, proposed Rule 303(c)(4) would require an intermediary to require that any person, when posting a comment in the communication channels, clearly disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or receives compensation, whether in the past or prospectively, to promote an issuer's offering. We anticipate that an intermediary could comply with this requirement in part by, for example, establishing a "pop-up" window which reminds the investor of the requirement each time the investor accesses, or attempts to post a comment on, the communication channels on the intermediary's platform. *See* discussion in Section II.C.5 below. *See also* proposed Rule 205 of Regulation Crowdfunding.

147. Should the proposed rules require intermediaries to take any different or additional steps to help achieve compliance with the requirement for promoters to disclose the receipt of compensation? If so, what other steps would be appropriate and why?

148. Should the proposed disclosures to investors be required to be made at some time other than at account opening? For instance, should the reminder about disclosure obligations be made each time an investor accesses the intermediary's platform or the communication channels provided by the intermediary? Why or why not?

149. The proposed rules would require disclosure be made to investors, in relation to obligations of any person who receives compensation, whether in the past or prospectively, to promote an issuer's offering, or who is a founder or an employee of an issuer that engages in promotional activities on behalf of the issuer on the intermediary's platform. Should the obligations apply to other classes of persons as well, such as affiliates of the issuer, regardless of whether they are engaged in promotional activities? Why or why not?

d. Compensation Disclosure

The proposed rules would require the intermediary, when establishing an account for an investor, to clearly disclose the manner in which it will be compensated in connection with offerings and sales of securities made in reliance on Section 4(a)(6).[404] This requirement would help to ensure investors are aware of any potential conflicts of interest of an intermediary that

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[404] *See* proposed Rule 302(d) of Regulation Crowdfunding. *See also* proposed Rule 303(f) of Regulation Crowdfunding.

arise from the manner in which the intermediary is compensated. While the JOBS Act does not require this disclosure, we believe that providing this information to investors before they invest would help to ensure that they are making informed investment decisions.[405]

Request for Comment

150. Is the requirement for an intermediary to disclose how it is compensated an appropriate requirement? Why or why not? Would a time other than at account opening be more appropriate for this disclosure? Please explain.

151. Should the proposed rules include any additional requirements with regard to disclosure of compensation? If so, what other requirements would be appropriate and why?

152. While the proposed rules do not specify the types of information that an intermediary must obtain from an investor at the account opening stage, we recognize that this stage provides an opportunity for intermediaries to collect certain demographic information about investors. Although some information intermediaries would collect from investors might already be required under their anti-money laundering obligations or pursuant to registered national securities association rules, there is some information about investors which might not be required to be collected but which, without involving disclosure of any personally identifiable information of investors, could help us and the applicable national securities association to better understand the level of

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405 *See* Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers: As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011) ("*Study on Investment Advisers and Broker-Dealers*"), *available at* http://www.sec.gov/news/studies/2011/913studyfinal.pdf, for more information about how compensation disclosure impacts investment decisions.

investor sophistication in this market and investor protection needs, among other things. For instance, connecting certain demographic information to offering characteristics and outcomes could help in the evaluation of the effectiveness of crowdfunding in raising capital for startups and small businesses. The information that could be collected includes, for example, demographic information about investors that excludes any personally identifiable information and is aggregated on a per offering basis, indicating characteristics such as education level, income, wealth, geographic distance from the issuer and professional affiliations. At the same time, we recognize that requiring the collection of this data could likely increase the burden on investors and intermediaries participating in transactions conducted pursuant to Section 4(a)(6). Should we require intermediaries to collect and provide some or all of this information to us and the applicable national securities association? Should some or all of this information be made more widely available? Why or why not? If so, which metrics should we require, and in what format, if any, should we require it be provided? To what extent do brokers already collect this information for offerings in which they are involved? Is there a particular point in time or method that would be more appropriate or convenient for intermediaries to collect this information? Would a requirement for intermediaries to collect this information at the account opening stage discourage investors from opening accounts with intermediaries, and ultimately limit the ability of issuers to raise capital in reliance on the exemption in Section 4(a)(6)? Please explain.

5. Requirements with Respect to Transactions

a. Issuer Information

Section 4A(a)(6) requires each intermediary to make available to the Commission and potential investors, not later than 21 days prior to the first day on which securities are sold to any investor (or such other period as the Commission may establish), any information provided by the issuer pursuant to Section 4A(b). The proposed rules would implement this provision by requiring each intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) to make available to the Commission and to potential investors any information required to be provided by the issuer under Rules 201 and 203(a) of proposed Regulation Crowdfunding.[406] The proposed rules would further require that: (1) an intermediary make this information publicly available on the intermediary's platform, in a manner that reasonably permits a person accessing the platform to save, download or otherwise store the information;[407] (2) this information be made publicly available on the intermediary's platform for a minimum of 21 days before any securities are sold in the offering, during which time the intermediary may accept investment commitments;[408] and (3) this information, including any additional information provided by the issuer,[409] remain publicly available on the intermediary's platform until the offer and sale of securities is completed or cancelled. An intermediary would be

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406 *See* proposed Rule 303(a) of Regulation Crowdfunding.

407 While we are not requiring that intermediaries make the relevant information available in any particular format, we note that issuers would be required to file the information on EDGAR. *See* proposed Rule 203 of Regulation Crowdfunding. *See also* Section II.B.3 above for a discussion of the filing requirements applicable to issuers.

408 Accordingly, the offering could not close at any time before the end of the 21st day after the issuer disclosure materials are made available on the intermediary's platform.

409 Additional information could include, for example, information required to be filed with the Commission in a specific format (*e.g.*, on EDGAR) under proposed Rules 201 and 203(a) of Regulation Crowdfunding, but prepared in a different presentation format, for example on slides, on the intermediary's platform.

prohibited from requiring any person to establish an account with the intermediary in order to access this information.

We believe that this approach also would satisfy the requirement under Section 4A(d) for the Commission to "make [available to the states], or . . . cause to be made [available] by the relevant broker or funding portal, the information" issuers are required to provide under Section 4A(b) and the rules thereunder. This approach should help investors, the Commission, FINRA (and any other applicable registered national securities association) and other interested parties, such as state regulators, to access information without impediment. The proposed rules should help to ensure that an investor has an adequate opportunity to evaluate the investment opportunity and determine whether it is suitable for him or her.[410] Finally, we do not believe that any person should be required to open an account with, or otherwise provide personal information to, an intermediary before reviewing the materials related to an offering or the educational materials provided by the intermediary.

One commenter expressed the view that an intermediary should not be required to send information to the Commission before listing an offering on its platform.[411] The proposed rules would permit an intermediary to make issuer information available to both the Commission and potential investors simultaneously through its platform. Another commenter recommended that the private placement memorandum provided by the issuer should be reviewed by a properly

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410 *See* proposed Rule 303(a)(1) of Regulation Crowdfunding. *See also* proposed Rules 303(a)(2) and 303(a)(3) of Regulation Crowdfunding. Intermediaries have broad recordkeeping obligations that would include any written materials that are used as part of an intermediary's business, which include issuer materials made available on its platform. Registered brokers would have to maintain records pursuant to Exchange Act Section 17 and the rules thereunder. 15 U.S.C. 78q; 17 CFR 240.17a *et seq*. Funding portals would be subject to the recordkeeping requirements of proposed Rule 406 of Regulation Crowdfunding. *See* discussion in Section II.D.5 below.

411 *See* Crowdfunding Offerings Ltd. Letter 2.

qualified securities representative prior to the intermediary providing the information to potential investors.[412] We are not proposing at this time to impose such a requirement. Although review by a securities professional could provide some degree of additional investor protection, we are mindful of Congress' intent that these offerings present a cost-effective method of raising capital. Further, the proposed rules would provide a safeguard for investors by requiring an intermediary to have a reasonable basis for believing that an issuer complies with the requirements of Section 4A(b) and Regulation Crowdfunding, and to deny access to an issuer or cancel its offering, if the intermediary believes that the issuer or the offering presents the potential for fraud or otherwise raises concerns regarding investor protection.[413]

Request for Comment

153. Should we require intermediaries to continue to display issuer materials for some period of time after completion of the offering? Why or why not? If such a requirement were used, which time period would be appropriate? Why? What would be the potential costs and benefits associated with any such requirement?
154. Section 4A(a)(6) requires an intermediary to make available the information that an issuer is required to provide under Section 4A(b). Should we require an intermediary to make efforts to ensure that an investor who has made an investment commitment has actually reviewed the relevant issuer information? Why or why not? If so, how could we implement this?
155. Instead of, or in addition to, requiring that intermediaries make issuer information available on their platforms, should we require that intermediaries

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412 *See* Arctic Island Letter.

413 *See* proposed Rule 302 of Regulation Crowdfunding and discussion in Section II.C.3 above.

deliver this information to investors? Why or why not? If so, should we specify a particular medium, such as e-mail or a screen the investor must click through?

156. Should we consider timeframes other than the minimum 21 days from the time an issuer offers securities on an intermediary's platform, during which the offering information should be made available?

157. Should some or all of the issuer's offering materials be required to remain on an intermediary's platform after the close of an offering? Why or why not? If so, for how long?

b. Investor Qualification

i. Compliance with Investment Limitations

Section 4(a)(6)(B) imposes certain limitations on the aggregate amount of securities that can be sold to an investor in reliance on Section 4(a)(6) during a 12-month period. Section 4A(a)(8) further imposes an obligation on intermediaries to ensure that no investor exceeds those limits. The proposed rules would implement this latter requirement by providing that, before permitting an investor to make an investment commitment on its platform, an intermediary must have a reasonable basis to believe that the investor satisfies the investment limitations under Section 4(a)(6)(B) and Regulation Crowdfunding.[414]

Three commenters stated that it would be difficult for an intermediary to determine whether an investor has exceeded the investment limitations because an investor may not always use the same intermediary.[415] Another commenter stated that it is unclear how an intermediary

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414 *See* proposed Rule 303(b)(1) of Regulation Crowdfunding. *See also* Section II.A.2 above for a further discussion of the limitations on investments.

415 *See* Cera Technology Letter; Crowdfunding Offerings Letter 3; Schwartz Letter.

will be able to verify the investment limits, unless the intermediary is permitted to rely upon an investor's representations regarding his or her prior crowdfunding investments.[416] Another commenter raised concerns that an investor may be able to establish multiple user accounts with a single intermediary and thereby exceed the maximum investment limit, despite the best efforts of the intermediary.[417] Another commenter suggested that each intermediary should be required to monitor investor activity only on its own platform.[418] The commenter further stated that before completing an investment through an intermediary, investors should be required to make representations to an intermediary regarding any investments made through another intermediary within the last year. Another commenter suggested that the Commission should permit intermediaries to create and use a centralized database for aggregate checks.[419]

We recognize that it would be difficult for intermediaries to monitor or independently verify whether each investor remains within his or her investment limits for each particular offering in which he or she intends to participate. While the proposed rules would permit reliance on a centralized database providing information about particular investors, if it could help provide an intermediary with a reasonable basis for a conclusion, we understand that none currently exists. For these reasons, the proposed rules provide that an intermediary may rely on

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416 *See* NSBA Letter. *See also* 2012 SEC Government-Business Forum, note 30 (recommending that investors should be permitted to self-certify as to their statutory investment limits and that funding portals should be permitted to rely on certifications made by third parties as to investment limits).

417 *See* Grow VC Letter (stating that the Commission should require the following measures: "closely monitoring investment activity in any user account; requiring each user account to provide unique bank account details which are not used by any other user account; and requiring the investor to represent and warrant that such investor understands the maximum investment limit and will not exceed such limits").

418 *See* RocketHub Letter 1.

419 *See* Spinrad Letter 1 (stating that the underlying database would consist of information representing users, offerings, transactions and other elements of the market, and it would be used to ensure that investors do not purchase beyond the annual limits, even from multiple issuers across multiple intermediaries).

an investor's representations concerning compliance with investment limitation requirements based on the investor's annual income and net worth and the amount of the investor's other investments in securities sold in reliance on Section 4(a)(6) through other intermediaries. For example, an intermediary may choose to satisfy this requirement by providing a function on its platform that prompts investors to enter amounts of their annual income, net worth, and the amount of total investments made over the past 12 months on all intermediaries' platforms, that would then generate the amount of investment the investor would be permitted to make at that time pursuant to the investment limitations. The intermediary could not rely on an investor's representations if the intermediary had reason to question the reliability of the representation. In this regard, it would not be reasonable for an intermediary to ignore other investments made by an investor in securities sold in reliance on Section 4(a)(6) through an account with that intermediary or other information or facts about an investor within its possession.

Request for Comment

158. Is the proposed approach for establishing compliance with investment limits appropriate? Why or why not? Is there another approach that we should consider? Please explain.

159. As mentioned above, we are proposing that an intermediary may rely on the representations of a potential investor. Is this an appropriate approach? Why or why not? Is there another approach we should consider? Please explain.

160. Should we require an intermediary to avail itself of readily available information concerning investor limits, such as a centralized database containing information relating to whether particular investors were in compliance with the investment limits, should one become established? Why or why not?

161. Should we require intermediaries to request other intermediary accounts that an investor may have before accepting an investment commitment? Why or why not?

ii. Acknowledgement of Risk

Section 4A(a)(4) requires an intermediary to ensure that each investor: (1) reviews the educational materials discussed above; (2) positively affirms that the investor understands that he or she is risking the loss of the entire investment and that the investor could bear such a loss; and (3) answer questions demonstrating an understanding of the level of risk generally applicable to investments in startups, emerging businesses and small issuers, the risk of illiquidity and such other matters as the Commission determines appropriate. As discussed above, the proposed rules would require an intermediary to provide to investors certain educational materials in connection with the opening of an account.[420] The proposed rules would further require an intermediary, each time before accepting an investment commitment, to obtain from the investor a representation that the investor has reviewed the intermediary's educational materials, understands that the entire amount of his or her investment may be lost and is in a financial condition to bear the loss of the investment.[421] The intermediary also must ensure each time before accepting an investment commitment that each investor answers questions demonstrating the investor's understanding that there are restrictions on the investor's ability to cancel an investment commitment[422] and obtain a return of his or her investment, that it may be difficult

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420 *See* proposed Rule 302(b) of Regulation Crowdfunding and discussion in Section II.C.4.b above.

421 *See* proposed Rule 303(b)(2) of Regulation Crowdfunding.

422 We proposed this requirement under discretionary authority granted in Section 4A(a)(4)(C)(iii). As discussed in Section II.C.4.b above, in relation to the educational materials, we believe that it is important for investors to receive this information before making any investment commitments.

for the investor to resell the securities, and that the investor should not invest any funds in a crowdfunding offering unless he or she can afford to lose the entire amount of his or her investment.

A commenter requested guidance on the steps intermediaries must take to ensure that an investor understands the educational materials intermediaries are required to provide.[423] One commenter expressed concern that the requirements in Section 4A(a)(4) could be intimidating to potential investors and recommended that we require very short affirmations that could easily be understood.[424] Another commenter stated that the level of understanding that an investor can prove is too subjective to be useful and that an intermediary could not design a system to guarantee that an investor understands a disclosure.[425] We agree that it would not be possible for an intermediary to ensure that all investors understand the risk disclosure. The requirements of the proposed rules are intended to require intermediaries to provide investors with meaningful disclosures concerning the risks of any potential investment and obtain answers demonstrating an understanding of the required statutory elements.[426] The questionnaire required under the

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423 *See* CFIRA Letter 2.

424 *See* Cera Technology Letter (stating that a check-the-box type approach could be used, as well as the following draft text: "I understand that I could easily lose all of the money I invest in this company," or "I understand that X% of start-ups in this category fail"). *See also* Liles Letter 2 (stating that asking potential investors to take a test to demonstrate understanding of risks would be unorthodox and awkward at best and that a signed acknowledgement by investors that they understand each enumerated warning about the specific risks in the investment would suffice for compliance with the risk disclosure requirement); Verdant Ventures Letter (stating that a check-the-box type of approach could be used on funding portal websites to acknowledge the understanding of risk specifically for investors who are making low investments of $100 to $500 and that the regulation levels should be adjusted proportionally to larger individual dollar investments, and therefore, low contribution amounts should be subject to less regulation).

425 *See* Crowdfunding Offerings Ltd. Letter 2.

426 *See* proposed Rule 303(b)(2) of Regulation Crowdfunding.

proposed rules should help to address concerns of commenters that Section 4A(a)(4) requires more than a mere self-certification.[427]

One commenter requested that the Commission develop a model form of acknowledgment that intermediaries can use and retain to satisfy the requirements of Section 4A(a)(4).[428] Another commenter suggested that intermediaries should have flexibility to try different methods of obtaining this acknowledgement.[429] We are not proposing a model form of acknowledgement or questionnaire. Rather, the proposed rules would permit an intermediary to develop the representation and questionnaire in any format that is reasonably designed to demonstrate the investor's receipt of the information and compliance with the other requirements under the proposed rules. As with the educational material requirements, we believe that an intermediary's familiarity with its business and likely investor base would make it best able to determine the format in which to present the material required under the proposed rules.[430] As one commenter suggested, an intermediary could design a multiple choice quiz that would not permit an investor to successfully make an investment commitment until the investor has

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427 *See* proposed Rule 303(b)(2)(ii) of Regulation Crowdfunding. *See, e.g.*, Spinrad Letter 1; NASAA Letter (stating that intermediaries "should [at a minimum] be required to design their web portals to require investors to click through a page that indicates they have read the investor-education information and to require investors to correctly answer a series of specific questions that are controlled by the Commission," and further stating that such requirements should be a precondition for membership or registration of an investor with a funding portal); The Motley Fool Letter (stating that a more involved process than a simple check-the-box type approach should be used to verify that investors acknowledge and understand the risks and that multiple choice questions should be used and tailored to testing whether potential investors understand the nature of crowdfunding risk, the potential for fraud, their legal rights and responsibilities and the probability of losing their entire investment). *See also* TechnologyCrowdFund Letter 1 (stating that the Commission should require each individual seeking to invest more than $2,000 to take an on-line course with a quiz on the possible pitfalls of crowdfunding).

428 *See* CompTIA Letter.

429 *See* Schwartz Letter.

430 *See* proposed Rule 303(b)(2)(i) of Regulation Crowdfunding.

correctly answered a specific number of questions.[431] Other formats that could be used are questions that must be answered "Yes" or "No," or "True" or "False." Any format used must be reasonably designed to demonstrate receipt and understanding of the information. Thus, the requirements of proposed Rule 303(b) would not be satisfied if, for example, an intermediary were to pre-select answers for an investor. We propose to give intermediaries flexibility in how they fulfill this requirement because we do not want to foreclose viable alternatives. There are many ways, especially on a web-based system, to convey information to, and obtain effective acknowledgement from, investors.

The proposed rules would require an intermediary to obtain an investor representation and completed questionnaire before accepting any investment commitment. Accordingly, the intermediary would be required to obtain these items each time an investor seeks to make an investment commitment.[432] This proposed requirement is intended to help ensure that investors engaging in transactions made in reliance on Section 4(a)(6) are fully informed and reminded of the risks associated with their particular investment before making any investment commitment.

Another commenter suggested that intermediaries should be required to designate a key person who will bear the responsibility to ensure that all investors demonstrate an understanding of the level of risks applicable to investments.[433] We are not proposing this requirement at this time. Although Section 4A(a)(4) requires an intermediary to ensure that each investor positively affirms that he or she understands the risks of investing in securities sold in reliance on Section

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431 *See* Spinrad Letter 1 (stating that if an investor were to answer a question incorrectly, an issuer could, for example, push the investor education material to investors for further review, or alternatively could, through a pop-up feature, explain the correct answer and then permit the investor to choose the right answer). *See also* note 427.

432 *See* proposed Rule 303(b)(2) of Regulation Crowdfunding.

433 *See* Commonwealth of Massachusetts Letter.

4(a)(6), at this time, we believe that each intermediary should have flexibility to design its own compliance program in a manner that is effective for it in light of its business model, types of offerings and any other relevant considerations.[434]

Request for Comment

162. Should we require intermediaries to have investors acknowledge issuer-specific or security-specific risks as part of the transaction process? Why or why not? If so, to what extent?

163. Are there considerations relating to investor acknowledgments we should take into account, other than those discussed above? Is the proposed requirement to obtain an acknowledgement as to investors' understanding of their ability to cancel investment commitments appropriate? Why or why not? Should we require acknowledgement of investors' understanding of any other matters? Why or why not? If so, which ones and why?

164. Are there any matters apart from the risks identified above that we should require to be addressed in the investor acknowledgements? If so, which ones, and why? How should they be addressed?

165. Should we provide a recommended form of questions and representations? Why or why not? If so, should the Commission provide the form as a starting point, and not a safe harbor, so that intermediaries can adapt the questions and representations to particular offerings? Why or why not?

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[434] FINRA (or any other applicable registered national securities association) could seek to impose a compliance structure that may require such designation. Any proposed requirement by FINRA (or any other applicable registered national securities association) would be filed with us pursuant to the Exchange Act and the rules thereunder. 17 CFR 240.19b-4.

c. Communication Channels

The proposed rules would require an intermediary to provide, on its platform, channels through which investors can communicate with one another and with representatives of the issuer about offerings made available on the intermediary's platform, subject to certain conditions.[435] While the JOBS Act does not impose this requirement, we believe that Congress contemplated that there would be such a mechanism in place for offerings made in reliance on Section 4(a)(6).[436] Some commenters refer to communication channels as an integral part of crowdfunding. For example, one commenter suggested that intermediaries should provide a mechanism for communication between issuers and investors, without necessarily requiring the communication itself to take place.[437] Others have urged us to encourage dialogue among potential investors and issuers as a key component of the crowdfunding model, suggesting that it would contribute to low levels of fraud.[438] One commenter also maintained that there is value in allowing interested parties generally, such as experts and journalists, to participate in these discussions, as well as maintaining transparency regarding the identity of those participating in the discussions.[439]

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435 *See* proposed Rule 303(c) of Regulation Crowdfunding.

436 *See* 158 CONG. REC. S2231 (daily ed. Mar. 29, 2012) (statement of Sen. Scott Brown) ("In addition to facilitating communication between issuers and investors, intermediaries should allow fellow investors to endorse or provide feedback about issuers and offerings, provided that these investors are not employees of the intermediary. Investors' credentials should be included with their comments to aid the collective wisdom of the crowd.").

437 *See* RocketHub Letter 1.

438 *See* Mollick Letter, Lucas Letter. One commenter raised a concern about communications being construed as investment advice by funding portals. *See* Grow VC Letter. *See also* Section II.D.3 below for a discussion of the proposed safe harbor for funding portals.

439 *See* Mollick Letter.

The communication channels we are proposing would provide a centralized and transparent means for members of the public that have opened an account with an intermediary to share their views about investment opportunities and to communicate with representatives of the issuer to better assess the issuer and investment opportunity. Also, though communications among investors could occur outside the intermediary's platform, communications by an investor with a crowdfunding issuer or its representatives about the terms of the offering would be required to occur through these channels,[440] on the single platform through which the offering is conducted.[441] This requirement should provide transparency and accountability, and thereby further the protection of investors.

Under the proposed rules, an intermediary that is a funding portal would be prohibited from participating in any communications in these channels, apart from establishing guidelines for communication and removing abusive or potentially fraudulent communications.[442] For example, a funding portal could establish guidelines pertaining to the length or size of individual postings in the communication channels and could remove postings that include offensive or incendiary language. Intermediaries that are funding portals are prohibited from providing investment advice or recommendations. In contrast, intermediaries that are brokers may provide investment advice and recommendations, subject to certain conditions.[443]

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440 *See* proposed Rule 204 of Regulation Crowdfunding and discussion in Section II.B.4 above.

441 *See* proposed Rule 100(a)(3) of Regulation Crowdfunding and discussion in Section II.A.3 above.

442 *See* proposed Rule 303(c) of Regulation Crowdfunding.

443 The Investment Advisers Act of 1940 excludes from the definition of investment adviser any broker or dealer whose performance of investment advisory services is "solely incidental" to the conduct of its business as a broker or dealer and who receives no "special compensation" for those advisory services. *See* Advisers Act Section 202(a)(11)(C) [15 U.S.C. 80b-2(a)(11)(C)]. *See also Study on Investment Advisers and Broker-Dealers*, note 405 at 15-16 (discussing the terms used in this exclusion). As such, brokers that are not registered as investment advisers are able to provide investment advice, provided they meet these two requirements. Subject to applicable rules, brokers also can make recommendations concerning

The proposed rules would require the intermediary to make the communications on the channels publicly available for viewing. For instance, an intermediary could not restrict viewing of the communications to only those investors who have opened accounts with it. We believe that this requirement is consistent with the concept of crowdfunding, as it provides transparent crowd discussions about a potential investment opportunity. The proposed rule would, however, require the intermediary to permit only those persons who have opened accounts with it to post comments. While we recognize that this requirement could narrow the range of views represented by excluding posts by anyone who has not opened an account with the intermediary, we believe that this proposed requirement would help to establish accountability for comments made in the communication channels. Among other things, the records required to be kept by intermediaries should help to track the origins of any abusive or potentially fraudulent comments made through the communication channels. Without this measure, we believe there could be greater risk of the communications including unfounded, potentially abusive, biased statements aimed unjustifiably to promote or discredit the issuer and improperly influence the investment decisions of members of the crowd.

The proposed rules also would require any person posting a comment in the communication channels to clearly and prominently disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or is otherwise compensated, whether in the past or prospectively, to promote the issuer's offering. This disclosure would apply to officers, directors and other representatives of the issuer, and also would be required of an intermediary that is a broker or its associated persons.

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securities, if they have a reasonable basis to believe that the recommendations are suitable. *See, e.g.*, FINRA Rule 2111 ("Suitability").

Although the statute requires issuers, but not intermediaries, to disclose compensation to promoters of an offering, we believe that intermediaries, as the hosts of the communication channels, would be well placed to take measures to ensure that promoters are clearly identified in their communication channels, in accordance with Section 4A(b)(3).[444] This requirement would be consistent with Section 4A(b)(3), which requires issuers to take steps required by the Commission and established by rule, to ensure disclosure of compensation or promotional activity "upon each instance of such promotional communication."

Request for Comment

166. Should we require intermediaries to provide communication channels, as proposed, on their platforms? Why or why not? If not, what other methods of communication could, or should, be used and why?

167. Are the proposed conditions imposed on the requirement to provide communication channels appropriate? Why or why not? For example, should the communications on the channels be available for public viewing or participation? Why or why not? What other restrictions, if any, should communication channels be subject to, and why? For example, should we require more specific actions for intermediaries to take in order to ensure adequate disclosure of issuers' and promoters' communications? If so, what actions and why?

168. Under the proposed rules, we limit the ability to post in the communication channels to only those persons who have opened accounts with the

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444 *See* discussion in Section II.B.5 above.

intermediaries and thereby identified themselves to the intermediaries. Is this restriction adequate? Why or why not? Would it be appropriate to permit anyone, including persons who have not identified themselves in any way, to post comments in intermediaries' communication channels? Why or why not?

169. The proposed rules would require any person posting a comment in the communication channels to disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or is otherwise compensated, whether in the past or prospectively, to promote the issuer's offering. Should we impose this requirement on other types of persons as well, such as affiliates of the issuer, regardless of whether they are engaging in promotional activities? Why or why not?

170. Should we require the intermediary to maintain the communication channels of its platform during the post-offering period, in order to permit communication between investors and the issuer after the offering has completed? Why or why not? If so, for how long after the offering is completed (*e.g.*, for one month, for six months, for one year, or longer) should the intermediary be required to maintain the channels?

d. Notice of Investment Commitment

The proposed rules would require an intermediary, upon receipt of an investment commitment from an investor, to promptly give or send to the investor a notification disclosing: (1) the dollar amount of the investment commitment; (2) the price of the securities, if known; (3) the name of the issuer; and (4) the date and time by which the investor may cancel the

investment commitment.[445] This notification would be required to be provided by e-mail or other electronic media, and to be documented in accordance with applicable recordkeeping rules.[446] The proposed notification is intended, among other things, to provide the investor with a written record of the basic terms of the transaction, as well as a reminder regarding his or her ability to cancel the investment commitment.

Request for Comment:

171. Would the notifications we are proposing to require be useful to investors? Why or why not? Should we provide further specificity as to when notice must be provided?

172. Are there any other circumstances under which an investor should receive a notice? If so, under what other circumstances?

e. Maintenance and Transmission of Funds

Securities Act Section 4A(a)(7) requires that an intermediary "ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount, . . . as the Commission shall, by rule, determine appropriate." The proposed rules would implement this provision and address the maintenance and protection of investor funds, pending completion of a transaction made in reliance on Section 4(a)(6).[447]

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445 *See* proposed Rule 303(d) of Regulation Crowdfunding. The statutory requirements for intermediaries do not expressly address an intermediary's obligation to notify an investor of receipt of the investor's commitment, although the statutory provision provides us with authority to do so in our rules. *See* Section 4A(a)(12).

446 Intermediaries that are brokers would be subject to the recordkeeping requirements of Exchange Act Rules 17a-3 and 17a-4, and intermediaries that are funding portals would be subject to recordkeeping requirements under proposed Rule 404 of Regulation Crowdfunding.

447 *See* proposed Rule 303(e) of Regulation Crowdfunding.

The proposed rules would require an intermediary that is a registered broker to comply with established requirements in Exchange Act Rule 15c2-4[448] for the maintenance and transmission of investor funds.[449] Application of Exchange Act Rule 15c2-4(b) to an intermediary that is a broker in the crowdfunding context, would require, in relevant part, that money or other consideration received is promptly deposited in a separate bank account, as agent or trustee for the persons who have the beneficial interest therein, until the appropriate event or contingency has occurred, and then the funds would be promptly transmitted or returned to the persons entitled thereto; or all such funds would be promptly transmitted to a bank, which has agreed in writing to hold such funds in escrow for the persons who have the beneficial interests therein and to transmit or return such funds directly to the persons entitled thereto when the appropriate event or contingency has occurred. Under Section 4A(a)(7), proceeds are to be transmitted to the issuer only if the target offering amount is met or exceeded. As explained in the adopting release to Rule 15c2-4, this rule was designed to prevent fraud "either upon the person on whose behalf the distribution is being made or upon the customer to whom the payment is to be returned if the distribution is not completed."[450]

The proposed rules would establish separate requirements for an intermediary that is a funding portal.[451] Because a funding portal cannot receive any funds, it would be required to direct investors to transmit money or other consideration directly to a qualified third party that

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448 17 CFR 240.15c2-4.

449 *See* proposed Rule 303(e)(1) of Regulation Crowdfunding.

450 *Adoption of Rule 15c2-4 under the Securities Exchange Act of 1934*, Release No. 34-6737 (Feb. 21, 1962) [27 F.R. 2089 (Mar. 3, 1962)].

451 *See* proposed Rule 303(e)(2) of Regulation Crowdfunding.

has agreed in writing[452] to hold the funds for the benefit of the investors and the issuer and to promptly transmit or return the funds to the persons entitled to such funds.[453] The proposed rules would define "qualified third party" to mean a bank[454] that has agreed in writing either (i) to hold the funds in escrow for the persons who have the beneficial interests in the funds and to transmit or return the funds directly to the persons entitled to them when the appropriate event or contingency has occurred; or (ii) to establish a bank account (or accounts) for the exclusive benefit of investors and the issuer. We have chosen to specify that the qualified third party would be a bank because investors, as well as intermediaries and issuers, would then be afforded the protections of existing regulations that apply to banks, in particular those pertaining to the safeguarding of customer funds.[455]

The proposed rules also would require an intermediary that is a funding portal to promptly direct transmission of funds from the qualified third party to the issuer when the aggregate amount of investment commitments from all investors is equal to or greater than the target amount of the offering and the cancellation period for each investor has expired,[456] but no earlier than 21 days after the date on which the intermediary makes publicly available on its platform the information required to be provided by the issuer such as information about the issuer and the offering pursuant to Rules 201 and 203(a) of proposed Regulation

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452 This written agreement would be required to be maintained by the funding portal pursuant to proposed Rule 404 of Regulation Crowdfunding. *See* discussion in Section II.D.5 below.

453 In the crowdfunding context, it is expected that the intermediary would be making the determination as to whether the contingency, *i.e.*, the target offering amount, has been met.

454 *See* Exchange Act Section 3(a)(6) [15 U.S.C. 78c(a)(6)] (defining "bank").

455 For example, protections afforded to bank accounts include FDIC deposit insurance. *See* Federal Deposit Insurance Corp., *FDIC Deposit Insurance Coverage*, http://www.fdic.gov/deposit/deposits/dis/.

456 *See* Section II.C.6 below for a discussion of the cancellation period.

Crowdfunding.[457] We believe that this approach is consistent with the requirements in (1) Section 4A(a)(7) providing for the transfer of funds to an issuer when the issuer's target offering amount has been met, (2) Section 4A(a)(6) providing that issuer information be made available to investors for at least 21 days prior to the first day on which securities are sold in the offering, and (3) Section 4A(b)(1)(G) providing that investors must be allowed a reasonable opportunity to rescind their investment commitment. Under our proposed rules, an intermediary could permit a minimum-maximum offering, for example, in which the minimum would serve as the target offering amount.[458]

The proposed rules also would require an intermediary that is a funding portal to promptly direct the return of funds to an investor when an investment commitment has been cancelled (including when there has been a failure to obtain effective reconfirmation when there has been a material change).[459] The proposed rules also would require an intermediary that is a funding portal promptly to direct the return of funds to investors when an issuer does not complete an offering.[460] This could occur if an issuer does not receive investment commitments

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457 *See* proposed Rule 303(e)(3)(i) of Regulation Crowdfunding. *See also* Exchange Act Rule 10b-9 [17 CFR 240.10b-9].

458 In a minimum-maximum offering, a minimum amount of securities must be sold within the offering period in order for a contingency to be satisfied, and the amount of securities sold may not exceed a pre-determined maximum. *See* Vim Funding Letter (suggesting that minimum and maximum offerings will allow issuers to focus on achieving "funding milestones" and the amount of funding they believe they need, while an "all or nothing" offering will likely incentivize issuers to seek smaller raises because of the possibility of failing at raising a larger amount). *Compare* AppleSeedz Letter (stating that an "all or nothing" offering would best protect investors). *See also* Section II.B.1.a.i(c) above for a discussion of the issuer's disclosure requirements about the use of proceeds in a minimum-maximum offering.

459 *See* proposed Rule 303(e)(3)(ii) of Regulation Crowdfunding.

460 *See* proposed Rule 303(e)(3)(iii) of Regulation Crowdfunding.

that meet its minimum target amount during the offering period. There also may be other circumstances in which an issuer chooses to cancel its offering.[461]

Some commenters suggested that investors should be able to transmit funds for an investment commitment through a mechanism such as those provided by Automated Clearing House ("ACH"), PayPal, Inc. or a linked bank account.[462] We are not proposing to limit or require a particular payment mechanism, so as to provide both intermediaries and investors with flexibility in the means of payment, but we note that under the statute and the proposed rules, an intermediary that is a funding portal may not hold, manage, possess or otherwise handle investor funds or securities.[463] One commenter urged us not to permit the use of credit cards to fund an investment because investors could claim charge-backs[464] after a security is sold.[465] Two commenters[466] advocated permitting the use of credit cards for certain types of crowdfunding offerings, with one noting that this payment method involves customary Internet disclosures on the part of the investor.[467] Again, we are not proposing to limit payment mechanisms, but we

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461 *See* proposed Rule 304(d) and discussion in Section II.C.6 below regarding offerings that are not completed.

462 *See* Vim Funding Letter (stating that investors should be able to authorize an intermediary to save investor banking information, in much the same way that consumers today can link a bank account to their online brokerage account); Arctic Island Letter (stating that funds should be transferred only to a bank in the United States).

463 *See* Exchange Act Section 3(a)(80)(D) [15 U.S.C. 78c(a)(80)(D)] and discussion in Section II.D.3 below.

464 In the United States, credit card customers have charge reversal rights under Regulation Z (12 CFR 226.13) of the Truth in Lending Act (15 U.S.C. 1666) and debit card holders are afforded such rights under Regulation E (12 CFR 205.6) of the Electronic Fund Transfer Act (15 U.S.C. 1693(b)).

465 *See* RocketHub Letter 1.

466 *See* City First Letter; RFPIA Letter 5.

467 *See* City First Letter.

note that an intermediary could, in its discretion, decline to accept certain payment methods, such as credit cards, or accept them only in certain circumstances. [468]

One commenter recommended that we prohibit purchases by an issuer or its officers, directors, control persons and other affiliates from counting toward meeting the target offering amount and obtaining a release of the funds held in escrow.[469] The commenter expressed concern that, without this prohibition, issuers that are unable to attract sufficient interest from unaffiliated investors could "game" the system by accepting affiliated investor funds in an offering that otherwise would have failed. We believe that this commenter's concern is reflected in the purpose and intent of the JOBS Act's crowdfunding provisions. In particular, we believe it would be contrary to the intent and purpose of the statute and the proposed rules to declare an offering "sold" on the basis of "*non-bona fide sales* designed to create the appearance of a successful completion of the offering."[470] As we have said in other contexts, non-bona fide purchases would include "purchases by the issuer through nominee accounts or purchases by persons whom the issuer has agreed to guarantee against loss."[471] Although we are not restricting directors and officers of an issuer from purchasing securities in an offering, we expect intermediaries to scrutinize any purchases by these individuals for "red flags," such as repeated

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468 We note that an investor's use of his or her right to dispute credit card charges could inhibit the ability of an issuer to meet its target or to provide accurate disclosures to investors and the Commission regarding the progress it has made toward, and whether it has, reached the target offering amount. This potential impact would affect offerings conducted through brokers and funding portals alike. We also note that pursuant to Exchange Act Section 3(a)(80)(D) (15 U.S.C. 78c(a)(80)(D)), a funding portal would be statutorily prohibited from extending credit or margin to customers.

469 *See* NASAA Letter.

470 *See Requirements of Rules 10b-9 and 15c2-4 under the Securities Exchange Act of 1934 Relating to Issuers, Underwriters and Broker-Dealers Engaged in an "All or None" Offering*, Release No. 34-11532, 7 S.E.C. Docket 403, 1975 WL 163128, at 1 (July 11, 1975).

471 *Id.*

investment commitments and cancellations, that would indicate that the purchase was designed to create an impression that the offering has reached, or will reach, its target amount.[472]

Several commenters urged us to adopt net capital standards for funding portals.[473] We are not proposing net capital standards for funding portals primarily because they are prohibited from handling, managing or possessing investor funds or securities. We believe that the requirements relating, in particular, to transmission of proceeds under the proposed rules would help ensure that investor funds are protected, without requiring funding portals to maintain net capital. We are, however, proposing to require funding portals to obtain fidelity bonds, as discussed below.[474]

Request for Comment

173. Are the proposed requirements for fund maintenance and transmission appropriate? Are there other types of custody arrangements that we should specifically permit? Why or why not? If so, what types of arrangements should we permit and how would they protect investor funds?

174. Should we prohibit any variations of a contingency offering, like minimum-maximum offerings? Why or why not? Should we require that offerings made in reliance on Section 4(a)(6) be conducted on an "all-or-none" basis? Why or why not?

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472 Intermediaries are required to cancel an offering if they believe the issuer or offering presents the potential for fraud or otherwise raises concerns regarding investor protection. *See* proposed Rule 301(c)(2) of Regulation Crowdfunding and discussion in Section II.C.3 above.

473 *See, e.g.*, Risingtidefunding.com Letter (stating that capital standards should be limited); Arctic Island Letter (stating that funding portals should be required to maintain net capital that is at least equivalent to that of broker-dealers that handle customer funds).

474 *See* discussion in Section II.D.1.c below.

175. Instead of a requirement to transmit funds "promptly," as proposed, should we establish fixed deadlines for transmission, such as three business days? Why or why not?

176. Should we expressly incorporate into the rules prior Commission, SRO and staff guidance regarding Exchange Act Rule 15c2-4 on, among other things: (1) the meaning of the phrase "distribution";[475] (2) the meaning of "prompt transmittal";[476] (3) the payment mechanics for escrow arrangements;[477] (4) "receipt of offering proceeds" in the context of payment by check;[478] (5) "prompt deposit," as it applies to the use of segregated deposit accounts; and (6) specifics as to who could act as the "agent or trustee" maintaining the segregated deposit account?[479] Why or why not? Should any other specific guidance regarding Rule 15c2-4 be explicitly incorporated into the rules? Please explain.

177. Should we expand the definition of "qualified third party" to include entities other than a bank? Why or why not? If so, which ones? Please explain how other entities could adequately safeguard customers' funds and securities?

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475 *See, e.g.*, *Baikie & Alcantara, Inc.,* Release No. 34-19410 (Jan. 6, 1983). *See also* Letter from Larry E. Bergmann, Assistant Director, Division of Market Regulation, Securities and Exchange Commission to Linda A. Wertheimer, Chairman, Subcommittee on Partnerships, Trusts and Unincorporated Associations, Federal Regulation of Securities Committee, American Bar Association (Oct. 16, 1984) (explaining that a "distribution" is any offering of securities, whether or not registered, that "is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods.").

476 *See* NASD (n/k/a FINRA), Notice to Members 84-64 (Nov. 26, 1984). *See also* NASD, Notice to Members 84-7 (Jan. 30, 1984).

477 *Id*.

478 *See* NASD (n/k/a FINRA), Notice to Members 94-7 (Jan. 24, 1994).

479 *Id.*

178. Should we require funding portals to maintain a certain amount of net capital? Why or why not? If so, what would be an appropriate amount, and how should that amount be determined?

179. Should we require or prohibit certain methods of payments for the purchase of securities under Section 4(a)(6)? Why or why not? Are there any particular concerns raised by different methods? Would it depend upon whether a broker-dealer or funding portal is facilitating the transaction? Why or why not?

f. Confirmation of Transaction

The proposed rules would require that an intermediary, at or before the completion of a transaction made pursuant to Section 4(a)(6), give or send to each investor a notification disclosing: (1) the date of the transaction; (2) the type of security that the investor is purchasing; (3) the identity, price and number of securities purchased by the investor, as well as the number of securities sold by the issuer in the transaction and the price(s) at which the securities were sold; (4) certain specified terms of the security, if it is a debt or callable security; and (5) the source and amount of any remuneration received or to be received by the intermediary in connection with the transaction, whether from the issuer or from other persons.[480] This notification would be required to be provided by e-mail or other electronic media, and to be documented in accordance with applicable recordkeeping rules.[481] As the Commission has long stated, transaction confirmations serve an important and basic investor protection function by,

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480 *See* Proposed Rule 303(f)(1) of Regulation Crowdfunding. The statutory requirements for intermediaries do not expressly address an intermediary's obligation to provide investors confirmation of a transaction, but the statute provides us with authority to do so in our rules. *See* Section 4A(a)(12).

481 Intermediaries that are brokers would be subject to the recordkeeping requirements of Exchange Act Rules 17a-3 and 17a-4, and intermediaries that are funding portals would be subject to recordkeeping requirements under proposed Rule 404 of Regulation Crowdfunding.

among other things, conveying information and providing a reference document that allows investors to verify the terms of their transactions, acting as a safeguard against fraud and providing investors a means by which to evaluate the costs of their transactions.[482] Each of the transaction items of information proposed to be required is intended to assist investors in memorializing and assessing their transactions. The requirement for an intermediary to disclose to an investor the source and amount of any remuneration received or to be received should help to highlight potential conflicts of interest the intermediary may have.

An intermediary that gives or sends to each investor the notification described above would be exempt from the requirements of Exchange Act Rule 10b-10 for the subject transaction.[483] The confirmation terms are similar to, but not as extensive as, those under Rule 10b-10. We believe that this difference is appropriate given the more limited scope of an intermediary's role in crowdfunding transactions. For example, Rule 10b-10 requires disclosure

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482 *See Confirmation of Transactions*, Release No. 34-34962 (Nov. 10, 1994) [59 FR 59612, 59613 (Nov. 17, 1994)].

483 *See* proposed Rule 303(f)(2) of Regulation Crowdfunding. Exchange Act Rule 10b-10 (17 CFR 240.10b-10) generally requires a broker-dealer effecting a customer transaction in securities (other than U.S. savings bonds or municipal securities) to provide a notification to its customer, at or before completion of a securities transaction, that discloses certain information specific to the transaction. Specifically, Rule 10b-10 requires the disclosure of the date, time, identity, prices and number of securities bought or sold; the capacity in which the broker-dealer acted (*e.g.*, as agent or principal); yields on debt securities; and under specified circumstances, the amount of remuneration the broker-dealer will receive from the customer and any other parties. With regard to the specified circumstances mentioned above, the remuneration disclosures of Rule 10b-10 generally are required, but certain exclusions apply. For example, the remuneration disclosures are generally required where a broker or dealer is acting as agent for a customer or some other person. In the case where remuneration is received or to be received by the broker from such customer in connection with the transaction, the disclosures are not required where the remuneration paid by such customer is determined pursuant to written agreement with such customer, otherwise than on a transaction basis. 17 CFR 240.10b-10(a)(2)(i)(B). In contrast, the remuneration disclosures of proposed Rule 303(f)(2)(vi) would be required across all crowdfunding transactions where remunerations are received or are to be received. Given the limitations on the dollar amount of securities that could be offered, as well as the limits on individual investment amounts, in transactions relying on Section 4(a)(6), we would not expect investors or potential investors to negotiate individualized compensation agreements.

regarding such matters as payment for order flow,[484] riskless principal transactions,[485] payment of odd-lot differentials[486] and asset-backed securities.[487] These items generally would not be relevant to crowdfunding securities transactions or an intermediary's participation in such transactions, and their inclusion in a crowdfunding securities confirmation may be confusing to investors. We believe, therefore, that if an intermediary satisfies the notification requirements of the proposed rules, the intermediary would have provided investors with sufficient relevant information regarding the crowdfunding security, and so would not be required to meet the additional requirements of Rule 10b-10.

Request for Comment

180. Are the proposed items of disclosure appropriate? Should we require more or less disclosure? Please explain. Should the disclosure items differ from those in Rule 10b-10? Are there any proposed disclosures that should be modified or deleted? Why or why not? If so, what different items should be included and why? Should the proposed notification requirements be deemed to be satisfied if an intermediary complies with Rule 10b-10? Why or why not? If we take this approach, would this confuse investors?

181. As mentioned above, we do not expect that investors would negotiate individualized compensation agreements with intermediaries in the crowdfunding context. Is this expectation appropriate? Why or why not?

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484 17 CFR 240.10b-10(a)(2)(i)(C).

485 17 CFR 240.10b-10(a)(2)(ii).

486 17 CFR 240.10b-10(a)(3).

487 17 CFR 240.10b-10(a)(7).

Should the proposed rules require disclosure of these arrangements, and if so, in a way that would be similar to or different from what is required under Rule 10b-10? Please explain.

6. Completion of Offerings, Cancellations and Reconfirmations

Section 4A(a)(7) requires an intermediary to allow investors to cancel their commitments to invest as the Commission shall, by rule, determine appropriate. As discussed above, Section 4A(b)(1)(G) requires issuers to provide investors, "prior to sale, . . . a reasonable opportunity to rescind the commitment to purchase the securities."

Commenters suggested a range of approaches to these statutory requirements. Some commenters favored a "rolling" rescission right, similar to the three business day rescission right provided in the Truth in Lending Act,[488] under which an investor could cancel an investment commitment within 24[489] or 48 hours[490] of making the initial commitment. Other commenters suggested permitting investors to cancel their investment commitments at any time prior to a specified date. For example, one commenter recommended permitting investors to cancel a

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488 15 U.S.C. 1601 *et seq.*; 12 CFR 226.

489 *See* RocketHub Letter 1 (stating that: (1) a system could be used whereby commitments to invest would be considered "pending" for 24 hours, during which an investor would be able to cancel his or her investment commitment; after the 24-hour period expires, an investor's commitment status would be changed from "pending" to "committed," and the investor's funds would be held in escrow until transferred to the issuer; (2) if an offering did not reach its target offering amount before a specific deadline, an investor's funds should be returned; (3) a short rescission period will protect investors from "pump & dump" schemes and minimize an issuer's exposure to the risk of a funding "short fall"; (4) a longer rescission period is unnecessary because Title III requires a minimum offering period of 21 days, giving potential investors enough time to review an offering before making an investment commitment; and (5) because Title III contemplates that issuers could raise capital "greater than a target offering amount," the issuer also must establish an offering cap that would limit oversubscriptions).

490 *See* NCA Letter (stating that this will prevent commitments from being made solely for the purpose of attracting new investors (*i.e.*, "pumping" the offering) and that cancellation should be permitted when there is a change in investment terms or materially adverse information is subsequently disclosed).

commitment for up to three days before the target date.[491] Another commenter suggested that an investor should be permitted to cancel a commitment until the moment that the target offering amount is reached, but not thereafter.[492] Another commenter recommended a ten-day window, after a target offering amount is met, during which investors could cancel a commitment to invest.[493] Another commenter recommended that an investor be permitted to cancel a commitment until the date the offering closes.[494] In contrast, one commenter recommended that an investor be permitted to cancel a commitment only if the offering fails to meet the target amount or for other limited purposes.[495]

We believe that the principles underlying crowdfunding indicate that investors should have the full benefit of the views of other potential investors regarding offerings made in reliance on Section 4(a)(6), even after they have made investment commitments.[496] The proposed rules, therefore, would give investors an unconditional right to cancel an investment commitment for any reason until 48 hours prior to the deadline identified in the issuer's offering materials.[497] Under this approach, an investor could reconsider his or her investment decision with the benefit

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491 *See* RFPIA Letter 3 (further stating that the Commission should impose penalties on issuers if they abuse this provision).

492 *See* Cera Technology Letter (stating that permitting investors to cancel a commitment to invest after the funding goal is reached could cause an entire fundraising round to collapse).

493 *See* Crowdfunding Offerings Ltd. Letter 2 (stating that funding portals should be permitted to have an open and closed period for rescinding a commitment to invest; that this option is necessary in the event that an investor cancels his or her commitment to invest during the window; and that a competitor could commit to invest and then cancel that commitment at a critical moment during the fundraising effort, causing the offering to fall short of the target offering amount).

494 *See* CFIRA Letter 9.

495 *See* Schwartz Letter.

496 *See, e.g.*, 158 CONG. REC. S5474-03 (daily ed. July 26, 2012) (statement of Sen. Jeff Merkley) ("Two important investor protections in the Crowdfund Act are the public review period and withdrawal rights. They are designed to allow investors the chance to carefully consider offerings, permitting the 'wisdom of the crowd' to develop, rather than perhaps just the 'excitement of the crowd.'").

497 *See* proposed Rule 304(a) of Regulation Crowdfunding.

of the views of the crowd and other information, until the final 48 hours of the offering. Thereafter, an investor would not be able to cancel any investment commitments made within the final 48 hours (except in the event of a material change to the offering, as discussed below). We believe that the other approaches suggested by commenters, described above, could either terminate the cancellation right too early, so that investors would not be able to benefit from the views of the crowd and other information they obtain, or too late, so that the issuer would be subject to uncertainty as to whether it had met the target offering amount. We believe that the proposed rules strike an appropriate balance between giving investors the continuing benefit of the collective views of the crowd and then, if desired, to cancel their investment commitments, while providing issuers with certainty about their ability to close an offering at the end of the offering period.

Pursuant to the proposed rules, if an issuer reaches the target offering amount prior to the deadline identified in its offering materials, it may close the offering once the target offering amount is reached, provided that: (1) the offering will have remained open for a minimum of 21 days; (2) the intermediary provides notice about the new offering deadline at least five business days prior to the new offering deadline; (3) investors are given the opportunity to reconsider their investment decision and to cancel their investment commitment until 48 hours prior to the new offering deadline; and (4) at the time of the new offering deadline, the issuer continues to meet or exceed the target offering amount.[498] We believe these conditions are appropriate, as they would result in adequate notice being provided to investors and are consistent with the statutory

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[498] *See* proposed Rule 304(b) of Regulation Crowdfunding. Consistent with the cancellation provision for an offering that does not close prior to the deadline identified in its offering materials, an investor would not be able to cancel any investment commitments made within the final 48 hours prior to the new offering deadline (except in the event of a material change to the offering).

provisions that offering materials are made available for at least 21 days before any securities can be sold to an investor,[499] that proceeds be provided to the issuer only once the target offering amount has been met[500] and that investors are provided an opportunity to cancel their commitments.[501]

If there is a material change to the terms of an offering[502] or to the information provided by the issuer regarding the offering, the proposed rules would require the intermediary to give or send to any potential investors who have made investment commitments notice of the material change, stating that the investor's investment commitment will be cancelled unless the investor reconfirms his or her commitment within five business days of receipt of the notice.[503] We recognize that complying with this requirement could result in certain offerings being extended beyond the offering period specified in the offering statement. If the investor fails to reconfirm his or her investment within those five business days, the proposed rules would require an intermediary, within five business days thereafter, to: (1) provide or send the investor a notification disclosing that the investment commitment was cancelled, the reason for the cancellation and the refund amount that the investor should expect to receive; and (2) direct the refund of investor funds. We believe that when material changes arise during the course of an offering, an investor who had made a prior investment commitment should have a reasonable

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499 *See* Section 4A(a)(6).

500 *See* Section 4A(a)(7).

501 *See id.*

502 We note that in those instances where an issuer has previously disclosed in its offering materials only the method for determining the price of the securities offered and not the final price of those securities, setting of the final price would be considered a material change. *See* Section II.B.2 above. We also note if the material change is to close the offering once the target offering amount is reached, which would be prior to the deadline identified in the offering materials, then the procedures required under proposed Rule 304(b), and not 304(c), would apply. *See* discussion in this Section II.C.6 above.

503 *See* proposed Rule 304(c)(1) of Regulation Crowdfunding.

period during which to review the new information and to decide whether to invest. This notification would be required to be provided by e-mail or other electronic media, and to be documented in accordance with applicable recordkeeping rules.[504]

Finally, if an issuer does not complete an offering because the target is not reached or the issuer decides to terminate the offering, the proposed rules would require an intermediary, within five business days, to: (1) give or send to each investor who had made an investment commitment a notification disclosing the cancellation of the offering, the reason for the cancelation, and the refund amount that the investor should expect to receive; (2) direct the refund of investor funds; and (3) prevent investors from making investment commitments with respect to that offering on its platform.[505] This notification would be required to be provided by e-mail or other electronic media, and to be documented in accordance with applicable recordkeeping rules.[506]

Request for Comment

182. Are the proposed requirements for cancellations and notifications appropriate? Why or why not? Should investors be permitted to withdraw commitments at any time until the offering closes? Should investors be provided with additional time to cancel their commitments after the closing of the offering if the commitment was made within 48 hours of the offering deadline? Would some

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504 Intermediaries that are brokers would be subject to the recordkeeping requirements of Exchange Act Rules 17a-3 and 17a-4, and intermediaries that are funding portals would be subject to recordkeeping requirements under proposed Rule 404 of Regulation Crowdfunding.

505 *See* proposed Rule 304(d) of Regulation Crowdfunding.

506 Intermediaries that are brokers would be subject to the recordkeeping requirements of Exchange Act Rules 17a-3 and 17a-4, and intermediaries that are funding portals would be subject to recordkeeping requirements under proposed Rule 404 of Regulation Crowdfunding.

time period other than 48 hours be more appropriate? Do the proposed rules, whereby an investor cannot cancel commitments made within 48 hours of the offering deadline, strike the appropriate balance between (1) giving investors the ability to cancel commitments in light of new views expressed in the crowd and (2) providing issuers with certainty about their ability to close an offering by meeting the target offering amount? Please explain. What are the advantages and disadvantages of any alternative time period? Should no new investment commitments be permitted after a date that is two full business days prior to the beginning of the 48-hour period when investments are no longer cancellable? Why or why not?

183. Should an investor be required to reconfirm his or her commitment to invest when a material change has occurred? Why or why not? Is the five business day period for reconfirmation after material changes appropriate? Would another time period be more appropriate? If so, what time period and why?

184. The proposed rules provide a mechanism by which existing disclosure materials can be modified in the event of a material change, with the original offering remaining open. Should the proposed rules require that an offering be cancelled in the event of a material change, and then, if the issuer desires, reopened in a new offering that includes the revised disclosure? Why or why not?

185. Are there any other circumstances under which an investor should receive a notification? If so, under what other circumstances? Should we provide further specificity on when notifications must be provided?

186. Under the proposed rules, in the event of a cancellation an intermediary would be required to provide a notice to prospective investors within five business days. Is this requirement appropriate? Should the time period be longer or shorter, such as 3 business days or 10 business days? Why or why not? Should we include any other notification requirements in the event an offering is canceled? If so, what requirement should we include and why?

7. Payments to Third Parties

Section 4A(a)(10) provides that an intermediary in a transaction made in reliance on Section 4(a)(6) shall not compensate "promoters, finders, or lead generators for providing the broker or funding portal with the personal identifying information of any potential investor."

One commenter noted that the terms "promoters," "finders" and "lead generators" are not defined in the statute.[507] The commenter also expressed concern that promoters, finders and lead generators could provide a broker or funding portal with potential investors' personally identifiable information as long as the broker or funding portal did not directly compensate them.[508]

Another commenter stated that "personal identifying information" should be clearly defined.[509] While agreeing that funding portals should not be permitted to compensate third parties for personally identifiable information of potential investors, the commenter asserted that funding portals, but not registered brokers, should be allowed to compensate promoters, finders or lead generators for directing potential issuers or investors to view either the portal itself or

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507 *See* Crowdfunding Offerings Letter 2.

508 *See id.* (stating that there could be circumstances in which a third party stands to gain in some way by a successful crowdfunding effort).

509 *See* RocketHub Letter 1.

specific offerings.[510] The commenter further stated that revenue sharing arrangements should not be restricted when these relationships are not promoter-, finder- or lead generator-based.[511]

The proposed rules would broadly prohibit an intermediary from compensating any person for providing it with the personally identifiable information of any investor or potential investor.[512] The term "personally identifiable information" would be defined to mean any information that can be used to distinguish or trace an individual's identity, either alone or when combined with other personal or identifying information that is linked or linkable to a specific individual.[513] Personally identifiable information could include, for example, any information, such as name, social security number, date or place of birth, mother's maiden name or biometric records, that can be used to identify an individual, as well as any other information that is linked directly to an individual, such as financial, employment, educational or medical information. We believe that any person compensated for providing the personally identifiable information of potential investors would be acting as a promoter, finder or lead generator within the meaning of Section 4A(a)(10). Thus, the proposed rules would prohibit compensation broadly to "any person."

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510 *See id.*

511 *See id.*

512 *See* proposed Rule 305(a) of Regulation Crowdfunding.

513 See proposed Rule 305(c) of Regulation Crowdfunding. The proposed definition is consistent with those used in other government agency reports that discuss strategies for protecting personally identifiable information. *See, e.g.*, Government Accountability Office ("GAO"), *Privacy: Alternatives Exist for Enhancing Protection of Personally Identifiable Information*, GAO-08-536, at 1 n.1 (May 2008); GAO, *Information Security: Protecting Personally Identifiable Information,* GAO-08-343, at 5 n.9 (Jan. 2008). *See also* Erika McCallister, Tim Grance and Karen Scarfone, *Guide to Protecting the Confidentiality of Personally Identifiable Information (PII): Recommendations of the National Institute of Standards and Technology*, U.S. Department of Commerce, National Institute of Standards and Technology, Special Publication 800-122, at ES-1 (Apr. 2010).

The proposed rules would, however, permit an intermediary to compensate a person for directing issuers or potential investors to the intermediary's platform if (1) the person does not provide the intermediary with the personally identifiable information of any potential investor, and (2) the compensation, unless it is paid to a registered broker or dealer, is not based, directly or indirectly, on the purchase or sale of a security offered in reliance on Section 4(a)(6) on or through the intermediary's platform.[514] The proposed rules would not permit a funding portal to compensate third parties by commission or other transaction-based compensation unless that third party is a registered broker or dealer and thereby subject to an established regulatory and oversight regime that provides important safeguards to investors. We believe that the prohibition on transaction-based compensation in the proposed rules would help to remove the incentive for high-pressure sales tactics and other abusive practices.[515] Under the proposed rules, an intermediary could pay a person a flat fixed fee[516] to direct other persons to the intermediary's platform through, for example, hyperlinks or search term results, if the intermediary received no personally identifiable information. Although the statute is clear that an intermediary cannot pay

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514 *See* proposed Rule 305(b) of Regulation Crowdfunding. We note that the receipt of direct or indirect transaction-based compensation would strongly indicate that the recipient is acting as a broker. As such, the party receiving the compensation in the scenario described needs to consider whether it would be required to register as a broker

515 *See Persons Deemed Not to Be Brokers,* Release No. 34-22172 (June 27, 1985) [50 FR 27,940, 27942 (July 9, 1985)] ("Compensation based on transactions in securities can induce high pressure sales tactics and other problems of investor protection that require application of broker-dealer regulation."). *See also* 158 CONG. REC. S5474-03 (daily ed. July 26, 2012) (statement of Sen. Jeff Merkley) ("[T]he limitation on off-platform advertising is intended to prohibit issuers—including officers, directors, and 20 percent shareholders—from promoting or paying promoters to express opinions outside the platform that would go beyond pointing the public to the funding portal. Such paid testimonials and manufactured excitement would represent a prohibited form of off-site advertising if those disclosures were not present. Whether on or off the platform, paid advertising must clearly be disclosed as such. In short, the investor deserves a transparent medium for making healthy decisions.").

516 A flat fixed fee is one that is not based on the success of the offering, and so would not be transaction-based compensation. As noted above, receipt of transaction-based compensation would strongly indicate that the recipient is acting as a broker, and the party receiving this kind of compensation needs to consider whether it would be required to register as a broker.

for the personally identifiable information of potential investors, we do not believe Congress intended to disrupt current practices, such as paying for advertising based on Internet search rankings. It would be acceptable under the proposed rules, therefore, for an intermediary to make payments to advertise its existence, provided that in doing so, it does not pay for the personally identifiable information of investors or potential investors.[517]

Request for Comment

187. Should we permit an intermediary to compensate a third party for directing potential investors to the intermediary's platform under the limited circumstances described above? Why or why not? Should any disclosures be required? Why or why not? Please identify reasonable alternatives to this approach, if any.

188. What other concerns may be relevant in the context of third parties referring others to intermediaries, and how could they be addressed? For example, should compensation be limited in some additional way? Please explain.

D. Additional Requirements on Funding Portals

1. Registration Requirement

a. Generally

Securities Act Section 4A(a)(1) requires that an intermediary facilitating a transaction made in reliance on Section 4(a)(6) register with the Commission as a broker or a funding portal. The statute does not, however, prescribe the manner in which a funding portal would register

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[517] *See also* proposed Rule 402 of Regulation Crowdfunding and discussion in Section II.D.3 below.

with the Commission.[518] Securities Act Section 4A(a)(12) requires intermediaries to comply with requirements as the Commission may, by rule, prescribe for the protection of investors and in the public interest. Exchange Act Section 3(h)(1)(C) also permits us to impose, as part of our authority to exempt funding portals from broker registration, "such other requirements under [the Exchange Act] as the Commission determines appropriate."

Some commenters asked specifically for clarification on the nature of a funding portal's registration requirements.[519] One commenter suggested that we permit a funding portal to have multiple intermediary websites under a single registration application.[520] The commenter argued that this will permit a registered funding portal to offer issuers the opportunity to offer their securities on a funding portal website that is specific as to parameters such as industry, geography, community and affinity group, which would result in a better organized market for both issuers and investors.

One commenter asked us to consider the creation of a "Registered Portal-Check," similar to the BrokerCheck system maintained by FINRA, to provide greater transparency to participants in Section 4(a)(6) transactions.[521] Another commenter asked us to require that funding portals, like issuers engaged in crowdfunding transactions in reliance on Section 4(a)(6), be organized

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518 *Compare* Exchange Act Section 15(b) [15 U.S.C. 78*o*(b)] (prescribing the manner of registration of broker-dealers).

519 *See* NSBA Letter; RocketHub Letter 1. *See also* Applied Dynamite Letter (stating that the requirements for those who wish to be intermediaries in offerings pursuant to Rule 506 of Regulation D should be harmonized with those for funding portals, and that we should provide for a common registration process for the two). We note, however, that Securities Act Section 4(b)(1) provides an exemption from broker-dealer registration for certain portals facilitating transactions pursuant to Rule 506 of Regulation D, as revised by Section 201 of the JOBS Act.

520 *See* NCA Letter.

521 *See* CFIRA Letter 2 (further stating that the system should "clearly identify the registration status of a funding portal and its management, display any regulatory actions against such portal and provide a hyperlink to its website").

under and subject to the laws of a State or territory of the United States or the District of Columbia.[522]

We are proposing to establish a streamlined registration process under which a funding portal would register with the Commission by filing a form with information consistent with, but less extensive than, the information required for broker-dealers on Form BD.[523] Under the proposed rules, a funding portal would register by completing a Form Funding Portal, which includes information concerning the funding portal's principal place of business, its legal organization and its disciplinary history, if any; business activities, including the types of compensation the funding portal would receive; control affiliates of the funding portal and disclosure of their disciplinary history, if any; FINRA membership or membership with any other registered national securities association; and the funding portal's website address(es) or other means of access.[524] We also are proposing, as discussed in greater detail below, not to permit nonresident entities to register as funding portals unless they comply with certain conditions designed to provide the Commission and FINRA (or any other registered national securities association) with appropriate tools for supervising such entities.

The funding portal's registration would become effective the later of: (1) 30 calendar days after the date that the registration is received by the Commission; or (2) the date the funding

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522 *See* Liles Letter 2 (stating that this requirement would strengthen the ability of the Commission and other U.S. authorities to make surprise audits or investigations of, or bring enforcement action against, a funding portal).

523 *See* 158 CONG. REC. S2230-31 (daily ed. Mar. 29, 2012) (statement of Sen. Scott Brown) ("As the Securities and Exchange Commission works to implement this new law, it is my hope that it will recognize that the funding portal registration process is meant to be more streamlined and less burdensome than traditional broker-dealer registration"); 158 CONG. REC. S1817-29 (daily ed. Mar. 20, 2012) (statement of Sen. Jeff Merkley) ("Our amendment provides two pathways: The first pathway is for a portal to register as a broker-dealer. The second is streamlined funding portal registration.").

524 *See* proposed Rule 400(a) of Regulation Crowdfunding. We discuss below the information required to be included in the form.

portal is approved for membership in FINRA or any other registered national securities association. This approach is intended to help ensure that a funding portal is subject to regulation by the Commission and FINRA or any other national securities association before it can engage in business with the public.

We also are proposing to require a funding portal to file an amendment to Form Funding Portal within 30 days of any of the information previously submitted on Form Funding Portal becoming inaccurate for any reason.[525]

The proposed rules would permit a funding portal that succeeds to and continues the business of a registered funding portal to also succeed to the registration of the predecessor on Form Funding Portal.[526] The registration would be deemed to remain effective as the registration of the successor, if the successor, within 30 days after such succession, files a registration on Form Funding Portal and the predecessor files a withdrawal on Form Funding Portal.[527] The rule would further provide that, if succession is based solely on a change of the predecessor's date or state of incorporation, form of organization or composition of a partnership, the successor may, within 30 days after the succession, amend the notice registration of the predecessor on Form Funding Portal to reflect these changes. Form Funding Portal would require the successor to provide certain information, such as the name and Commission file number of the predecessor. The successor also would be required to briefly describe details of the succession, including any assets or liabilities not assumed by the successor.

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525 *See* proposed Rule 400(b) of Regulation Crowdfunding. A similar process exists for registered broker-dealers under Exchange Act Rule 15b3-1 (17 CFR 240.15b3-1).

526 *See* proposed Rule 400(c) of Regulation Crowdfunding.

527 Under the proposed rules, the registration of the predecessor funding portal would be deemed withdrawn 45 days after the notice registration on Form Funding Portal is filed by the successor. A similar process exists for registered broker-dealers under Exchange Act Rule 15b1-3 (17 CFR 240.15b1-3).

The proposed rules are intended to provide an efficient registration mechanism for a person that becomes a successor to a funding portal.[528] The provisions on succession are intended to be used only when there is a direct and substantial business nexus between the predecessor and the successor.[529] The proposed rules would not be designed for use by a funding portal in order to sell its registration, eliminate substantial liabilities, spin off personnel or facilitate the transfer of a "shell" organization that does not conduct a funding portal business. To require that there be a legitimate connection between the predecessor and the successor, the instructions to the proposed Form Funding Portal would limit the term "successor" to an entity that assumes or acquires substantially all of the assets and liabilities of the predecessor funding portal's business. In addition, the proposed rule would not apply where the predecessor funding portal intends to continue to engage in funding portal activities.[530]

In certain circumstances, the proposed rule would allow the successor to file an amendment to the predecessor's Form Funding Portal. Successions by amendment would be limited to those successions that result from a formal change in the structure or legal status of the funding portal but do not result in a change in control.[531] Assuming that there is no change in control, succession by amendment would be available for changes in the form of organization, in legal status and in composition of a partnership.

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528 We are proposing to treat funding portal successions in a manner consistent with broker-dealer successions. *See Registration of Successors to Broker-Dealers and Investment Advisers,* Release No. 34-31661 (Dec. 28, 1992) [58 FR 7 (Jan. 4, 1993)].

529 We are proposing that a direct and substantial nexus exist between a predecessor and successor funding portal to be consistent with the applicable rules for broker-dealer successions.

530 *See* proposed Rule 400(c)(1) of Regulation Crowdfunding, which requires the predecessor funding portal to file a withdrawal on Form Funding Portal as a condition of the successor registration.

531 *See* proposed Rule 400(c)(2) of Regulation Crowdfunding.

In all other successions, the successor would be able to operate under the registration of the predecessor for a limited period of time only if it files its own completed application for registration on Form Funding Portal within 30 days after such succession. Examples of the types of successions that would require this type of application filing would include, but not be limited to, acquisitions and consolidations.

The proposed rules would require a funding portal to promptly file a withdrawal of registration on Form Funding Portal upon ceasing to operate as a funding portal.[532] The withdrawal would be effective on the later of 30 days after receipt by the Commission, after the funding portal is no longer operational, within such longer period of time as to which the funding portal consents or within such period of time as to which the Commission, by order, may determine as necessary or appropriate in the public interest or for the protection of investors.[533] This delaying provision would provide time to evaluate whether a withdrawal is the result of a legitimate winding down of a funding portal's business or whether there are additional factors to consider in connection with the funding portal's withdrawal that are relevant to the protection of investors. Based on such information, we would determine whether any actions, including enforcement proceedings, should be taken against the withdrawing funding portal.

The proposed rules[534] provide that each application for registration, amendment thereto, successor registration or withdrawal would be considered filed when a complete Form Funding Portal is submitted with the Commission or its designee. The proposed rules also require

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532 *See* proposed Rule 400(d) of Regulation Crowdfunding.

533 A similar process exists for registered broker-dealers under Exchange Act Section 15(b)(5) (15 U.S.C. 78*o*(b)(5)) and Rule 15b6-1 (17 CFR 240.15b6-1) thereunder.

534 *See* proposed Rule 400(e) of Regulation Crowdfunding.

duplicate originals of the application to be filed with surveillance personnel designated by the registered national securities association of which the funding portal is a member.

Under the approach to registration that we are proposing, and as described by the requirements of proposed Form Funding Portal (discussed below), a funding portal would be able to operate multiple website addresses under a single funding portal registration, provided the funding portal discloses on Form Funding Portal all the websites and names under which it does business. Allowing for multiple website addresses might allow a funding portal to customize each address to fit its specific needs, such as appealing to certain industries or investors while reducing regulatory costs. We recognize that permitting multiple website addresses by a single registrant could result in investors being confused about the identity of the registrant. We believe, however, that the potential for confusion is justified by the value of the additional flexibility afforded to intermediaries.[535]

One commenter requested that we implement a system similar to the BrokerCheck system operated by FINRA for registered funding portals.[536] We are not proposing that the Commission create such a system at this time because, as discussed below, the information in a funding portal's completed Form Funding Portal would be available for public viewing through the Commission's website or other such electronic system, as determined by the Commission in the future, subject to the redaction of certain personally identifiable information, or other information with a significant potential for misuse, of the contact person(s) or other identified individuals of the funding portal.

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535 We note that brokers are currently required to prominently disclose in any retail communications their name, or the name under which their broker-dealer business is primarily conducted as disclosed on their registration form. *See* FINRA Rule 2210(d)(3).

536 *See* CFIRA Letter 2.

Request for Comment

189. Is the proposed method for registration appropriate? Why or why not? Are there methods that would be less burdensome to potential funding portals while not impairing investor protection? If so, what are those methods?

190. Should we impose other restrictions or prohibitions on affiliations of the funding portal, such as affiliation with a registered broker-dealer or registered transfer agent? If so, what are they and why?

191. Should the Commission, as proposed, permit a funding portal to have multiple intermediary websites under a single registration application? Why or why not?

b. Form Funding Portal

A funding portal seeking to register with the Commission would need to file a completed Form Funding Portal with the Commission.[537] We propose to make a blank Form Funding Portal available through the Commission's website or such other electronic database, as determined by the Commission in the future.

To access the registration system and enter information on Form Funding Portal, a funding portal would have to first establish an account and obtain credentials (*i.e.*, username and password). We propose that an applicant would need to fill out general user information fields, including name, address, phone number, e-mail address, organization name and employer identification number, and user account information (*i.e.*, username and password), and select and answer a security question. Once accepted by the registration system, the applicant would receive an e-mail notification that the account has been established, and the applicant would be

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[537] *See* proposed Rule 400(a) of Regulation Crowdfunding.

able to access and complete Form Funding Portal. We anticipate that applicants ordinarily would obtain access credentials the same day that they are requested.

In order to complete Form Funding Portal, a funding portal would be required to check a box indicating the purpose for which the funding portal is filing the form:

- to register as a funding portal with the Commission, through an initial application;
- to amend any part of the funding portal's most recent Form Funding Portal, including a successor registration; or
- to withdraw from registration as a funding portal with the Commission.

If the funding portal is submitting an amendment or withdrawing from registration, it also would be necessary to provide the Commission file number assigned to the funding portal at the time of its initial application to register. This information would be used to cross-reference amendments and withdrawals to the original registration, thus allowing Form Funding Portal to be used for the initial application to register, amendments to registration and withdrawal from registration.

We intend proposed Form Funding Portal to be a streamlined version of Form BD. We believe Form BD is an appropriate model for Form Funding Portal, because funding portals are limited purpose brokers that are conditionally exempt from registration as broker-dealers. There are certain questions on Form BD that we believe are not applicable to funding portals. For example, a funding portal is prohibited from holding or maintaining customer funds or securities; therefore, proposed Form Funding Portal, unlike Form BD, does not include any questions about holding customer funds and securities. Funding portals also are restricted in their activities in ways that broker-dealers are not; thus, proposed Form Funding Portal includes particular questions that address these differences. For example, because a funding portal is prohibited

from holding and maintaining customer funds, proposed Form Funding Portal would request information about a funding portal's escrow arrangements. As funding portals also are subject to certain compensation restrictions, Form Funding Portal would require a description of the funding portal's compensation arrangements.

Form Funding Portal seeks to strike a balance between efficiency in completing the form and requesting sufficient information from funding portals. The proposed form consists of eight sections, including items related to: identifying information, form of organization, successions, control persons, disclosure information, non-securities related business, escrow, and compensation arrangements, and withdrawal. These items would require an applicant to provide certain basic identifying and contact information concerning its business; list its direct owners and executives; identify persons that directly or indirectly control the funding portal, control the management or policies of the funding portal and persons the funding portal controls; and supply information about its litigation and disciplinary history and the litigation and disciplinary history of its associated persons.[538] In addition, an applicant would be required to describe any non-securities related business activities and supply information about its escrow arrangements, compensation arrangements with issuers and fidelity bond.[539] Upon a filing to withdraw from registration, a funding portal would be required to provide certain books and records

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538 This information would be used to determine whether to approve an application for registration, to decide whether to revoke registration, to place limitations on the applicant's activities as a funding portal and to identify potential problem areas on which to focus during examinations. If an applicant or its associated person has a disciplinary history, then the applicant could be required to complete the appropriate Disclosure Reporting Page ("DRP"), either Criminal, Regulatory, Civil Judicial, Bankruptcy, Bond or Judgment.

539 *See* Section II.D.1.c. below.

information. In addition, as discussed in detail below,[540] applicants that are incorporated in or organized under the laws of a jurisdiction outside of the United States or its territories, or whose principal place of business is not in the United States or its territories, would be required to complete Schedule C to Form Funding Portal, which requires information about the applicant's arrangements to have an agent for service of process in the United States, as well as an opinion of counsel addressing the ability of the applicant to provide the Commission and the national securities association of which it is a member with prompt access to its books and records and to submit to onsite inspection and examination by the Commission and the national securities association.

We propose that a person duly authorized to bind the funding portal be required to sign Form Funding Portal in order to execute the documents.[541] A person executing Form Funding Portal and Schedule C (if applicable) would be required to represent that the person has executed the form on behalf of, and is duly authorized to bind, the funding portal; the information and statements contained in the form and other information filed are current, true and complete; and if the person is filing an amendment, to the extent that any information previously submitted is not amended, such information is currently accurate and complete.[542] The funding portal also would be required to consent that service of any civil action brought by, or notice of any proceeding before, the Commission or any national securities association of which it is a member, in connection with the funding portal's investment-related business, may be given by

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540 *See* Section II.D.1.d. below.

541 *See* execution statement of proposed Form Funding Portal.

542 *See id.*

registered or certified mail to the funding portal's contact person at the main address, or mailing address, on the form.[543]

We believe that this information is important for our oversight of funding portals, including, among other things, assessing a funding portal's application and performing examinations of funding portals, and that it is pertinent to investors and issuers. We propose to make all current Forms Funding Portal, including amendments and registration withdrawal requests, immediately accessible and searchable by the public, with the exception of certain personally identifiable information or other information with significant potential for misuse (including the contact employee's direct phone number and e-mail address and any IRS Employer Identification Number, social security number, date of birth, or any other similar information).[544] Making these documents publicly available and searchable would enhance transparency of the registration process and the funding portal industry as it develops, while the limited redactions would appropriately protect the privacy of the individuals involved.

Request for Comment

192. What type of web-based registration should the Commission use for accessing Form Funding Portal? Would a system like EDGAR be appropriate, or would a different type of system be preferable? Why?

193. Should we consider alternatives to creating a new form for funding portal registration? Should we amend the existing Form BD to provide for funding portal registration? Why or why not? Which questions on Form BD would be relevant to funding portals and why? Are there other questions we should

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543 *See id.*

544 *See* the proposed Instructions to Form Funding Portal.

include for funding portals that are not on the proposed Form Funding Portal or in existing Form BD? If so, which questions and why?

194. Are there types of information (other than personally identifiable information) required by proposed Form Funding Portal that should not be made readily accessible to the public? If so, what types of information and why?

195. Should we require the identifying and contact information requested on Form Funding Portal, or should it be modified in any way? Should additional information be required? If so, which information and why?

196. Are the proposed disclosures in Form Funding Portal unduly burdensome? Are there certain requirements that should be eliminated or modified? Which requirements and why? Would such changes be consistent with investor protection?

197. Should proposed Form Funding Portal be modified to request from funding portals a narrative description of their compliance programs and due diligence procedures with respect to issues? Would some other form of reporting be more useful? Why or why not?

198. Are the proposed representations required of a person who executes Form Funding Portal appropriate? Should the Commission require attestations? If so, from whom?

199. Should we require any other information from a funding portal that is withdrawing from registration?

c. Fidelity Bond

The proposed rules would require, as a condition of registration, that a funding portal have in place, and thereafter maintain for the duration of such registration, a fidelity bond[545] that: (1) has a minimum coverage of $100,000; (2) covers any associated person of the funding portal unless otherwise excepted in the rules set forth by FINRA or any other registered national securities association of which it is a member; and (3) meets any other applicable requirements, as set forth by FINRA or any other registered national securities association of which it is a member.[546]

Although not mandated by the statute, we believe that a fidelity bond requirement would help insure against the loss of investor funds that might occur if, for example, a funding portal were to violate the prohibition set forth in Section 304(b) of the JOBS Act on holding, managing, possessing or otherwise handling investor funds or securities. This is a meaningful protection because funding portals would not be members of the Securities Investor Protection Corporation ("SIPC"). If a firm is a SIPC member and goes out of business, then the cash and securities held for each customer by that firm are generally protected up to $500,000, including a $250,000 limit for cash.[547] Because funding portals are non-SIPC members,[548] funding portal customers would not receive this SIPC protection. Furthermore, given that we are not proposing to require, pursuant to our discretionary authority, that funding portals be subject to minimum net capital requirements, a fidelity bond would provide a single layer of protection, in the event of such

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545 A fidelity bond is a type of insurance that aims to protect its holder against certain types of losses, including but not limited to those caused by the malfeasance of the holder's officers and employees, and the effect of such losses on the holder's capital. *See* Release No. 34-63961 (Feb. 24, 2011) [76 FR 11542 (Mar. 2, 2011)].

546 *See* proposed Rule 400(f) of Regulation Crowdfunding.

547 *See* the Securities Investor Protection Act of 1970, Pub. L. No. 91-598 (1970).

548 Membership in SIPC applies only to persons registered as brokers or dealers under Section 15(b) of the Exchange Act. *See* 15 U.S.C. 78ccc(a)(2).

losses. While the proposed rule imposes this requirement as a condition to registration, we anticipate that, like the fidelity bond requirement registered broker-dealers are currently subject to pursuant to SRO rules, specific requirements of the fidelity bond for funding portals would be set forth in rules of FINRA or any other registered national securities association. In recognition of the limits on the amounts investors may invest, and the amounts issuers may raise, through crowdfunding, as provided in Section 4(a)(6), we propose to require that funding portals' fidelity bonds have an amount of coverage that is equivalent to the minimum amount of coverage registered broker-dealers are required to have under FINRA Rule 4360, which is $100,000.[549] Furthermore, we believe that fidelity bond coverage would be most effective if it covers actions by not only the funding portal entity, but also all of its associated persons.

Request for Comment

200. Is it appropriate for us to require a funding portal to have a fidelity bond? Why or why not?

201. With respect to the fidelity bond requirement, is the proposed coverage of $100,000 appropriate for funding portals? If not, what other amount or formula for calculating the required amount would be more appropriate and why?

202. Is it appropriate to require the fidelity bond to cover associated persons of the funding portal? Why or why not?

203. Are there other specific terms of a fidelity bond that we should consider requiring? If so, what terms and why?

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549 *See* FINRA Rule 4360. Introducing brokers, like funding portals, do not hold customer funds and securities. Introducing brokers are required to maintain a minimum bond of $100,000 under current SRO rules, and we are proposing the same minimum amount for funding portals.

204. Apart from requiring a funding portal to have a fidelity bond, is there some other requirement that could be imposed on funding portals, like insurance or something similar to SIPC, which would further protect investors? If so, what type of requirement and why?

d. Requirements for Nonresident Funding Portals

Although there is no statutory requirement that funding portals be domestic entities, we are mindful of our ability to effectively oversee this new category of registrants – as well as more generally the development of the new crowdfunding market and role of intermediaries in that market – given the greater challenges entailed in supervising, examining, and enforcing the requirements that would be applicable to activities of intermediaries based outside the United States.[550] At the same time, we recognize that the use of funding portals located outside the United States could provide more choices for U.S. issuers seeking to engage an intermediary to facilitate a crowdfunding offering, and potentially expand those issuers' access to investors located abroad. In seeking to strike an appropriate balance among these considerations, we propose not to permit nonresident entities to register as funding portals unless they comply with certain conditions designed to provide the Commission and FINRA (or any other registered national securities association) with appropriate tools for supervising such entities.

Under the proposed rules, registration pursuant to Rule 400 of Regulation Crowdfunding by a nonresident funding portal (a funding portal incorporated in or organized under the laws of any jurisdiction outside of the United States or its territories, or having its principal place of

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[550] The exemption under Section 4(a)(6) is not available for a transaction involving the offer or sale of securities by an issuer that is not organized under and subject to the laws of a State or territory of the United States or the District of Columbia. *See* Section 4A(f), discussed in Section II.A.3 above.

business outside the United States or its territories)[551] would be first conditioned upon there being an information sharing arrangement in place between the Commission and the competent regulator in the jurisdiction under the laws of which the nonresident funding portal is organized or where it has its principal place of business that is applicable to the nonresident funding portal. The proposed rules would further require a nonresident funding portal to (1) obtain a written consent and power of attorney appointing an agent for service of process in the United States (other than the Commission or a Commission member, official or employee), upon whom may be served any process, pleadings, or other papers in any action; (2) furnish the Commission with the name and address of its agent for services of process on Schedule C of Form Funding Portal; (3) certify that it can, as a matter of law, provide the Commission and any national securities association of which it is a member with prompt access to its books and records and can, as a matter of law, submit to onsite inspection and examination by the Commission; and (4) provide the Commission with an opinion of counsel and certify on Schedule C on Form Funding Portal that the firm can, as a matter of law, provide the Commission and such national securities association with prompt access to its books and records and can, as a matter of law, submit to onsite inspection and examination by the Commission and the national securities association.[552]

In general, the requirements for nonresident funding portals that we are proposing are consistent with those we have proposed for other nonresident entities subject to our regulation.[553]

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551 *See* proposed Rule 400(g)(1) of Regulation Crowdfunding.

552 *See* proposed Rule 400(g) of Regulation Crowdfunding. Exchange Act Section 3(h)(1)(C) permits us to impose, as part of our authority to exempt funding portals from broker registration, "such other requirements under [the Exchange Act] as the Commission determines appropriate."

553 *See*, *e.g.*, *Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants*, Release No. 34-65543 (Oct. 12, 2011) [76 FR 65784 (Oct. 24, 2011)], at 65799 – 65801. *See also Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms*

These requirements aim to ensure that funding portals that are not based in the United States, or that are subject to laws other than those of the United States, would nevertheless be accessible to us and other relevant regulators for purposes of accessing the books and records of, conducting examinations and inspections of, and enforcing U.S. laws and regulations with respect to, these entities.

Requirements for a nonresident funding portal to obtain an agent for service of process in the United States, and to furnish the Commission with the name and address of this agent, are important to facilitate enforcement of the federal securities laws and the rules thereunder by the Commission and others (*e.g.*, the U.S. Department of Justice and any other agency or entity with law enforcement authority). The proposed rules also would require a registered nonresident funding portal to promptly appoint a successor agent if it discharges its identified agent for service of process or if its agent for service of process is unwilling or unable to accept service on its behalf. A registered funding portal must promptly amend Schedule C to its Form Funding Portal if its agent, or the agent's name or address, changes. Finally, the proposed rules would require the registered nonresident funding portal to maintain, as part of its books and records, the agreement with the agent for service of process for at least three years after termination of the agreement.

The proposed rules would require that each nonresident funding portal provide an opinion of counsel and certify, as a matter of law, that it can provide the Commission, and the national securities association of which it is a member, with prompt access to its books and records and submit to onsite inspections and examinations. We believe that this proposed certification and

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Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants, Release No. 34-69490 (May 1, 2013) [78 FR 30968 (May 23, 2013)].

supporting opinion of counsel are important to confirm that each nonresident funding portal is in the position to provide the Commission and the national securities association with information that is necessary for us and the national securities association to effectively fulfill our regulatory oversight responsibilities.[554] Commenters have previously brought to our attention that it may conflict with the laws of certain jurisdictions to provide such an opinion.[555] Failure to make this certification or provide an opinion of counsel would provide a basis to deny an application for registration.

The requirement for an information sharing agreement is designed to provide the Commission greater assurance that it will be able to obtain the information about a nonresident funding portal necessary for the Commission's oversight of the nonresident funding portal. The home country regulator may possess information concerning, for example, the funding portal's affiliations, contractual relationships with issuers, and the nature and extent of measures taken to protect investors. In this context, particularly in the event that evidence arises of potential fraudulent or other unlawful activity by a nonresident funding portal, the ability to obtain information and secure the cooperation of the home country regulator according to established practices and protocols should help to address the increased challenges that may arise from oversight of entities located outside the United States.

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554 *See* Exchange Act Section 3(h)(1)(A).

555 *See* comment letter from Sarah A. Miller, Chief Executive Officer, Institute of International Bankers, dated August 21, 2013, *available at* https://www.sec.gov.edgekey.net/comments/s7-34-10/s73410.shtml. *See also* comment letters from Patrick Pearson, European Commission, dated August 21, 2013, and Kenneth E Bentsen, Jr., Executive Vice President, Public Policy and Advocacy, Securities Industry and Financial Markets Association, dated December 16, 2011, *available at* https://www.sec.gov.edgekey.net/comments/s7-34-10/s73410.shtml; comment letter from Carlos Tavares, Vice-Chairman, European Securities and Markets Authority, dated January 17, 2011, *available at* http://www.sec.gov/comments/s7-35-10/s73510-19.pdf.

A registered nonresident funding portal also would be required to re-certify, on Schedule C to Form Funding Portal, within 90 days after any relevant changes in its legal or regulatory framework, and provide a revised opinion of counsel confirming that, as a matter of law, the entity will continue to meet its obligations to provide the Commission and the national securities association with prompt access to its books and records and to be subject to inspection and examination. Failure to make this certification or provide an opinion of counsel may be a basis for the Commission to revoke the nonresident funding portal's registration.

Request for Comment

205. Is the term nonresident funding portal defined appropriately? If not, how should it be modified? Please explain.
206. Should the Commission impose additional or different conditions for nonresident funding portals than those proposed? If so, what conditions, and why? Should any be eliminated? Why or why not? What effect might such conditions have on the development of the industry and the market, and on issuers and investors? Please explain.
207. If, as a matter of law, it would be impossible or impractical for a nonresident funding portal to obtain the required opinion of counsel, what other actions or requirements could address our concern that we and the national securities association would be able to have direct access to books and records and adequately examine and inspect the funding portal?
208. Should any of the proposed requirements be more specific? For example, should only certain types of entities (such as law firms) be allowed to act as U.S. agents for service of process? Please explain.

209. Should a nonresident funding portal be required to appoint a U.S. agent for purposes of all potential legal proceedings, including those from nongovernmental entities? Why or why not?

210. Should we require the opinion of counsel if it might contradict the laws of a jurisdiction where an intermediary is incorporated? Why or why not? If not, should we impose an alternative requirement?

211. Should we specify that the opinion of counsel contain any additional information? For instance, should we require the opinion to reference the applicable local law or, in the case of an amendment, the manner in which the local law was amended? Please explain.

2. Exemption from Broker-Dealer Registration

Exchange Act Section 3(h)(1) directs the Commission to exempt, conditionally or unconditionally, a registered funding portal from the requirement to register as a broker or dealer under Exchange Act Section 15(a), provided that the funding portal: (1) remains subject to the examination, enforcement and other rulemaking authority of the Commission; (2) is a member of a registered national securities association; and (3) is subject to other requirements that the Commission determines appropriate. The proposed rules would exempt a registered funding portal from the broker registration requirements of Exchange Act Section 15(a)(1), in connection with its activities as a funding portal.[556]

But for the exemption from registration Congress directed, a funding portal would be

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[556] *See* proposed Rule 401(a) of Regulation Crowdfunding.

required to register as a broker under the Exchange Act.[557] The obligations imposed under the JOBS Act on an entity acting as an intermediary in a crowdfunding transaction would bring that entity within the definition of "broker" under Exchange Act Section 3(a)(4). A funding portal would be "effecting transactions in securities for the account of others" by, among other things, ensuring that investors comply with the conditions of Securities Act Section 4A(a)(4) and (8), making the securities available for purchase through the funding portal, and ensuring the proper transfer of funds and securities as required by Securities Act Section 4A(a)(7).[558] In addition, a funding portal's receipt of compensation linked to the successful completion of the offering also would be indicative of acting as a broker in connection with these transactions.

Pursuant to Exchange Act Section 3(h)(1), as stated above, we are proposing rules that would exempt an intermediary that is registered as a funding portal from the requirement to register as a broker-dealer under Exchange Act 15(a)(1). Consistent with the JOBS Act, the funding portal would remain subject to the full range of our examination and enforcement authority.[559] In this regard, the proposed rules would require that a funding portal permit the

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557 *See* Exchange Act Section 3(a)(4)(A) [15 U.S.C. 78c(a)(4)(A)] (defining "broker" as "any person engaged in the business of effecting transactions in securities for the account of others"). An entity acting as an intermediary in the offer and sale of securities pursuant to Section 4(a)(6), as contemplated in Title III of the JOBS Act, would not come within the meaning of "dealer," which is defined in Exchange Act Section 3(a)(5)(A) (15 U.S.C. 78c(a)(4)(A)), because it would not be engaging in the business of buying and selling securities for its own account. *See also* Exchange Act Section 15(a) [15 U.S.C. 15*o*(a)] and proposed Rule 300(b) of Regulation Crowdfunding.

558 At the same time, there are statutory restrictions on the scope of services that a funding portal could provide. Among other things, a funding portal could act as an intermediary only in transactions involving the offer or sale of securities pursuant to Securities Act Section 4(a)(6). Further, a funding portal, by definition, could not offer investment advice or recommendations; solicit purchases, sales, or offers to buy the securities offered or displayed on its website or portal; compensate persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal; or hold manage, possess or otherwise handle investor funds or securities. *See generally* Exchange Act Section 3(a)(80).

559 *See* Exchange Act Section 3(h)(1)(C). *See also* Securities Act Section 20 [15 U.S.C. 77t] and Exchange Act Sections 21 and 21C [15 U.S.C. 78u and 78u-3]. In addition, we highlight that Exchange Act Sections 15(b)(4) and 15(b)(6) (15 U.S.C. 78*o*(b)(4) and 78*o*(b)(6)) apply to brokers (including funding portals)

examination and inspection of all of its business and business operations that relate to its activities as a funding portal, such as its premises, systems, platforms and records, by representatives of the Commission, and of the national securities association of which it is a member.[560] The proposed rules also would impose certain recordkeeping requirements.[561]

The proposed rules would provide that, notwithstanding this exemption from broker registration, for purposes of Chapter X of Title 31 of the Code of Federal Regulations, a funding portal would be deemed to be "required to be registered" as a broker with the Commission under the Exchange Act, thereby requiring funding portals to comply with Chapter X, including certain anti-money laundering ("AML") provisions thereunder.[562]

Request for Comment

212. Is the proposed exemption for funding portals from broker registration appropriate? Why or why not?

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regardless of whether or not they are registered with the Commission as brokers. Exchange Act Section 15(b)(4) authorizes the Commission to bring administrative proceedings against a broker when the broker violates the federal securities laws (and for other misconduct) and provides for the imposition of sanctions, up to and including the revocation of a broker's registration. Exchange Act Section 15(b)(6) provides similar enforcement authority against the persons associated with a broker, including barring persons from associating with any Commission registrant. *See* Section II.D.3 below for further discussion, in response to commenters' concerns, about the scope of permissible activities in which funding portals may engage under the safe harbor of proposed Rule 402.

560 *See* proposed Rule 403 of Regulation Crowdfunding. *See also* discussion in Section II.D.4 below.

561 *See* proposed Rule 404 of Regulation Crowdfunding. *See also* discussion in Section II.D.5 below.

562 *See* 31 CFR 1010.100(h) and 1023.100(b) (defining broker or dealer for purposes of the applicability of AML requirements). *See* Currency and Foreign Transactions Reporting Act of 1970 (commonly referred to as the Bank Secrecy Act ("BSA")) [12. U.S.C. 1829b, 12 U.S.C. 1951-1959, 31 U.S.C. 5311-5330]. *See also* proposed Rule 403(b) of Regulation Crowdfunding and discussion in Section II.D.4 below. Securities Act Section 4A(a)(12) requires intermediaries to comply with requirements as the Commission may, by rule, prescribe for the protection of investors and in the public interest. As discussed in Sections II.C.1 and II.D.2 above, a funding portal is a broker that, in the absence of the exemption from the requirement to register as a broker or dealer provided for under the JOBS Act in Exchange Act Section 3(h)(1), would otherwise be required to register as a broker under Section 15(a) (15 U.S.C. 78*o*) of the Exchange Act, and by being so registered, would be subject to the full range of BSA obligations applicable to registered broker-dealers. As discussed further in Section II.D.4.b below, we believe such obligations also should be imposed on funding portals.

213. Should the exemption be conditioned on the funding portal remaining in compliance with Subpart D of the proposed rules? Why or why not?

214. Is it appropriate to propose to require funding portals to comply with the same requirements for purposes of Chapter X of Title 31 of the Code of Federal Regulations as imposed on a person required to be registered as a broker or a dealer? Why or why not?

215. Should the proposed exemption from broker registration be conditioned upon a funding portal's compliance with applicable Subpart C and D rules of proposed Regulation Crowdfunding? Why or why not? Should the failure to comply with certain requirements cause a funding portal to lose its exemption? If so, which requirements and why? Under what circumstances should the Commission consider revoking the exemption of a funding portal that fails to comply with these requirements?

3. Safe Harbor for Certain Activities

Exchange Act Section 3(a)(80) provides that a funding portal may not offer investment advice or make recommendations; solicit purchases, sales or offers to buy the securities offered or displayed on its platform or portal; compensate employees, agents or other persons for such solicitation or based on the sale of securities displayed or referenced on its platform or portal; hold, manage, possess or otherwise handle investor funds or securities; or engage in such other activities as the Commission, by rule, determines appropriate.

We received a number of comments concerning the scope and definition of permissible activities for a funding portal. A number of commenters sought guidance on services they might be permitted to provide consistent with the prohibition on offering investment advice or

recommendations.[563] We also received comments seeking clarification about the prohibitions on funding portals soliciting investors and handling funds and securities.[564]

One commenter asked us to clarify what activities would constitute prohibited investment advice and suggested that the Commission should establish "bright lines" that would make it clear how a funding portal can avoid being viewed as giving prohibited investment advice.[565] This commenter and others provided numerous examples of potential funding portal activities, including:

- advising issuers on the structure and contents of their offerings;[566]
- providing access to the portal's platform to certain issuers and rejecting or removing others, based on criteria such as the "type" or "market characteristics" of the offerings (*e.g.*, film production securities, women- or minority-owned businesses or businesses in specific geographical areas);[567]
- removing an offering before the end of the offering period for lack of investor interest;[568]
- removing an issuer for failing to provide documents responsive to the funding portal's due diligence or qualification standards, including standards other than those

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563 *See, e.g.*, NCA Letter; NSBA Letter; CFIRA Letter 2.

564 *See, e.g.*, CFIRA Letter 2; NCA Letter; Wright Letter 1; RocketHub Letter 1; Grow VC Letter.

565 *See* CFIRA Letter 2.

566 *See id*.

567 *See* NCA Letter; NSBA Letter.

568 *See id*.

established by our rules,[569] or the portal's belief that an offering or the issuer may be fraudulent or abusive;[570]

- highlighting, or otherwise making more prominent, the offering(s) of one or more issuers;[571]
- organizing issuers listed on the funding portal's platform into groups based on the funding portal's view of the riskiness of the investment;[572]
- providing information management tools (*i.e.*, search functions and automatic notification mechanisms) on the funding portal's platform;[573]
- providing a "valuation framework" that could guide investors in determining a fair valuation for securities listed on the funding portal's platform, while also creating a "negotiation space" for an issuer and its potential investors;[574] and
- hosting on the funding portal's platform:
    - third-party market and news updates;[575]
    - third-party opinions (including those of investors) on message boards and other information exchanges moderated by the funding portal;[576] or

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569 *See id.*

570 *See* CFIRA Letter 3.

571 *See* RocketHub Letter 1; Wright Letter 1.

572 *See id.*

573 *See* CFIRA Letter 3.

574 A "negotiation space" would provide some ability for investors to set or influence the price of the securities, which would not necessarily depend on a specific valuation of the securities. *See* Pearfunds Letter.

575 *See* RocketHub Letter 1; Wright Letter 2.

576 *See* CFIRA Letter 3; Applied Dynamite Letter; Grow VC Letter.

- judgments about issuers made by a funding portal or its vendors or partners.[577]

With regard to the prohibition on solicitation, one commenter noted that the mere act of having a web platform available to the public on which issuers can list their offerings could be viewed as impermissible solicitation.[578] Another commenter asked whether funding portals would be permitted to compensate employees and agents to solicit issuers by commission, referral fee or otherwise.[579] Another commenter asked that we preserve the ability of funding portals to pay for search listings or advertisements in online social networks.[580]

Commenters requested that we identify the kinds of third parties that could hold, manage, possess or otherwise handle investor funds and securities in connection with an offering made in reliance on Section 4(a)(6).[581] One commenter stated that a fiduciary would likely hold the funds for disposition as instructed by the funding portal and asked whether this instruction would constitute an impermissible handling of the funds.[582] Another commenter stated that an intermediary should be authorized by the issuer and investors to operate as an escrow agent to facilitate transactions.[583] One commenter asserted that funding portals need the ability to

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577 *See* Applied Dynamite Letter.

578 *See* Crowdfunding Offerings Ltd. Letter 2.

579 *See* NCA Letter.

580 *See* Cera Technology Letter.

581 *See* Crowdfunding Offerings Ltd. Letter 2; NSBA Letter.

582 *See* Crowdfunding Offerings Ltd. Letter 4.

583 *See* RocketHub Letter 1 (further stating that the intermediary should be permitted to hold investor funds in an escrow account that is segregated from the operating funds of the intermediary and that withdrawals from the account only be permitted for: "payments to offerings that have successfully closed (having reached or exceeded their funding goals); payments to investors requesting refunds of uncommitted funds; or payment of established intermediary fees").

temporarily hold customer funds to properly clear and settle a securities transaction.[584] The commenter further contended that, to ensure issuers are not overwhelmed with thousands of new shareholders, intermediaries, including funding portals, should be able to act as nominees of the investors who are the beneficial owners of the securities.

In light of these questions and comments, we are proposing to provide a non-exclusive, conditional safe harbor for funding portals that engage in certain limited activities.[585] Failure of a funding portal to meet the conditions of this non-exclusive safe harbor would not create a presumption that the funding portal is in violation of the statutory prohibitions of Exchange Act Section 3(a)(80) or the rules in proposed Regulation Crowdfunding.[586]

In proposing the safe harbor, we are mindful that, while Section 304 of the JOBS Act directs us to exempt a registered funding portal, conditionally or unconditionally, from broker-dealer registration and associated regulatory requirements, the statutory provisions also make clear that the activities in which a funding portal may engage are far more limited than those of a registered broker-dealer.[587] At the same time, we recognize that the statutory prohibitions could

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584 *See* Grow VC Letter.

585 *See* proposed Rule 402 of Regulation Crowdfunding. The term "investment advice" is not defined in the crowdfunding provisions of the JOBS Act or otherwise in the federal securities laws, and we do not include a definition of that term in our proposal. In the context of interpreting the term "investment adviser," the determination of whether a particular communication rises to the level of investment advice depends on the facts and circumstances and is construed broadly. To the extent a funding portal limits its securities activities to those permitted by the proposed rules, including the safe harbor, we preliminarily believe that it would not come within the meaning of the term investment adviser under the Advisers Act. If it conducts other activities, such as advising an issuer concerning the investment of proceeds in securities, however, it would need to consider whether it comes within the meaning of that term under the Advisers Act. *See* Advisers Act Section 202(a)(11) [15 U.S.C. 80b-2(a)(11)]. *See also* 2012 SEC Government-Business Forum, note 29 (stating that there is a need for safe harbors that explicitly permit certain activities that may otherwise be seen as indicia of broker-dealer status or activities that are prohibited or otherwise subject to separate regulation).

586 *See* proposed Rule 402(a) of Regulation Crowdfunding.

587 *See* Exchange Act Section 3(a)(80). *See also* 158 CONG. REC. S5474-03 (daily ed. July 26, 2012) (statement of Sen. Jeff Merkley) ("The Crowdfund Act is designed so that funding portals will be subject to

be read so broadly as to limit the utility of funding portals. The proposed rule seeks to strike an appropriate balance by identifying certain limited activities in which a funding portal may engage, consistent with the statutory prohibitions.[588] These activities relate to:

- limiting offerings made on or through the funding portal's platform based on eligibility requirements;
- highlighting and displaying offerings on the platform;
- providing communication channels for potential investors and issuers;
- providing search functions on the platform;
- advising issuers on the structure or content of offerings;
- compensating others for referring persons to the funding portal and for other services; and
- advertising the funding portal's existence.

In addition, the proposed rules would clarify that, consistent with other provisions of Regulation Crowdfunding,[589] funding portals may deny access to issuers in certain circumstances, accept investment commitments and direct the transmission of funds, in connection with offerings conducted on their platforms.

- **Limiting Offerings**

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fewer regulatory requirements than broker-dealers because they will do fewer things than broker-dealers. Among other limits, the law prohibits funding portals from engaging in solicitation, making recommendations, and providing investment advice. Relative passivity and neutrality, especially with respect to the investing public, are touchstones of the funding portal streamlined treatment.").

588 *See* proposed Rule 402 of Regulation Crowdfunding.

589 *See, e.g.*, proposed Rules 303(d) and 303(e) of Regulation Crowdfunding.

We anticipate that some funding portals may wish to limit, to some extent, the scope of their businesses by, for example, specializing in offerings by issuers in certain industries or geographic locations. In some circumstances, these limitations could be viewed as providing investment advice. To accommodate reasonable limitations, the proposed safe harbor would permit a funding portal to apply objective criteria to limit the offerings on its platform, without being deemed to be providing investment advice.[590] Those criteria would be required to be reasonably designed to result in a broad selection of issuers offering securities through the funding portal's platform and be applied consistently to all potential issuers and offerings, so as not to recommend or implicitly endorse one issuer or offering over others. The criteria also would be required to be clearly displayed on the funding portal's platform.

The requirements that the objective criteria be reasonably designed to result in a broad selection of issuers, and be applied consistently, are intended to ensure that the funding portal does not provide impermissible investment advice by, for example, applying criteria that would so limit the number of issuers that the funding portal could be viewed as providing an implicit endorsement or recommendation of those issuers' offerings. An issuer that meets these criteria, and is not otherwise disqualified, would, subject to the funding portal's measures to reduce the risk of fraud under proposed Rule 301,[591] be eligible to list its offering on the funding portal's platform.

One criterion could include the type of security being offered (such as common stock, preferred stock or debt securities). We believe that this criterion would be appropriate because potential investors may be interested in certain types of securities as a consideration separate

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590 *See* proposed Rule 402(b)(1) of Regulation Crowdfunding.

591 *See* discussion in Section II.C.3 above.

from the identity of issuers. Other criteria also could include the geographic location of the issuer or the industry or business segment of the issuer. We believe that these criteria would be appropriate because a funding portal may wish to specialize and focus its efforts on facilitating offerings in particular areas or industries.[592] The proposed rule would require funding portals to disclose to investors the criteria they use to limit the offerings available on their platforms. This should help investors better appreciate any niche focus of a funding portal and the scope of the offerings available on the funding portal's platform. In addition, we recognize that a funding portal may seek to limit the number of issuers or offerings on its platform at any given time, including for resource reasons. The application of the objective criteria could, in practice, result in the number of issuers or offerings displayed on the platform being very small, such as, for example, in the period soon after a funding portal begins operations. Nevertheless, we would not consider the funding portal to be providing investment advice if the objective criteria are designed to result in a broad selection of issuers.

To qualify for the safe harbor, a funding portal may not use criteria based on an assessment of the merits or the shortcomings of a particular issuer or offering. In particular, a funding portal may not deny access to an issuer based on the advisability of investing in the issuer or its offering.[593] As noted above, one commenter stated that the prohibition on investment advice could potentially preclude a funding portal from denying access to a

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592 *See, e.g.*, CrowdFund Connect Letter (stating that rural communities could build new local based co-operatives similar to the electric and telephone cooperatives for new technologies).

593 Of course, a funding portal would be required to deny access to the issuer if the funding portal has a reasonable basis for believing that issuer is subject to a disqualification or if the funding portal believes that the issuer or the offering presents the potential for fraud or otherwise raises concerns regarding investor protection. *See* proposed Rule 301(c) of Regulation Crowdfunding.

fraudulent offering or issuer.[594] This would place investors at unnecessary risk and would be contrary to the funding portal's obligation under the proposed rules to deny access to its platform if it believes that the issuer or its offering presents potential for fraud or otherwise raises concerns regarding investor protection.[595] Thus, as described above, a funding portal must deny access if it believes that the issuer or its offering has potential for fraud or otherwise raises concerns regarding investor protection.[596]

- **Highlighting Issuers and Offerings**

Under the proposed rules, a funding portal may highlight particular offerings of securities made in reliance on Section 4(a)(6) on its platform based on objective criteria that may include: the type of securities being offered (*e.g.,* common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the number or amount of investment commitments made; and the progress in meeting the target offering amount or, if applicable, the maximum offering amount, and minimum or maximum investment amount.[597] A potential investor, for example, may have a strong interest in supporting a small issuer that is within the potential investor's geographic vicinity. Other potential investors may be interested in offerings that are about to close soon, that have particular maximum investment amounts or that have generated significant interest from users of the funding portal's platform. Some investors may only be interested in offerings in which a significant percentage of the target

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594 *See* CFIRA Letter 3.

595 *See* proposed Rule 301 of Regulation Crowdfunding.

596 Consistent with proposed Rule 301, proposed Rule 402(b)(10) of Regulation Crowdfunding would clarify that a funding portal may deny access to an issuer if the funding portal believes that the issuer or its offering has potential for fraud or otherwise raises concerns regarding investor protection.

597 *See* proposed Rule 402(b)(2) of Regulation Crowdfunding.

amount has been committed.[598] We believe that the listed criteria are sufficiently objective, so as to reduce the risk of a funding portal applying them to advance a particular bias or subjective assessment of the issuers or offerings.

Consistent with the prohibition on investment advice and recommendations, the criteria must be reasonably designed to highlight a broad selection of issuers, so as not to recommend or implicitly endorse one issuer or offering over another, and must be applied consistently to all potential issuers and offerings. The selection criteria may not be based on an assessment of the merits of a particular issuer or offering and must be clearly displayed on the funding portal's platform, to permit investors to comprehend on what basis certain issuers are being highlighted, and, thereby, to help prevent them from misconstruing the highlighting as a recommendation or implicit endorsement of any issuer or offering. The funding portal may not highlight an issuer or offering based on the advisability of investing in the issuer or offering. To help prevent conflicts of interest and incentives for funding portals to favor certain issuers over others, the proposed rules would prohibit a funding portal from receiving any special or additional compensation for highlighting (or offering to highlight) one or more issuers or offerings on its platform.[599]

Some commenters sought clarification whether funding portals could distinguish offerings based on riskiness.[600] We are not proposing a safe harbor for this type of distinction at this time, because we preliminarily believe that an assessment of risk necessarily involves the exercise of judgment indicative of the giving of investment advice.

- **Providing Search Functions**

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598 *See* Howe, note 2.

599 *See* proposed Rule 402(b)(2)(iii) of Regulation Crowdfunding.

600 *See* RocketHub Letter 1; Wright Letter 1.

The proposed rules would permit a funding portal to provide, on its platform, search functions or other tools that users could use to search, sort or categorize the offerings available on the funding portal's platform according to objective criteria.[601] Search functions could help potential investors to more efficiently search for offerings that focus on a specific industry, funding goal or other criteria. Under the proposed rules, a funding portal also would be able to categorize offerings into general subject areas, so that a potential investor could readily find those offerings on the funding portal's platform. The proposed rules would also permit more granular tools that, for example, could provide a potential investor the ability to sort offerings based on a combination of different criteria, such as by the percentage of the target offering amount that has been met, geographic proximity to the investor and number of days remaining before an offering is to close.[602] The objective criteria specified in the proposed rules are consistent with those in the proposed safe harbor for highlighting issuers and offerings.[603] Consistent with the activities specifically prohibited by statute, funding portals would not be permitted to use criteria that search, sort or categorize offerings based on the advisability of investing in the issuer or its offering or an assessment of any characteristic of the issuer, its business plan, its management, or risks associated with an investment. One commenter questioned whether a funding portal could give potential investors the ability to create automated

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601 *See* proposed Rule 402(b)(3) Regulation Crowdfunding. *See also* 158 CONG. REC. 2231 (daily ed. Mar. 29, 2012) (statement of Sen. Scott Brown) ("Funding portals should be allowed to organize and sort information based on certain criteria. This will make it easier for individuals to find the types of companies in which they can potentially invest. This type of capability – commonly referred to as curation – should not constitute investment advice.").

602 *See* proposed Rule 402(b)(3) of Regulation Crowdfunding.

603 *See* proposed Rule 402(b)(2)(ii) of Regulation Crowdfunding.

e-mail notifications, based on criteria they have provided to identify particular offerings on the funding portal's platform.[604] The proposed rules would permit funding portals to do so.

We recognize that there are many potential ways that a tool or mechanism can be used to search, sort or categorize offerings. The proposed rules are intended to be sufficiently broad to cover any number of combinations of implementing tools or mechanisms for a search, while limiting the search parameters to objective criteria.

- **Providing Communication Channels**

The proposed rules would permit a funding portal to provide, on its platform, communication channels by which investors could communicate with one another and with representatives of the issuer about offerings of securities displayed on the funding portal's platform, in accordance with the conditions set out in proposed Rule 303(c).[605] The safe harbor would specify that a funding portal (including its associated persons, such as its employees) may not participate in these communications, other than to establish guidelines about communication and to remove abusive or potentially fraudulent communications. For the reasons discussed above, a funding portal would be required to make communication channels available to the general public and to restrict the posting of comments on those channels to those who have accounts.[606] In addition, the funding portal would need to require persons posting comments to disclose, in the channel, whether they receive or would receive any compensation for promoting an issuer.

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604 *See* CFIRA Letter 3.

605 *See* proposed Rule 402(b)(4) of Regulation Crowdfunding.

606 *See* discussion in Section II.C.5.c above and proposed Rule 303(c)(2) of Regulation Crowdfunding.

Communication channels should facilitate the access to information among members of the public and provide potential investors with the crowd's insight as to the merits of an issuer or business plan.[607] Restricting funding portal participation should help to ensure that funding portals do not provide impermissible recommendations or investment advice. Moreover, requiring potential investors to have accounts with the funding portal before posting a comment should provide a control that could aid in promoting accountability for comments made and help ensure that interested persons, such as those associated with the issuer or receiving compensation to promote the issuer, are properly identified.[608]

As suggested by commenters, the proposed rule would permit a funding portal to create a "negotiation space" in which those who have opened accounts with the funding portal and issuers could discuss and potentially negotiate certain aspects of the issuer's offering, including the price of the issuer's securities.[609]

- **Advising Issuers**

The proposed rules would permit a funding portal to advise an issuer about the structure or content of the issuer's offering, including preparing offering documentation.[610] This advice is not the type of advice that we believe should be impermissible.[611] We also believe that funding

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607 *See, e.g.*, Bradford, note 1. *See also* Howe, note 2.

608 *See* 158 CONG. REC. S2231 (daily ed. Mar. 29, 2012) (statement of Sen. Scott Brown) ("In addition to facilitating communication between issuers and investors, intermediaries should allow fellow investors to endorse or provide feedback about issuers and offerings, provided that these investors are not employees of the intermediary. Investors' credentials should be included with their comments to aid the collective wisdom of the crowd.") *See also* discussion in Section II.C.5.c above.

609 *See* Pearfunds Letter; CFIRA Letter 3.

610 *See* proposed Rule 402(b)(5) of Regulation Crowdfunding.

611 *Compare Registration of Municipal Advisors*, Release No. 34-63576 (Dec. 10, 2010) [76 FR 824 (Jan. 6, 2011)] (noting that Commission staff has taken the position that financial advisors that limit their advisory

portals and brokers could provide certain services to issuers in order to facilitate the offer and sale of securities in reliance on Section 4(a)(6), and without this kind of advice to issuers, crowdfunding as a method to raise capital would not be viable. In particular, to the extent that the issuers that may choose to conduct offerings in reliance on Section 4(a)(6) would include startups and small businesses, we expect that these issuers would seek in many cases to obtain advice on the structure of the offering from intermediaries. Funding portals would be in a position to provide this type of assistance relatively efficiently, together with the other services under the proposed rules that they would be permitted to provide to issuers.

The proposed safe harbor would permit funding portals to advise an issuer about the structure and content of the issuer's offering in a number of ways. A funding portal could, for example, provide pre-drafted templates or forms for an issuer to use in its offering that would help it comply with its proposed disclosure obligations.[612] Other examples of permissible assistance could include, as commenters have suggested, advice about the types of securities the issuer can offer, the terms of those securities and the procedures and regulations associated with crowdfunding.[613]

- **Paying for Referrals**

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activities to advising municipal issuers as to the structuring of their financings, rather than providing advice for compensation regarding the investment of assets, may not need to register as investment advisers).

612 *See, e.g.*, 158 CONG. REC. S2231 (daily ed. Mar. 29, 2012) (statement of Sen. Scott Brown) ("Similarly, funding portals should be allowed to engage in due diligence services. This would include providing templates and forms, which will enable issuers to comply with the underlying statute. In crafting this law, it was our intent to allow funding portals to provide such services."); 158 CONG. REC. S5474-03 (daily ed. July 26, 2012) (statement of Sen. Jeff Merkley) ("Subject to such limits as the SEC determines necessary for the protection of investors and the crowdfunding issuers, funding portals should be able to provide (or make available through service providers) services to assist entrepreneurs utilizing crowdfunding, including, for example, providing basic standardized templates, models, and checklists. Enabling them to help small businesses construct simple, standard deal structures will facilitate quality, low-cost offerings.").

613 *See* CFIRA Letter 2.

The proposed rules would clarify that, consistent with proposed Rule 305, a funding portal could compensate a third party for referring a person to the funding portal if the third party does not provide the funding portal with personally identifiable information of any potential investor. For example, a third party could provide hyperlinks to a funding portal in order to inform potential investors learn about securities offerings made in reliance on Section 4(a)(6). Any compensation, unless paid to third party that is a registered broker or dealer, could not be based, directly or indirectly, on the purchase or sale of a security offered in reliance on Section 4(a)(6) on or through the funding portal's platform.[614] Otherwise, such transaction-based compensation could trigger broker-dealer registration requirements. We also believe that this prohibition on transaction-based compensation would help to remove the incentive for high-pressure sales tactics and other abusive practices.[615]

- **Compensation Arrangements with Registered Broker-Dealers**

The proposed rules would specify that a funding portal could enter into certain arrangements with a registered broker-dealer, through which they could compensate each other for services.[616] In speaking with industry participants, we understand that because the statute narrowly defines the permissible activities in which funding portals may engage, funding portals may wish to contract or affiliate with registered broker-dealers, which are not subject to similar constraints.[617] For example, a registered broker-dealer could, among other things, recommend

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614 *See* proposed Rule 402(b)(6) of Regulation Crowdfunding. *See also* discussion in Section II.C.7 above. Proposed Rule 305 of Regulation Crowdfunding would implement the prohibition in Section 4A(a)(10).

615 *See* note 515.

616 *See* proposed Rules 402(b)(7) and 402(b)(8) of Regulation Crowdfunding.

617 Exchange Act Section 3(a)(80) limits the permissible securities activities of a funding portal to those in connection with the offer and sale of securities in reliance on Securities Act Section 4(a)(6).

securities offered on the funding portal's platform or provide services involving the handling of investor funds and securities. Conversely, funding portals may wish to offer certain services, including information technology services, to a broker-dealer, for a fee. Each party to this type of arrangement would, because it is a regulated entity, need to comply with all applicable regulations, including the rules of the registered national securities association of which it is a member.

Proposed Rule 402(b)(7) would permit a funding portal to pay or offer to pay compensation to a registered broker or dealer for services in connection with the funding portal's offer or sale of securities in reliance on Section 4(a)(6). Proposed Rule 402(b)(8) would permit a funding portal to provide services to and receive compensation from a registered broker-dealer in connection with the funding portal's offer or sale of securities in reliance on Section 4(a)(6).[618] Compensation could include any monetary form of payment, such as fees, discounts, commissions, concessions, reimbursement of expenses and other allowances. The proposed safe harbor would not, however, permit a funding portal to receive transaction-based compensation for referrals of potential investors in other types of offerings being effected by a registered broker-dealer, such as a Rule 506 offering.[619] The proposed rules would require the funding portal to provide any services pursuant to a written agreement with the registered broker-dealer, and they also would require the payments to be compliant with, and not prohibited by, the rules

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618 *See also* FINRA, *Payments to Unregistered Persons: FINRA Request Comment on Proposed Consolidated FINRA Rule Governing Payments to Unregistered Persons*, Regulatory Notice 09-69 (Dec. 2009), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p120480.pdf.

619 Receipt of transaction-based compensation in connection with such referrals could cause a funding portal to be a broker required to register with us under Exchange Act Section 15(a)(1) (15 U.S.C. 78*o*(a)(1)).

of the registered national securities association of which the funding portal is a member.[620] The proposed rules would require that a funding portal's offers to pay, and payments made to, a registered broker-dealer, as well as a funding portal's receipt of compensation from a registered broker-dealer, under these arrangements, be compliant with Regulation Crowdfunding. In particular, these arrangements would have to be compliant with proposed Rule 305 which prohibits, with certain exceptions, an intermediary from compensating any person for providing the intermediary with the personally identifiable information of any investor or potential investor.[621] These proposed provisions, taken as a whole, are intended to facilitate intermediaries' cooperation with each other and promote the use of the Section 4(a)(6) exemption to raise capital, while maintaining a clear audit trail.

- **Advertising**

The proposed rules would permit a funding portal to advertise its existence and engage in certain other limited advertising activities.[622] The proposed rule does not limit the manner in which a funding portal could advertise its existence. A funding portal may, for example, choose to advertise through social media, internet advertisements or traditional sources of advertising like print media.

In addition, funding portals could identify issuers and offerings in the advertisements on the basis of criteria that are reasonably designed to identify a broad selection of issuers (so as not to recommend or implicitly endorse one issuer or offering over others) and are applied consistently to all potential issuers and offerings. The criteria, consistent with those described

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620 *See, e.g.,* FINRA Rule 4311 ("Carrying Agreements").

621 *See* proposed Rule 305 of Regulation Crowdfunding and discussion in Section II.C.7 above.

622 *See* proposed Rule 402(b)(9) of Regulation Crowdfunding.

above with regard to highlighting issuers and offerings on the platform and the ability to provide investors with search functions, could include the type of securities being offered, the geographic location of the issuer, the industry or business segment of the issuer, the number or amount of investment commitments made, the progress in meeting the issuer's target offering amount and, if applicable, the maximum offering amount and the minimum or maximum investment amount.[623] Of course, a funding portal is subject to the statutory prohibition on providing investment advice and recommendations, and soliciting, and so the safe harbor would not permit a funding portal to advertise in such a way that expresses that any of the offerings offered on its platform are of a higher quality, are safer, or are more worthy investments compared to any others, whether offered on its platform or those of other intermediaries.

The proposed rule would also specify that the funding portal could not receive special or additional compensation for identifying an issuer or offering in its advertisement, because this could create an incentive for the funding portal to promote one issuer over another. This prohibition should help to limit the dissemination of information that may be misleading or easily misconstrued.[624]

- **Denying Access Based on Potential Fraud or Investor Protection Concerns**

In light of the comments received, the proposed rules would require a funding portal to deny access to its platform to, or cancel an offering of, an issuer that the funding portal believes

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623 As a funding portal could be subject to liability for fraud, it would need to consider whether its advertisements are not misleading or otherwise fraudulent, such as by implying that past performance of offerings on its platform is indicative of future results. *See* Exchange Act Rule 10b-5 [17 CFR 240.10b-5].

624 In response to one commenter, we note that this would preserve the ability of funding portals to pay for search listings or advertisements in online social networks. *See* Cera Technology Letter.

may present the potential for fraud or otherwise raises concerns regarding investor protection, as is required under proposed Rule 301(c).[625]

- **Accepting Investor Commitments**

The proposed rules would permit a funding portal, on behalf of an issuer, to accept investment commitments from potential investors for securities offered in reliance on Section 4(a)(6) by that issuer on the funding portal's platform.[626] Given the breadth of the statutory prohibition on holding, managing, possessing or otherwise handling investor funds or securities, we believe that it is important to clarify the activities, in this area, in which a funding portal may permissibly engage, including with regard to accepting investment commitments.[627]

Although some commenters expressed the view that funding portals should be permitted to handle investor funds and securities in a limited capacity as the issuer's transfer agent or to be the holder of record,[628] we do not believe that these activities would be consistent with the statutory directive in Exchange Act Section 3(a)(80). In our view, a funding portal acting as custodian for securities through a book entry system likely would be engaged in handling or managing securities in violation of the statutory prohibition in Section 3(a)(80).[629]

- **Directing Transmission of Funds**

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625 *See* proposed Rule 402(b)(10) of Regulation Crowdfunding. *See also* discussion in Section II.C.3 above.

626 *See* proposed Rule 402(b)(11) of Regulation Crowdfunding.

627 As described above, we are proposing other measures that would prescribe the requirements for funding portals with respect to the maintenance and transmission of funds, including the use of a qualified third party to hold and transmit investor funds. *See* discussion in Section II.C.5.d above.

628 *See* Crowdfunding Offerings Ltd. Letter 4; RocketHub Letter 1.

629 *Cf*. Exchange Act Section 3(a)(23) [15 U.S.C. 78c(a)(23)] (defining "clearing agency" as an intermediary who "acts as a custodian of securities in connection with a system for the central handling of securities" where the securities may be administered "by bookkeeping entry without physical delivery of securities certificates").

The proposed rules would provide that a funding portal could fulfill its obligations with respect to the maintenance and transmission of funds and securities, as set forth in proposed Rule 303, without violating the prohibition in Exchange Act Section 3(a)(80)(D).[630] Thus, subject to other applicable rules, a funding portal could direct investors where to transmit funds or remit payment in connection with the purchase of securities offered and sold in reliance on Section 4(a)(6).[631] It also could direct a qualified third party to release the proceeds of an offering to the issuer upon completion of the offering or to return investor proceeds when an investment commitment or offering is cancelled.[632] We believe that these discrete activities would facilitate crowdfunding transactions without exceeding the scope of permissible activities, and without unduly raising investor protection concerns.

Request for Comment

216. Does the proposed safe harbor appropriately define the actions in which a funding portal may engage? Are there other activities that should be addressed in the safe harbor? Are there activities included in the proposed safe harbor that should be modified or eliminated? If so, which activities and why?

217. Are there any additional conditions that should apply to the activities covered under the proposed safe harbor? If so, which conditions, and why?

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630 We believe the statutory requirements, and the rules we are proposing to implement such requirements, provide clear requirements for the protection of investor funds. In addition, the requirement for the funding portals to maintain a fidelity bond under proposed Rule 400(f) provides an additional protection with respect to investor funds. *See* discussion in Section II.D.1 above. *See also* proposed Rule 400(f) of Regulation Crowdfunding.

631 *See* proposed Rule 402(b)(12) of Regulation Crowdfunding.

632 *See* proposed Rule 402(b)(13) of Regulation Crowdfunding.

218. Exchange Act Section 3(a)(80) provides that a funding portal may not offer investment advice, and the proposed rules would provide a conditional safe harbor for certain activities that funding portals may engage in without violating the statutory prohibition on providing investment advice. Is the safe harbor sufficient, or should we provide additional guidance regarding the status of funding portals under the Investment Advisers Act of 1940? Why or why not? Please discuss.

219. Should the proposed safe harbor permit a funding portal to limit the offerings on its platform? If so, are the criteria set forth in the proposed rules appropriate? Why or why not? If not, what other criteria or conditions would be appropriate?

220. Are there any additional criteria that a funding portal should be permitted to use when highlighting issuers and offerings on its platform? If so, which ones and why? Should a funding portal be permitted to highlight issuers and offerings based on criteria that specifically relate to the activities of users on its site, such as offerings that have been viewed by the largest number of visitors to the platform over a particular time period? Why or why not?

221. As a condition of the proposed safe harbor, should we require funding portals to clearly display, on their platforms, the objective criteria they use in limiting or highlighting offerings? Why or why not?

222. Under the proposed safe harbor, should we permit a funding portal to post news, such as market news and news about a particular issuer or industry, on its platform? Why or why not? If so, what restrictions, conditions or other safeguards should apply, in particular so that a funding portal would not be

providing impermissible investment advice? For example, are there certain types of news or news feeds that should or should not be permitted, or should we restrict a funding portal from posting only positive news coverage? Should a funding portal be able to freely select the news stories it posts, or should there be some objective criteria? Please explain.

223. Are the proposed limitations on a funding portal advertising its past offerings appropriate? Should we consider other advertising limitations? Should the proposed advertising rules be modified in any other way?

224. Should we permit a funding portal to receive transaction-based compensation for referring potential investors to a registered broker-dealer? Why or why not? If so, should we impose disclosure requirements or other measures to mitigate potential conflicts? What should those requirements be and why? Should we permit a funding portal to receive transaction-based compensation from an affiliate? Why or why not?

225. In addition to transaction-based compensation, are there other types of compensation that we should prohibit funding portals from paying to persons who are not registered broker-dealers? Should we permit, as proposed, funding portals to enter into compensation arrangements with registered broker-dealers or with any other regulated entities? Why or why not? If so, what types of regulated entities should be included? Please explain.

226. Are there circumstances in which a funding portal could provide transfer agent services without handling investor funds or securities? If so, please describe.

227. Should the proposed safe harbor permit a funding portal to engage in any other activities in connection with the required communication channels? Why or why not? If so, which activities and why?

228. Should the proposed safe harbor include other types of activities that potentially could be construed as investment advice? If so, which ones and why? Would an exemption from the Investment Advisers Act of 1940 or other regulatory relief be appropriate in connection with such activities? Are there types of advice an issuer may seek from a funding portal, that would not be considered advice about the structure or content of the issuer's offering? Please explain.

229. Should the agreed-upon terms of an arrangement with a funding portal be required to be documented in a written agreement with the issuer? Are there certain terms that should be included?

230. Should the proposed safe harbor permit funding portals to provide a mechanism by which investors can rate an issuer or an offering? If so, what safeguards, if any, should be required?[633] Should the Commission, as a condition of the safe harbor, limit the ability to rate to persons who have opened an account with the funding portal?[634]

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633 An intermediary that is a registered broker could provide a mechanism for investors to rate an issuer or offering. *But see Social Media Websites and the Use of Personal Devices for Business Communications*, FINRA Regulatory Notice 11-39 (Aug. 2011), *available at http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p124186.pdf* (noting that a firm is responsible under NASD Rule 2210 for third-party site content if the firm has adopted or has become entangled with the site's content).

634 Any person who promotes an issuer's offering for compensation, whether past or prospective, or who is a founder or an employee of an issuer that engages in promotional activities on behalf of the issuer on the intermediary's platform, must clearly disclose in all communications on the intermediary's platform, respectively, the receipt of compensation and that he or she is engaging in promotional activities on behalf of the issuer. *See* proposed Rule 302(c) of Regulation Crowdfunding.

4. Compliance

a. Policies and Procedures

The proposed rules would require a funding portal to implement written policies and procedures reasonably designed to achieve compliance with the federal securities laws and regulations thereunder, relating to its business as a funding portal.[635] Under the proposed rules, a funding portal would have discretion to establish, implement, maintain and enforce those policies and procedures based on its relevant facts and circumstances. We believe that it is important to provide this flexibility in order to accommodate the various business models funding portals may have while at the same time accomplishing the Commission's investor protection goals. We also recognize that FINRA or any other registered national securities association may have separate requirements in this regard. Inherent in the notion of reasonably designed compliance policies and procedures is that a funding portal would promptly update its policies and procedures to reflect changes in applicable rules and regulations, as well as its business practices and the changing marketplace.

Request for Comment

231. Should we specify requirements for funding portals' compliance policies and procedures? Why or why not? If so, what requirements and why?
232. Should we require funding portals to update their policies and procedures to reflect changes in applicable rules and regulations within a specified time period

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635 *See* proposed Rule 403(a) of Regulation Crowdfunding. As a condition to exempting funding portals from the requirement to register as a broker or a dealer under Exchange Act Section 15(a)(1) (15 U.S.C. 78*o*(a)(1)), Exchange Act Section 3(h)(1)(C) provides that registered funding portals must comply with such other requirements as the Commission determines appropriate.

after the change occurs? If so, what time period would be appropriate (*e.g.*, 30 days, 60 days, six months)?

b. Anti-Money Laundering

The proposed rules require that funding portals comply with certain AML provisions,[636] as set forth in Chapter X of Title 31 of the Code of Federal Regulations.[637] We preliminarily believe that funding portals could play a critical role in detecting, preventing, and reporting money laundering and other illicit financing, such as market manipulation and fraud. As discussed in more detail below, we believe it is important for funding portals to comply with BSA requirements, because they would be engaged in a similar business as a category of registered broker-dealers – introducing brokers – which have BSA obligations.[638] Specifically, while a funding portal is prohibited by statute from handling, managing or possessing customer funds or securities, which means it cannot accept cash from customers or maintain custody of customer securities – and an introducing broker typically does not accept cash or maintain custody of customer securities – we believe that a funding portal, like an introducing broker, is in the best position to "know its customers," and to identify and monitor for suspicious and potentially illicit activity at the individual customer level, as compared to the qualified third party, which may not see such activity given its less direct contact with individual customers.[639]

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636 *See* proposed Rule 403(b) of Regulation Crowdfunding. *See also* proposed Rule 401(b) and discussion in Section II.D.2 above, which discusses how funding portals fall within the scope of Chapter X of Title 31 of the Code of Federal Regulations.

637 *See* note 562.

638 *See* 31 C.F.R 1023.100 *et seq.*

639 *See, e.g.*, NASD (n/k/a FINRA), *NASD Provides Guidance To Member Firms Concerning Anti-Money Laundering Compliance Programs Required by Federal Law*, Special Notice to Members 02-21 (Apr. 2002), *available at https://www.finra.org/Industry/Regulation/Notices/2002/p003703* (stating that "introducing brokers generally are in the best position to 'know the customer,' and thus to identify potential

We also believe it is important for funding portals to comply with BSA requirements because they would be in engaged in the same business of effecting securities transactions for the accounts of others as registered broker-dealers, which have BSA obligations. To require otherwise could inadvertently steer potential money launders to funding portals.

Moreover, we expect that funding portals would often facilitate offerings of microcap or low-priced securities, which may be more susceptible to fraud and market manipulation.[640] We believe that imposing the monitoring and reporting requirements of the BSA on funding portals would establish a valuable oversight, prevention and detection mechanism. The Financial Action Task Force ("FATF"), an inter-governmental body whose objective is to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system, has also identified low-priced and privately-placed securities as potential vehicles for laundering money.[641] As explained by FATF, these securities pose a money laundering risk because they are often used to generate illicit assets through market manipulation, insider trading and fraud.[642] In addition, unlawfully acquired assets can be used to purchase these securities in order to resell them and create the appearance of legitimately sourced

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money laundering concerns at the account opening stage, including verification of the identity of the customer and deciding whether to open an account for a customer.").

640 A number of the Commission's enforcement actions in the BSA area have involved broker-dealers failing to report suspicious activity involving microcap securities fraud. *See, e.g.*, *In the Matter of Gilford Securities, Incorporated, Ralph Worthington, IV, David S. Kaplan, and Richard W. Granahan*, Release No. 34-65450 (Sept. 30, 2011); *In the Matter of Elizabeth Pagliarini*, Release No. 34-63964 (Feb. 24, 2011).

641 *See* FINANCIAL ACTION TASK FORCE ("FATF"), *Money Laundering and Terrorist Financing in the Securities Sector* 20-21 (Oct. 2009) ("FATF Typology") (discussing the money laundering risks associated with low priced securities, private issuers and shell companies).

642 *Id.* As explained in the FATF Typology, illicit actors "can either use existing shares that are already publicly traded or start a shell company for the express purpose of engaging in those illicit activities. In addition, criminal organizations also have been known to use illicit assets generated outside the securities industry to engage in market manipulation and fraud." *Id*.

funds.[643] We believe that securities offered and sold in reliance on Section 4(a)(6) could be susceptible to money laundering because they are low priced, are placed in an offering that is exempt from registration and not subject to the filing review process of a registered offering. In addition, we expect that many of the issuers relying on the exemption in Section 4(a)(6) may be shell companies, which have been associated with a high risk of money laundering.[644] We believe that Congress was aware of these risks, which is why, in part, it chose to require that securities offered and sold in reliance on Section 4(a)(6) be sold through a regulated intermediary.[645]

The BSA[646] and its implementing regulations establish the basic framework for AML obligations imposed on financial institutions.[647] The BSA is intended to facilitate the prevention, detection and prosecution of money laundering, terrorist financing and other financial crimes.

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643 *Id*. "Moreover, criminal organizations can also initially invest in a private company that they can then use as a front company for commingling illicit and legitimate assets. They can then take this company public through an offering in the public securities markets, thus creating what appear to be legitimate offering revenues. Alternatively, criminal organizations can acquire a publicly traded company and use it to launder illicit assets." *Id*. The FATF Typology further highlighted the risk of shell companies that, for example, "can be established to accept payments from criminal organizations for non-existent services. These payments, which appear legitimate, can be deposited into depository or brokerage accounts and either wire transferred out of a jurisdiction or used to purchase securities products that are easily transferable or redeemable." *Id*. at 39.

644 *See, e.g.*, Joint Release, *Guidance on Obtaining and Retaining Beneficial Ownership Information*, FIN-2010-G001 (Mar. 5, 2010) (noting that criminals, money launderers, tax evaders and terrorists may exploit the privacy and confidentiality surrounding some business entities, including shell companies and other vehicles designed to conceal the nature and purpose of illicit transactions and the identities of the persons associated with them); Financial Crimes Enforcement Network, *The Role of Domestic Shell Companies in Financial Crime and Money Laundering: Limited Liability Companies* (Nov. 2006), *available at* http://www.fincen.gov/news_room/rp/files/LLCAssessment_FINAL.pdf.

645 158 CONG. REC. S1781 (daily ed. Mar. 19, 2012) (statement of Sen. Carl Levin) ("Senior citizens, state securities regulators, and others worry that this will give rise to money laundering and fraud risks.")

646 *See* BSA, note 562.

647 *See* 31 CFR Chapter X.

Below, we clarify which aspects of these regulations we anticipate would be relevant to funding portals, given the limited scope of their activities.[648]

Among other things, the BSA and its implementing regulations require a "broker or dealer in securities" (sometimes referred to in the regulations as a "broker-dealer") to: (1) establish and maintain an effective AML program ("AML Program Requirement");[649] (2) establish and maintain a Customer Identification Program ("CIP Requirement");[650] (3) monitor for and file reports of suspicious activity ("the SAR Requirement");[651] and (4) comply with requests for information from the Financial Crimes Enforcement Network ("FinCEN") (the "Section 314(a) Requirements").[652] For purposes of the BSA obligations, a "broker or dealer in securities" is defined as a "broker or dealer in securities, registered or required to be registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934, except persons who register pursuant to [S]ection 15(b)(11) of the Securities Exchange Act of 1934."[653] As discussed above in Section II.D.2.a, for purposes of Chapter X of Title 31 of the

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648 We also propose to impose on funding portals obligations that are analogous to those imposed on broker-dealers pursuant to Exchange Act Rule 17a-8 (17 CFR 240.17a-8), which requires broker-dealers to comply with the reporting, recordkeeping and record retention requirements of the BSA's implementing regulations, as found in Chapter X of Title 31 of the CFR. These proposed obligations are discussed in Section II.D.5 below, which also addresses other recordkeeping requirements we are proposing for funding portals. *See* proposed Rule 404(f) of Regulation Crowdfunding.

649 *See* 31 U.S.C. 5318(h). *See also* 31 CFR 1023.210; FINRA Rule 3310.

650 31 CFR 1023.220.

651 31 CFR 1023.320. *See also* FINRA Rule 3310.

652 31 CFR 1010.520.

653 31 CFR 1010.100(h). As noted above, certain FinCEN regulations apply to a "broker-dealer," which is defined as a "person registered or required to be registered as a broker or dealer with the Commission under the Securities Exchange Act of 1934 (15 U.S.C. 77a *et seq*.), except persons who register pursuant to 15 U.S.C. 78*o*(b)(11)." 31 CFR 1023.100(b). Such broker-dealers also would meet the definition of "broker or dealers in securities" above.

Code of Federal Regulations, a funding portal is "required to be registered" as a broker or dealer with the Commission under the Exchange Act.

Finally, we note that while other parties involved in transactions conducted pursuant to Section 4(a)(6) through a funding portal (such as a bank acting as a qualified third party to hold investor funds) have their own BSA obligations, again, as noted above, we believe that the funding portal, like an introducing broker, is in the best position to "know its customers," and to identify and monitor for suspicious and potentially illicit activity at the individual customer level.

While a funding portal would be required to comply with all of the provisions in the BSA and its implementing regulations that are applicable to broker-dealers, the Commission anticipates that, as a practical matter, a funding portal's BSA obligations would typically be limited, based on the relatively limited securities activities in which funding portals would be permitted to engage. For a typical transaction involving an individual U.S. investor, funding portal activities, for example, would not involve the maintenance of "correspondent accounts" with foreign financial institutions or the offer of "private banking accounts" that would trigger the corresponding due diligence obligations under the BSA.[654] While it is possible that a funding portal's activities could trigger other BSA obligations, we expect that the nature of a funding portal's business would typically implicate the AML Program Requirement, the CIP Requirement, the SAR Requirement and the information sharing provisions of the Section 314(a) Requirements. We, therefore, highlight these obligations below.

Brokers and funding portals, which as noted above meet the definition of "broker,"[655] can satisfy the AML Program Requirement by implementing and maintaining an AML program that

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654 *See* 31 CFR 1010.610 and 1010.620.

655 *See* discussion in this section above and in Section II.D.2.a above.

complies with SRO rules.[656] Generally, under existing rules applicable to brokers, an AML program must be in writing and include, at a minimum: (1) policies, procedures and internal controls reasonably designed to achieve compliance with the BSA and its implementing rules; (2) policies and procedures that can be reasonably expected to detect and cause the reporting of transactions under 31 U.S.C. 5318(g) and the implementing regulations thereunder; (3) the designation of an AML compliance officer, including notification to the SROs; (4) ongoing AML employee training; and (5) an independent test of the firm's AML program, annually for most firms.[657]

FinCEN's BSA regulations also require brokers, and thus would require funding portals, to establish a written CIP that, at a minimum, includes procedures for: (1) obtaining customer identifying information from each customer prior to account opening; (2) verifying the identity of each customer,[658] to the extent reasonable and practicable, within a reasonable time before or after account opening; (3) making and maintaining a record of obtained information relating to identity verification; (4) determining, within a reasonable time after account opening or earlier, whether a customer appears on any list of known or suspected terrorist organizations designated

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656 31 CFR 1023.210 (providing that a broker-dealer is deemed to have satisfied the requirement to establish an AML program if it (1) implements and maintains an anti-money laundering program that complies with the rules, regulations or requirements of its SRO governing such programs; and (2) the rules, regulations or requirements of the SRO have been approved, if required, by the SEC).

657 *See, e.g.*, FINRA Rule 3310. FINRA's existing AML program rule applies to member broker-dealers. FINRA or any other national registered securities association may adopt an AML Program Requirement specific to funding portals. Consistent with the BSA, any such rule must require that the AML program include, at a minimum: the development of internal policies, procedures and controls; designation of a compliance officer, an ongoing employee training program and an independent audit function to test the program. *See* 31 U.S.C. 5318(h).

658 For purposes of the CIP requirements, a customer is generally defined as "a person that opens a new account." 31 CFR 1023.100(d).

by Treasury;[659] and (5) providing each customer with adequate notice, prior to opening an account, that information is being requested to verify the customer's identity.[660]

The CIP rule provides that, under certain defined circumstances, brokers, which would include funding portals, may rely on the performance of another financial institution to fulfill some or all of the requirements of the broker's CIP.[661] In order for brokers (which would include funding portals) to rely on the other financial institution, for example, the reliance must be reasonable.[662] The other financial institution also must be subject to an AML compliance program rule and be regulated by a federal functional regulator.[663] Additionally, the broker and the other financial institution must enter into a contract, and the other financial institution must certify annually to the broker that it has implemented an AML program and that it will perform the specified requirements of the broker's CIP.[664]

Under the SAR Requirement, brokers and funding portals, which as noted above meet the definition of "broker,"[665] must file a suspicious activity report if: (1) a transaction is conducted or attempted to be conducted by, at, or through a broker; (2) the transaction involves or aggregates funds or other assets of at least $5,000; and (3) the broker knows, suspects or has reason to suspect that the transaction: (i) involves funds or is intended to disguise funds derived from illegal activity, (ii) is designed to evade requirements of the BSA, (iii) has no business or

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659 To date, there are no designated government lists to verify specifically for CIP purposes.

660 31 CFR 1023.220.

661 31 CFR 1023.220(a)(6).

662 31 CFR 1023.220(a)(6)(i).

663 31 CFR 1023.220(a)(6)(ii).

664 31 CFR 1023.220(a)(6)(iii).

665 *See* discussion in this section above and in Section II.D.2.a above.

apparent lawful purpose, and the broker knows of no reasonable explanation for the transaction after examining the available facts, or (iv) involves the use of the broker-dealer to facilitate criminal activity.[666] The suspicious activity must be reported on a form prescribed by FinCEN, which includes instructions.[667] Brokers, which would include funding portals, must maintain a copy of any suspicious activity report filed, as well as supporting documentation for a period of five years from the date of filing the report.[668] The report (and any information that would reveal its existence) must be kept confidential.[669]

Under the Section 314(a) Requirements, brokers, which would include funding portals, also must respond to mandatory requests for information made by FinCEN on behalf of federal law enforcement agencies.[670] Law enforcement agencies with criminal investigative authority are permitted to request that FinCEN solicit, on the agency's behalf, certain information from a financial institution, including brokers; FinCEN also may make similar requests on its own behalf or on behalf of certain components of Treasury.[671] Upon receiving such a request, a broker (which would include a funding portal) is required to search its records to determine whether it has accounts for, or has engaged in transactions with, any specified individual, entity or organization.[672] If the broker identifies an account or transaction identified with any individual, entity or organization named in the request, it must report certain relevant

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666 31 CFR 1023.320(a).

667 31 CFR 1023.320(b).

668 31 CFR 1023.320(d).

669 31 CFR 1023.320(e).

670 31 CFR 1010.520.

671 31 CFR 1010.520(b).

672 31 CFR 1010.520(b)(3).

information to FinCEN.[673] Brokers also must designate a contact person (typically the firm's AML compliance officer) to receive the requests and must maintain the confidentiality of any request and any responsive reports to FinCEN.[674]

Request for Comment

233. We identified the AML Program, CIP, SAR and 314(a) Requirements as the most significant requirements that would most typically apply to funding portals, in light of the nature of their business. Under the proposed rules, however, funding portals would be subject to all BSA requirements applicable to registered brokers. Are there any other requirements under the BSA and its implementing regulations that should be clarified, with regard to application in the crowdfunding context, or excluded from application to funding portals? If so, which ones?

234. Is express compliance with the BSA by funding portals, as proposed, necessary to protect against the risk of money laundering, given that other regulated entities involved in transactions conducted pursuant to Section 4(a)(6), such as the qualified third party we propose to require be involved in the transmission of proceeds, are subject to the BSA? Please explain.

235. Is there another approach, other than the one we have proposed, to help protect against the risk of money laundering, that does not rely on BSA compliance? If so, please explain.

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673 31 CFR 1010.520(b)(3)(ii).

674 31 CFR 1010.520(b)(3)(iii) and (iv).

c. Privacy

Section 4A(a)(9) requires intermediaries to take such steps to protect the privacy of information collected from investors as the Commission shall, by rule, determine appropriate. One commenter suggested that the responsibility for storing confidential information should rest with the intermediary and that data should not be shared with, or stored by, any other organization.[675] The commenter recommended requiring intermediaries to store information in a secure fashion on a dedicated, secure server. The commenter also urged the Commission to identify, by rule or otherwise, an appropriate industry standard for protection of this data, perhaps looking to standards adopted in the legal and banking industries as examples. Another commenter suggested that a procedure should be established to allow the public to control the delivery and the amount of e-mails soliciting funds for crowdfunding projects.[676]

The proposed rules would implement the requirements of Section 4A(a)(9) by subjecting funding portals, as brokers, to the same privacy rules applicable to brokers.[677] Proposed Rule 403(c), therefore, would require funding portals to comply with Regulation S-P (Privacy of Consumer Financial Information and Safeguarding Personal Information),[678] Regulation S-AM

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675 *See* RocketHub Letter 1.

676 *See* Bach Letter.

677 *See* proposed Rule 403(c) of Regulation Crowdfunding.

678 *See Privacy of Consumer Financial Information (Regulation S–P)*, Release No. 34-42974 (June 22, 2000) [65 FR 40334 (June 29, 2000)].

(Limitations on Affiliate Marketing)[679] and Regulation S-ID (Identity Theft Red Flags)[680] (collectively, the "Privacy Rules").[681]

Regulation S-P governs the treatment of nonpublic personal information by brokers, among others.[682] It generally requires a broker to provide notice to investors about its privacy policies and practices; describes the conditions under which a broker may disclose nonpublic personal information about investors to nonaffiliated third parties; and provides a method for investors to prevent a broker from disclosing that information to most nonaffiliated third parties by "opting out" of that disclosure, subject to certain exceptions. Regulation S-AM allows a consumer, in certain limited situations, to block affiliates of covered persons (*i.e.*, brokers, dealers, investment companies and both investment advisers and transfer agents registered with the Commission) from soliciting the consumer based on eligibility information (*i.e.*, certain financial information, such as information regarding the consumer's transactions or experiences with the covered person) received from the covered person.[683] Regulation S-ID generally requires brokers to develop and implement a written identity theft prevention program that is designed to detect, prevent and mitigate identity theft in connection with certain existing accounts or the opening of new accounts.[684]

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679 *See Regulation S–AM: Limitations on Affiliate Marketing*, Release No. 34-60423 (Aug. 4, 2011) [74 FR 40398 (Aug. 11, 2009)].

680 *See Identity Theft Red Flags Rules*, Release No. 34-69359 (Apr. 10, 2013) [78 FR 23637 (Apr. 19, 2013)] ("*Identity Theft Red Flags Rules*") (adopted jointly with the Commodity Futures Trading Commission).

681 *See* 17 CFR 248.

682 *See* 17 CFR 248 Subpart A.

683 17 CFR 248 Subpart B.

684 *See Identity Theft Red Flags Rules*, note 680.

While we recognize that crowdfunding activities, like any Internet-based communications, could raise novel issues not already addressed in existing regulations and guidance, we believe that it is unnecessary to repeat identical, existing requirements, in a separate rule proposal only for funding portals, or to propose rules that would apply not only to crowdfunding, but to a broader set of technology-based activity. We believe that the requirements of the Privacy Rules would impose relatively minimal costs on funding portals,[685] but provide key investor protections, and that persons who deal with funding portals, as opposed to brokers, should not have to lose the benefit of those protections.

Although one commenter suggested the development of a procedure to allow the public to control the delivery and the amount of e-mails that solicit funds for crowdfunding projects,[686] we note that the definition of funding portal in Exchange Act Section 3(a)(80) and the proposed rules[687] prohibit a funding portal from soliciting investors for specific crowdfunding projects. Moreover, Section 4A(b)(2) and the proposed rules[688] prohibit issuers from advertising the terms of an offering, except for directing potential investors to the intermediary.[689] The proposed rules[690] also incorporate prohibitions on the transmission of personally identifiable information in connection with intermediaries' advertisements, referrals and payments to third parties.[691] We believe that these provisions, in combination with the Privacy Rules, address the commenter's

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685 *See* discussion in Section IV.C.2.l below.

686 *See* Bach Letter.

687 *See* proposed Rule 300(c) of Regulation Crowdfunding.

688 *See* proposed Rule 204 of Regulation Crowdfunding.

689 *See* discussion in Section II.B.4 above.

690 *See* proposed Rules 305 and 402(b)(6) of Regulation Crowdfunding.

691 *See* discussion in Sections II.C.7 and II.D.3 above.

concern. Although one commenter urged us not to permit intermediaries to store information with third parties,[692] we note that our recordkeeping rules applicable to brokers permit the use of third-party service providers for storing records.[693] We are proposing a similar requirement for funding portals, as discussed in Section II.D.5 below. A different requirement for funding portals would not be consistent with the requirements for brokers and may not be economically feasible for some intermediaries.

Request for Comment

236. Is it appropriate to implement the requirements of Section 4A(a)(9) by applying the requirements of the Privacy Rules to funding portals? Why or why not? Is the nature of a funding portal's activities such that a different requirement to protect privacy would be more appropriate? Please explain.

237. Are there specific considerations with respect to privacy and crowdfunding that are not already adequately addressed in the Privacy Rules? If so, what are they and how should we address them?

238. Should we provide additional guidance concerning the application of the Privacy Rules to funding portals? If so, which parts and why?

239. Under the proposed rules, funding portals would be required to collect information about their customers in order to comply with anti-money laundering provisions, as brokers are required to do, as discussed above in relation to proposed Rule 402(b). At the same time, intermediaries would be required to take steps to protect the privacy of information collected from

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692 *See* RocketHub Letter 1.

693 *See* 17 CFR 240.17a-4(i).

customers, as set forth in Section 4A(a)(9). Do our proposed rules achieve the appropriate balance between these two objectives? What other approaches would achieve an appropriate balance? Please explain.

d. Inspections and Examinations

Congress specified that funding portals must remain subject to our examination authority.[694] Under the proposed rules, a funding portal would be required to permit the examination and inspection of all of its business and business operations that relate to its activities as a funding portal, such as its premises, systems, platforms and records, by our representatives and by representatives of the registered national securities association of which it is a member.

Request for Comment

240. Are there any additional provisions that should be incorporated in the proposed rules regarding inspection and examination of funding portals? Please explain.

5. Records To Be Created and Maintained by Funding Portals

The proposed rules would require a funding portal to create and maintain certain records.[695] We believe that it is important for funding portals to be subject to a recordkeeping requirement in order to create a meaningful audit trail of the crowdfunding transactions and communications. Without these records, the Commission and any registered national securities

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694 As a condition to exempting funding portals from the requirement to register as broker-dealers under Exchange Act Section 15(a)(1) (15 U.S.C. 78c(a)(1)), Exchange Act Section 3(h)(1)(A) requires that registered funding portals remain subject to, among other things, our examination authority. *See* proposed Rule 403(d) of Regulation Crowdfunding.

695 *See* proposed Rule 404 of Regulation Crowdfunding. Exchange Act Section 3(h)(1)(C) permits us to impose, as part of our authority to exempt funding portals from broker registration, "such other requirements under [the Exchange Act] as the Commission determines appropriate."

association would have difficulty examining a funding portal for compliance with the requirements of Regulation Crowdfunding, the BSA[696] and the federal securities laws.

The proposed rules would require a funding portal to make and preserve certain records for five years, with the records retained in a readily accessible place for at least the first two years.[697] The records would include those regarding investors who purchase or attempt to purchase securities through the funding portal, such as information relating to educational materials provided to investors, account opening and transactions (including notices of investment commitments and reconfirmations), as required under Subpart C. They also would include records relating to issuers that offer and sell, or attempt to offer and sell, securities through the funding portal and to persons having control with respect to those issuers. This proposed requirement would better enable regulators to gather information about the activities in which the funding portal has been engaged, as well as about the issuers and investors that use the funding portal for their crowdfunding transactions.

The proposed rules also would require a funding portal to maintain records of all communications that occur on or through its platform.[698] Some commenters expressed concerns about the ability of funding portals to track and store communications that take place outside of their platforms.[699] We believe that funding portals should be responsible to keep records of only

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696 In the release adopting Exchange Act Rule 17a-8 (17 CFR 240.17a-8), which requires broker-dealers to comply with the reporting, recordkeeping and record retention rules adopted under the BSA, the Commission noted that the "most effective means of enforcing compliance with the reporting and recordkeeping requirements is through on-site examinations of broker-dealer firms conducted by the Commission and the self-regulatory organizations . . . ." *See Recordkeeping by Brokers and Dealers*, Release No. 34-18321 (Dec. 10, 1981) [46 FR 61454 (Dec. 17, 1981)].

697 *See* proposed Rules 404(a)(1) through (9) of Regulation Crowdfunding.

698 *See id*.

699 *See* CFIRA Letter 13.

the communications that occur on or through their platforms, including in the communication channels they are required to provide. We do not believe they should be responsible for keeping records of communications that take place exclusively outside of their platforms, such as on third-party social media sites or elsewhere on the Internet. The proposed rules also would require a funding portal to keep all records related to persons that use communication services provided by a funding portal to promote an issuer's securities or to communicate with potential investors.[700] These proposed requirements would help regulators to examine the funding portal for any potential connection with promoters, including associated persons that act as promoters, whose promotion or communication activities could cause the funding portal to lose its exemption from broker-dealer registration.

The proposed rules would require a funding portal to maintain records demonstrating its compliance with requirements of Subparts C (intermediary obligations) and D (funding portal requirements).[701] This proposed requirement would require a funding portal to keep all the records it has created in the course of its business in order to comply with Regulation Crowdfunding. This requirement alone would not, however, require the creation of any records or proscribe the format or manner of any records. This proposed requirement would not only assist in regulators' compliance examinations, but also should assist funding portals in complying with the rules pertaining to their crowdfunding activities.

The proposed rules would require a funding portal to maintain all notices provided by the funding portal to issuers and investors generally through the funding portal's platform or

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700 *See* proposed Rule 404(a)(3) of Regulation Crowdfunding.

701 *See* proposed Rule 404(a)(5) of Regulation Crowdfunding.

otherwise.[702] This proposed requirement would assist regulatory examination of the funding portal for any communications to issuers or investors that could indicate violations of particular provisions of proposed Regulation Crowdfunding.

The proposed rules would require a funding portal to maintain records of all written agreements (or copies thereof) entered into by a funding portal, relating to its business as such.[703] This proposed requirement is intended to capture details of any funding portal arrangements and the funding portal's compliance with applicable requirements.

The proposed rules would require a funding portal to create and maintain daily, monthly and quarterly summaries of transactions effected through it.[704] The purpose of this proposed requirement is to help ensure that an historical and ongoing record exists of the transactions that have been conducted through the funding portal, especially given the high volume of transactions we expect to occur on funding portals' platforms.

The proposed rules would require a funding portal to make and keep a log of each offering, reflecting the progress of each issuer in meeting the target offering amount.[705] This

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[702] These would include, but not be limited to: (1) notices addressing hours of funding portal operations (if any); (2) funding portal malfunctions; (3) changes to funding portal procedures; (4) maintenance of hardware and software; (5) instructions pertaining to access to the funding portal; and (6) denials of, or limitations on, access to the funding portal. *See* proposed Rule 404(a)(6) of Regulation Crowdfunding.

[703] *See* proposed Rule 404(a)(7) of Regulation Crowdfunding.

[704] These would include: (1) issuers for which the target offering amount has been reached and funds distributed; and (2) transaction volume, expressed in number of transactions, number of securities involved in a transaction and total amounts raised by and distributed to issuers, as well as total dollar amounts raised across all issuers, expressed in U.S. dollars. *See* proposed Rule 404(a)(8) of Regulation Crowdfunding.

[705] *See* proposed Rule 404(a)(9) of Regulation Crowdfunding.

proposed requirement is intended to support, or otherwise be compared against, information included on an issuer's filing of Form C-U.[706]

The proposed rules also would require that a funding portal make and preserve its organizational documents, during its operation as a funding portal and of any successor funding portal.[707] This proposed requirement is intended to ensure that these key documents are maintained for identification and verification purposes.

These recordkeeping requirements are similar to, but in many ways less extensive than, those for registered broker-dealers under Exchange Act Rule 17a-4(a).[708] Because funding portals would be engaged in a more limited range of activities than brokers and a relatively high proportion of funding portals would be new market entrants that may not have formal recordkeeping practices in place, the proposed requirements are relatively streamlined, compared to those for brokers. The proposed funding portal recordkeeping requirements would require only those documents that relate to the funding portal's business and would require the portal to retain them for five years, but in an easily accessible place for the first two years, for purposes of facilitating and ensuring timeliness of inspections. A funding portal would be required to produce, reproduce and maintain the required records in the original, non-alterable format in

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706 *See* discussion in Section II.B.1 above. *See also* Section II.C.5 above for a discussion of proposed Rule 303(a) of Regulation Crowdfunding.

707 These would include, but not be limited to: (1) partnership agreements; (2) articles of incorporation or charter; (3) minute books; and (4) stock certificate books (or other similar type documents). *See* proposed Rule 404(b) of Regulation Crowdfunding.

708 Exchange Act Rule 17a-4 provides more extensive details of the types of records required, and it also specifies different time periods for retention, namely three to six years, depending on the type of record. 17 CFR 240.17a-4(a).

which they were created or as permitted under Exchange Act Rule 17a-4(f).[709] This flexibility should be appropriate for funding portals, because we believe that many of their documents would already be in electronic form. Thus, funding portals should not incur a significant additional burden for maintenance of those records. This flexibility also is consistent with the broker recordkeeping requirements under Exchange Act Rule 17a-4(f).

We recognize that a funding portal may find it cost-effective or otherwise appropriate to use the recordkeeping services of a third party. The proposed rules would allow third parties to prepare or maintain the required records on behalf of the funding portal, provided that there is a written agreement in place between the funding portal and the third party in which the third party states that the required records are the property of the funding portal and would be surrendered promptly on request by the Commission or the national securities association of which the funding portal is a member.[710] The funding portal also would be required to file, with the registered national securities association of which it is a member, this written undertaking, signed by a duly authorized representative of the third party. We believe that this provision

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709 *See* proposed Rule 404(c) of Regulation Crowdfunding. Permitted formats would include the use of electronic storage media that otherwise permits the funding portal to comply with its obligations under the proposed rules. 17 CFR 240.17a-4(f).

710 *See* proposed Rule 404(d) of Regulation Crowdfunding. An agreement between a funding portal and a third party would not relieve the funding portal from its responsibility to prepare and maintain records, as required under proposed Rule 404 of Regulation Crowdfunding. The written undertaking would be required to include the following provision: "With respect to any books and records maintained or preserved on behalf of [name of funding portal], the undersigned hereby acknowledges that the books and records are the property of [name of funding portal], and hereby undertakes to permit examination of such books and records at any time, or from time to time, during business hours by representatives of the Securities and Exchange Commission, the national securities association of which the funding portal is a member, and to promptly furnish to the Commission and national securities association of which the funding portal is a member, a true, correct, complete and current hard copy of any, all, or any part of, such books and records." *See* proposed Rule 404(d) of Regulation Crowdfunding. This provision is consistent with the recordkeeping provisions applicable to brokers under Exchange Act Rules 17a-4(f) (17 CFR 17a-4(f)) and 17a-4(j) (17 CFR 240.17a-4(j)), but it is somewhat simplified to be more appropriate for funding portals.

would help to ensure that records maintained or preserved by a third party would be readily available for examination.

Under the proposed rules, all records of a funding portal would be subject at any time, or from time to time, to such reasonable periodic, special or other examination by our representatives and representatives of the registered national securities association of which the funding portal is a member.[711] We believe that this requirement would facilitate our oversight of funding portals and crowdfunding activities, as Congress intended.[712]

Finally, the proposed rules would require that a funding portal comply with the reporting, recordkeeping and record retention requirements of Chapter X of Title 31 of the Code of Federal Regulations, a requirement analogous to that imposed on broker-dealers under Exchange Act Rule 17a-8.[713] This requirement is intended to ensure that funding portals create and maintain an accurate record of their compliance with BSA obligations, including the requirement to maintain records of suspicious activity reports.[714] As noted above, we believe that it is important for funding portals to be subject to a recordkeeping requirement, along the same lines of the requirement applicable to brokers, to create a meaningful audit trail of the crowdfunding transactions and communications that occur on and through their platforms. Without these

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711 *See* proposed Rule 404(e) of Regulation Crowdfunding.

712 *See* Exchange Act Section 3(h)(1)(A). *See also* 158 CONG. REC. S5474-03 (daily ed. July 26, 2012) (statement of Sen. Jeff Merkley) ("I would encourage the SEC and the relevant national securities association to engage in regular reviews and reports regarding developments in the crowdfunding marketplace. . . . Should problems arise, these authorities should act quickly, including use of their full rulemaking and enforcement authorities. . . . For [crowdfunding] to succeed long-term, it will require careful oversight, especially during the early stages.").

713 17 CFR 240.17a-8.

714 We note that a funding portal's proposed obligation, under the BSA, to report suspicious activity includes an obligation to maintain the confidentiality of suspicious activity reports and any information that would reveal the existence of a suspicious activity report. *See generally* 31 CFR 1023.320.

records, we, FINRA or any other registered national securities association, would have difficulty examining a funding portal for compliance with the requirements of Regulation Crowdfunding, the BSA[715] and the federal securities laws. Although under the proposed rules funding portals would be required to create and maintain certain records, we believe this particular rule is necessary to achieve consistent application of, and ability to examine and enforce, BSA requirements across all intermediaries, whether brokers or funding portals.

Request for Comment

241. We have proposed a variety of documents and data to be retained by a funding portal. Are these documents and data appropriate? Should other types of documents and data be required to be retained, and if so, which documents and data and why? Are any of the documents and data we propose to require be retained unnecessary, unclear or not sufficiently detailed? If so, which ones? Please explain. Should any of the proposed books and records requirements be modified? If so, please explain why.

242. What burdens or costs would the retention of such information entail? Is it appropriate to base the books and records requirements of funding portals on the books and records requirements for broker-dealers generally? Have we appropriately tailored the broker-dealer requirements for funding portals? If not, how should they be further modified? Would these tailored requirements create any competitive advantages for funding portals as compared to broker-dealers engaged solely in the same limited activities in which a funding portal may

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715 *See* note 696.

engage? Are there books and records requirements currently applicable to broker-dealers, but not included in the proposed rules, that should be included? Please provide examples of any such requirements or any suggested alternatives.

E. Miscellaneous Provisions

1. Insignificant Deviations from Regulation Crowdfunding

We are proposing to provide issuers a safe harbor for certain insignificant deviations from a term, condition or requirement of Regulation Crowdfunding.[716] To qualify for the safe harbor, the issuer relying on the exemption would have to show that: (1) the failure to comply with a term, condition or requirement was insignificant with respect to the offering as a whole; (2) the issuer made a good faith and reasonable attempt to comply with all applicable terms, conditions and requirements of Regulation Crowdfunding; and (3) the issuer did not know of the failure to comply, where the failure to comply with a term, condition or requirement was the result of the failure of the intermediary to comply with the requirements of Section 4A(a) and the related rules, or such failure by the intermediary occurred solely in offerings other than the issuer's offering.

The first two prongs of the safe harbor provision are modeled after a similar provision in Rule 508 of Regulation D,[717] and we believe a similar safe harbor is appropriate for offerings made in reliance on Section 4(a)(6). The offering exemption in Section 4(a)(6) was designed to help alleviate the funding gap and the accompanying regulatory concerns faced by startups and small businesses, many of which may not be familiar with the federal securities laws. We believe that issuers should not lose the Section 4(a)(6) exemption because of a failure to comply

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716 *See* proposed Rule 502 of Regulation Crowdfunding.

717 17 CFR 230.508.

that is not significant with respect to the offering as a whole, so long as the issuer, in good faith, attempted to comply with the rules. We also propose to include the third prong of the safe harbor because, under the statute, an issuer could lose the exemption because of the failure of the intermediary to comply with the requirements of Section 4A(a). We believe that an issuer should not lose the offering exemption due to such failure by the intermediary, which likely would be out of the issuer's control, if the issuer did not know of such failure or such failure related to offerings other than the issuer's offering. Absent this safe harbor, we believe issuers may be hesitant to participate in offerings in reliance on Section 4(a)(6) due to uncertainty regarding their ability to rely on the exemption, which could undermine the facilitation of capital raising for startups and small businesses.

We believe that the potential harm to investors that might result from the applicability of this safe harbor would be minimal because the deviations must be insignificant to the offering as a whole for the safe harbor to apply. In addition, the proposed rules would provide that notwithstanding this safe harbor, any failure to comply with Regulation Crowdfunding would nonetheless be actionable by the Commission.[718] We believe that this safe harbor would address concerns raised by one commenter and a member of Congress.[719] We also believe it appropriately would protect an issuer who made a diligent attempt to comply with the proposed rules from losing the exemption as a result of insignificant deviations from Regulation Crowdfunding.

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[718] *See* proposed Rule 502(b) of Regulation Crowdfunding.

[719] *See* 2012 SEC Government-Business Forum, note 29 (recommending that we provide a safe harbor for "innocent violations of procedural or disclosure requirements" in transactions relying on Section 4(a)(6)). *See also* 158 CONG. REC. S2230 (daily ed. Mar. 29, 2012) (statement of Sen. Scott Brown) ("[I]ssuers should not be held liable for misstatements or omissions that were made by mistake").

Request for Comment

243. Is a safe harbor for certain insignificant deviations from a term, condition or requirement of Regulation Crowdfunding appropriate? If so, is the proposed safe harbor sufficiently broad or too broad? Are there additional conditions that should apply for an issuer to rely on the safe harbor? If so, what conditions and why?

244. Should we define the term "insignificant" or use a different term? Please explain. Should we use a standard requiring something other than "good faith and reasonable attempt" to comply with the requirements? If so, what standard and why? Is it appropriate for the safe harbor to cover the failure of the intermediary to comply with the requirements of Section 4A(a) if the issuer did not know of such failure or such failure occurred solely in offerings other than the issuer's offering? Why or why not?

245. Are there certain deviations that should never be considered insignificant for purposes of this safe harbor? Why or why not? Should we provide examples of deviations that we would consider significant? If so, what should those be (*e.g.*, failure to file the Form C: Offering Statement on EDGAR)?

2. Restrictions on Resales

Section 4A(e) provides that securities issued in reliance on Section 4(a)(6) may not be transferred by the purchaser for one year after the date of purchase, except when transferred: (1) to the issuer of the securities; (2) to an accredited investor; (3) as part of an offering registered with the Commission; or (4) to a family member of the purchaser or the equivalent, or in connection with certain events, including death or divorce of the purchaser, or other similar

circumstances, in the discretion of the Commission. Section 4A(e) further provides that the Commission may establish additional limitations on securities issued in reliance on Section 4(a)(6).

The proposed rules track the provisions of Section 4A(e).[720] We also are proposing to include instructions in the rules to define "accredited investor" and a "member of the family of the purchaser or the equivalent." Under the proposed rules, the term "accredited investor" would have the same definition as in Rule 501(a) of Regulation D.[721]

The statute does not define "member of the family of the purchaser or the equivalent." We propose to define the phrase to mean a "child, stepchild, grandchild, parent, stepparent, grandparent, spouse or spousal equivalent, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of the purchaser, and shall include adoptive relationships." This definition tracks the definition of "immediate family" in Exchange Act Rule 16a-1(e),[722] but with the addition of "spousal equivalent." We propose to include the term spousal equivalent to address the concept in Section 4A(e)(1)(D) of the "equivalent" of a member of the family of the purchaser. The proposed rules would define spousal equivalent to mean a cohabitant occupying a relationship generally equivalent to that of a spouse.[723] This is the same definition as in Rule 202(a)(11)(G)-1(d)(9) under the Investment Advisers Act of 1940.[724] We believe issuers and investors would benefit from definitions that are consistent with

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720 *See* proposed Rule 501 of Regulation Crowdfunding.

721 17 CFR 230.501(a). *See also* note 38.

722 17 CFR 240.16a-1(e).

723 *See* proposed Instruction to paragraph (c) of proposed Rule 501 of Regulation Crowdfunding.

724 17 CFR 275.202(a)(11)(G)-1(d)(9). *See also Family Offices*, Release No. IA-3220 (Jun. 22, 2011) [76 FR 37983 (June 29, 2011)] (adopting release); *Family Offices*, Release No. IA-3098 (Oct. 12, 2010) [75 FR 63753 (Oct. 18, 2010)] (proposing release).

those already used in our rules, rather than creating a new definition, because issuers may be familiar with those terms and should benefit from existing Commission and staff guidance. The proposed rules also would provide that securities offered and sold in reliance on Section 4(a)(6) may be transferred during the initial one-year period to a trust controlled by the initial purchaser or to a trust created for the benefit of a member of the family of the purchaser or the equivalent. We believe allowing transfers in such cases would be consistent with the intent of the provision because the person that controls or benefits from the trust would otherwise be covered by the rules.

Request for Comment

246. Are the proposed limitations on resale appropriate? Why or why not? If not, what approach would be more appropriate and why? Should there be additional limitations on resale, especially after the first year? Why or why not? If so, what should they be and why? If an issuer no longer was in compliance with the ongoing reporting requirements[725] or was no longer in business, should we place restrictions on the resale of the issuer's securities or otherwise limit the ability of those shares to trade? If so, please describe the appropriate restrictions and explain how we could implement such restrictions.

247. To transfer securities to an accredited investor during the one-year period beginning when the securities are sold in reliance on Section 4(a)(6), the seller

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[725] *See* Section II.B.2 above for a discussion of the ongoing reporting requirements.

would need to have a reasonable belief that the purchaser is an accredited investor.[726] Is this approach appropriate? Why or why not?

248. Is the proposed use of the definition of "accredited investor" in Rule 501(a) of Regulation D appropriate? Why or why not? Should a different definition be used for purposes of Regulation Crowdfunding? Please explain.

249. Is the proposed definition of "member of the family of the purchaser or the equivalent" appropriate? Is it appropriate to track the definition of "immediate family" under Exchange Act Section 16 (with the addition of "spousal equivalent"), or would another definition be more appropriate? Should any persons be included or not included in the definition? Why or why not? Should we use a consistent definition throughout Regulation Crowdfunding even if it differs from similar rules in other Commission regulations? Why or why not?

3. Information Available to States

Under Section 4A(d), the Commission shall make available, or shall cause to be made available by the relevant intermediary, the information required under Section 4A(b) and such other information as the Commission, by rule, determines appropriate to the securities commission (or any agency or office performing like functions) of each State and territory of the United States and the District of Columbia.

One commenter suggested that all information filed with the Commission should be made available to state regulators.[727] Another commenter questioned whether open Internet access to

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[726] *See* proposed Rule 501(b) of Regulation Crowdfunding.

the crowdfunding platforms would be sufficient, questioning a platform's ability to maintain or archive records from websites that are routinely updated.[728] Another commenter suggested that the requirement in Section 4A(d) should create an affirmative obligation for an intermediary only if a state regulator requests information in excess of what is provided to the Commission.[729]

We are proposing to require issuers to file on EDGAR the information required by Section 4A(b) and the related rules. Information filed on EDGAR is publicly available and would, therefore, be available to each state, territory and the District of Columbia. We believe this approach would satisfy the requirement to make the information available. Accordingly, we do not believe that it is necessary to propose to impose any additional obligations on intermediaries with respect to this requirement.

Request for Comment

250. Would the availability of information on EDGAR satisfy the requirement to make the information available to each state, territory and the District of Columbia? Are there other means of making the information available? Should we impose any additional obligations on intermediaries with respect to this requirement? If so, what are they? For example, should we require issuers or intermediaries to provide this information directly to state regulators? Please explain.

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727 *See* Commonwealth of Massachusetts Letter.

728 *See* NASAA Letter.

729 *See* RocketHub Letter 1.

4. Exemption from Section 12(g)

Section 303 of the JOBS Act amended Exchange Act Section 12(g) to provide that "the Commission shall, by rule, exempt, conditionally or unconditionally, securities acquired pursuant to an offering made under [S]ection 4[(a)](6) of the Securities Act of 1933 from the provisions of this subsection."

As amended by the JOBS Act, Section 12(g) requires, among other things, that an issuer with total assets exceeding $10,000,000 and a class of securities held of record by either 2,000 persons, or 500 persons who are not accredited investors, register such class of securities with the Commission.[730] Crowdfunding contemplates the issuance of securities to a large number of holders, which could increase the likelihood that Section 4(a)(6) issuers would exceed the thresholds for reporting in Section 12(g). Section 303 could be read to mean that securities acquired in a crowdfunding transaction would be excluded from the record holder count permanently, regardless of whether the securities continue to be held by a person who purchased in the crowdfunding transaction. An alternative reading could provide that securities acquired in a crowdfunding transaction would be excluded from the record holder count only while held by the original purchaser in the Section 4(a)(6) transaction, as a subsequent purchaser of the securities would not be considered to have "acquired [the securities] pursuant to an offering made under [S]ection 4[(a)](6)."

Commenters expressed concern that once the securities issued pursuant to Section 4(a)(6) are transferred, the exemption from Section 12(g) registration could cease to apply and any new

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730 *See* Section 501 of the JOBS Act. In the case of an issuer that is a bank or a bank holding company, Exchange Act Section 12(g)(1)(B) (15 U.S.C. 78*l*(g)(1)(B)) requires, among other things, that the issuer, if it has total assets exceeding $10,000,000 and a class of securities held of record by 2,000 persons, register such class of securities with the Commission. *See* Section 601 of the JOBS Act.

holders of those securities would be included in the calculation of holders of record for purposes of Section 12(g), which could potentially require an issuer to register its securities with the Commission.[731] Another commenter noted that the prospect that resales could trigger registration requirements under the Exchange Act might provide an incentive for issuers to attempt in some way to restrict resale and transfer of the securities issued in the offering made in reliance on Section 4(a)(6), even after the lapse of the one year transfer limitation, which would be to the detriment of small crowdfunding investors seeking liquidity.[732] One commenter suggested that the exemption from Section 12(g) registration should attach to different securities issued in a subsequent restructuring, recapitalization or similar transaction that is exempt from, or otherwise not subject to, the registration requirements of Section 5, so long as the parties to the transaction are affiliates of the original issuer.[733] The same commenter suggested that the availability of the exemption be conditioned on the issuer complying with the ongoing reporting requirements and not having total assets at the last day of the fiscal year in excess of $25 million.[734]

Proposed Rule 12g-6 provides that securities issued pursuant to an offering made under Section 4(a)(6) would be permanently exempted from the record holder count under

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731 *See* Liles Letter 1; NCA Letter (stating that the time and expense associated with registration of a class of securities could affect an issuer's working capital and business operations); CFIRA Letter 2 (stating that the need for additional capital to meet registration requirements would result in an issuer either having to borrow money, thus leveraging its business, or raising additional capital through a subsequent equity offering that would dilute existing stockholders); ABA Letter 2 (stating that a Section 12(g) exemption limited to the initial purchaser of securities would undermine the utility of such an exemption and that an initial purchaser should not be able to force an issuer to register under Section 12(g) simply by reselling his or her securities).

732 *See* Liles Letter 1.

733 *See* ABA Letter 2.

734 *Id.*

Section 12(g). An issuer seeking to exclude a person from the record holder count would have the responsibility for demonstrating that the securities held by the person were initially issued in an offering made under Section 4(a)(6). We believe that allowing issuers to sell securities pursuant to Section 4(a)(6) without becoming Exchange Act reporting issuers is consistent with the intent of Title III.[735] In this regard, we note that Title III provides for an alternative reporting system under which issuers would be required to file annual reports with the Commission.[736] We believe this is consistent with the proposal to permanently exempt securities issued in reliance on Section 4(a)(6) from the record holder count under Section 12(g). Section 303 of the JOBS Act does not extend the exemption from Section 12(g) to different securities issued in a subsequent restructuring, recapitalization or similar transaction, so we are not proposing to exempt such securities at this time, as one commenter suggested.[737] We also are not proposing to condition the exemption on the issuer's compliance with the ongoing reporting requirements or on the issuer not having total assets in excess of a certain amount, as the same commenter suggested.[738] We believe that the size of the issuer should not affect the availability of the exemption because conditioning the exemption on the issuer not exceeding a certain amount of total assets would impose an additional burden on successful issuers that unsuccessful issuers would not face, which in turn would discourage growth. We also believe that failure to comply with the ongoing reporting requirements could be better addressed as proposed by making the issuer ineligible to

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735 *See* 158 CONG. REC. S1829 (daily ed. Mar. 20, 2012) (statement of Sen. Jeff Merkley) ("It also provides a very important provision so the small investors do not count against the shareholder number that drives companies to have to become a fully public company. That is critical and interrelates with other parts of the [crowdfunding] bill before us.").

736 *See* Section II.B.2 above for a discussion of the requirement to file annual reports.

737 *See* ABA Letter 2.

738 *See id.*

use the exemption under Section 4(a)(6),[739] rather than by requiring such issuer to register a class of securities under Section 12(g).[740]

Request for Comment

251. Should the Commission permanently exempt securities issued pursuant to an offering under Section 4(a)(6) from the record holder count under Section 12(g), as proposed? Why or why not? Should the Commission exempt securities issued under Section 4(a)(6) only when held of record by the original purchaser in the Section 4(a)(6) transaction, an affiliate of the original purchaser, a member of the original purchaser's family or a trust for the benefit of the original purchaser or the original purchaser's family? Why or why not? Are there other ways to implement Section 303 that may be more appropriate? Please explain.

252. One commenter suggested[741] that the Section 4(a)(6) exemption should survive and attach to different securities issued in a subsequent restructuring, recapitalization or similar transaction that is exempt from, or otherwise not subject to, the registration requirements of Section 5, if the parties to the transaction are affiliates of the original issuer. While we are not proposing to

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739 *See* proposed Rule 100(b)(6) of Regulation Crowdfunding.

740 We note, however, that making the issuer ineligible to use the exemption under Section 4(a)(6) if the issuer failed to comply with the ongoing reporting requirements could have a limited impact since it only would impact an issuer that intended to rely on the Section 4(a)(6) exemption for future offers and sales. *But see* Bradford note 1 ("The need to go back to investors for future funding should constrain self-dealing, opportunistic behavior by the entrepreneur.").

741 *See* ABA Letter 2.

implement this suggestion at this time, we invite commenters to discuss the advantages and disadvantages of this approach.

253. The same commenter suggested[742] that the availability of the exemption under Section 12(g)(6) should be conditioned on the issuer not having total assets, at the last day of the fiscal year with respect to which the Section 12(g) compliance determination is made (or a reasonable time before or after such date), in excess of $25 million. Should we condition the availability of the exemption under Section 12(g)(6) on the issuer not having total assets in excess of $25 million? If not $25 million, should the availability of the exemption be conditioned on total assets not exceeding some other amount (*e.g.*, $10 million, $50 million, etc.)? Should this determination be made as of the last day of the fiscal year or a different date? Please explain.

254. Should issuers that fail to comply with the ongoing reporting requirements[743] of Regulation Crowdfunding be disqualified from relying on the exemption under Section 12(g)(6), as suggested by one commenter?[744] Why or why not?

255. How would issuers be able to distinguish securities issued in a transaction exempt under Section 4(a)(6) from securities issued in other offerings? What would be the costs associated with making such a determination?

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742 *See id.*

743 *See* proposed Rules 202 and 203(b) of Regulation Crowdfunding and Section II.B.2 above for a discussion of the ongoing reporting requirements.

744 *See* ABA Letter 2.

5. Scope of Statutory Liability

As noted above, Securities Act Section 4A(c) sets forth a liability provision for crowdfunding transactions under Section 4(a)(6).[745] Section 4A(c) provides that an issuer will be liable to a purchaser of its securities in a transaction exempted by Section 4(a)(6) if the issuer, in the offer or sale of the securities, makes an untrue statement of a material fact or omits to state a material fact required to be stated or necessary in order to make the statements, in light of the circumstances under which they were made, not misleading, provided that the purchaser did not know of the untruth or omission, and the issuer does not sustain the burden of proof that such issuer did not know, and in the exercise of reasonable care could not have known, of the untruth or omission. Section 4A(c)(3) defines, for purposes of the liability provisions of Section 4A, an issuer as including "any person who offers or sells the security in such offering." On the basis of this definition, it appears likely that intermediaries, including funding portals, would be considered issuers for purposes of this liability provision. We believe that steps intermediaries could take in exercising reasonable care in light of this liability provision would include establishing policies and procedures[746] that are reasonably designed to achieve compliance with the requirements of Regulation Crowdfunding, and that include the intermediary conducting a review of the issuer's offering documents, before posting them to the platform, to evaluate whether they contain materially false or misleading information.

Under this liability provision, an investor who purchases securities in a crowdfunding transaction may bring an action against the issuer to recover the consideration paid for the

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745 The anti-fraud and civil liability provisions of the Securities Act, such as Sections 12(a)(2) and 17, apply to exempted transactions, including those transactions that will be conducted in reliance on Section 4(a)(6).

746 With respect to intermediaries that are funding portals, see proposed Rule 403(a) of Regulation Crowdfunding and the discussion in Section II.D.4 above.

security, with interest, or damages if the person no longer holds the security. The statute further provides that actions brought under Section 4A(c) will be subject to the provisions of Securities Act Sections 12(b) and 13, as though the liability were created under Securities Act Section 12(a)(2).

6. Disqualification

Section 302(d) of the JOBS Act requires the Commission to establish disqualification provisions under which an issuer would not be eligible to offer securities pursuant to Section 4(a)(6) and an intermediary would not be eligible to effect or participate in transactions pursuant to Section 4(a)(6). Section 302(d)(2) specifies that the disqualification provisions must be "substantially similar" to the disqualification provisions contained in Rule 262 of Regulation A,[747] and they also must cover certain actions by state regulators enumerated in Section 302(d)(2). The disqualifying events listed in Rule 262 apply to the issuer and certain other persons associated with the issuer or the offering, including the issuer's predecessors and affiliated issuers; directors, officers and general partners of the issuer; beneficial owners of 10 percent or more of any class of the issuer's equity securities; promoters connected with the issuer; and underwriters and their directors, officers and partners. Rule 262 disqualifying events include:

- felony and misdemeanor convictions in connection with the purchase or sale of a security or involving the making of a false filing with the Commission (the same criminal conviction standard as in Section 302(d) of the JOBS Act) within the last five years in the case of issuers and 10 years in the case of other covered persons;

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747 17 CFR 230.262.

- injunctions and court orders within the last five years against engaging in or continuing conduct or practices in connection with the purchase or sale of securities, or involving the making of any false filing with the Commission;
- United States Postal Service false representation orders within the last five years;
- filing, or being named as an underwriter in, a registration statement or Regulation A offering statement that is the subject of a proceeding to determine whether a stop order should be issued, or as to which a stop order was issued within the last five years; and
- for covered persons other than the issuer:
    - being subject to a Commission order:
        - revoking or suspending their registration as a broker, dealer, municipal securities dealer or investment adviser;
        - placing limitations on their activities as such;
        - barring them from association with any entity; or
        - barring them from participating in an offering of penny stock; or
    - being suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or national securities association for conduct inconsistent with just and equitable principles of trade.

The disqualifying events specifically required by Section 302(d)(2) are:

- final orders issued by state securities, banking, savings association, credit union and insurance regulators, federal banking regulators and the National Credit Union Administration that either:

- bar a person from association with an entity regulated by the regulator issuing the order; engaging in the business of securities, insurance or banking; or engaging in savings association or credit union activities; or
- are based on a violation of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct within a 10-year period ending on the date of the filing of the offer or sale; and

- felony and misdemeanor convictions in connection with the purchase or sale of a security or involving the making of a false filing with the Commission.

One commenter urged us to apply the same standards adopted by the Commission for Rule 506 of Regulation D[748] to this exemption.[749] Another commenter stated that searching for most disqualifying events could be achieved with automated or semi-automated inquiries to databases or data services, but other disqualifying events would be difficult to identify with those types of inquiries and should be the responsibility of the issuer to address with representations and warranties.[750] One commenter stated that if a bankruptcy proceeding would be a disqualifying event, it should be limited to a bankruptcy proceeding of the issuer or the intermediary and not include a personal bankruptcy proceeding.[751] Another commenter

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748 *See* Securities Act Rule 506(d) [17 CFR 230.506(d)]. *See also Disqualification Adopting Release*, note 101.

749 *See* NASAA Letter (stating that an offering made pursuant to Section 4(a)(6) also should be subject to disqualification based on the prior bad acts of the funding portal and its management).

750 *See* Applied Dynamite Letter (stating that certain disqualifying events have open-ended definitions that would make it difficult to satisfy with confidence: "any court of competent jurisdiction" having entered an order because there is no limit to the number of courts which may have, at some time, been competent to enter an order regarding an issuer; being "subject to" certain unpublished orders or injunctions such as a United States Postal Service false representation order; and the extension of disqualification events to predecessors and affiliated issuers because of the innumerable ways in which two companies might be deemed to be affiliated).

751 *See* Landon Letter 1.

recommended that the disqualification rules: (1) not be so broad as to affect "persons who may not be true bad actors – such as persons who consent to the entry of judgments which do not also include meaningful monetary or other penalties;" (2) not apply retroactively to cover disqualifying events prior to the adoption of the final rules; and (3) apply to other types of exempt offerings (including offerings made in reliance on Regulation A).[752]

a. Issuers and Certain Other Associated Persons

The disqualification provisions included in Section 302(d) of the JOBS Act are modeled on the disqualification provisions included in Section 926 of the Dodd-Frank Act, which required the Commission to adopt rules, "substantially similar" to Rule 262, that disqualify securities offerings involving certain "felons and other 'bad actors'" from reliance on Rule 506 of Regulation D.[753] On July 10, 2013, we adopted rules to implement Section 926 of the Dodd-Frank Act to disqualify certain securities offerings from reliance on Rule 506 of Regulation D.[754] The proposed disqualification rules,[755] as they relate to issuers and certain other associated persons, are modeled on the Rule 506 disqualification rules, which, in turn, are substantially similar to the disqualification provisions in Rule 262.

i. Covered Persons

The proposed rules would apply the disqualification provisions to:

- the issuer and any predecessor of the issuer or affiliated issuer;
- any director, officer, general partner or managing member of the issuer;

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752 *See* SEC Government-Business Forum, note 29.

753 *See* Dodd-Frank Act, note 38.

754 *See Disqualification Adopting Release*, note 101.

755 *See* proposed Rules 503(a)-(c) of Regulation Crowdfunding.

- any 20 percent Beneficial Owner;
- any promoter connected with the issuer in any capacity at the time of the sale;
- any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with sales of securities in the offering (which we refer to as a "compensated solicitor"); and
- any director, officer, general partner or managing member of any such compensated solicitor.

These covered persons are substantially similar to those currently covered by the disqualification rules for Rules 262 and 506. The proposed rules would cover any "officer"[756] of the issuer, mirroring the coverage in Rule 262, rather than any "executive officer [and] other officer participating in the offering"[757] as it is currently covered in Rule 506. In adopting the Rule 506 disqualification rules, we noted that an "officer" test would be unduly burdensome and overly restrictive due to the larger and more complex organizations that are involved in many Rule 506 transactions as compared to the smaller entities that use Regulation A. We also noted that limiting the coverage of the Rule 506 disqualification rules to executive officers and officers who participate in the offering would lessen the potential compliance burden by limiting the number of covered persons. In contrast, we believe that the startups and small businesses that may seek to raise capital in reliance on Section 4(a)(6) generally will be smaller than the entities

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[756] Under Securities Act Rule 405, the term "officer" is defined as "a president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization." 17 CFR 230.405.

[757] Under Securities Act Rule 405, the term "executive officer" is defined as a "president [of the registrant], any vice president of the registrant in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy making function or any other person who performs similar policy making functions for the registrant." 17 CFR 230.405.

involved in Rule 506 transactions and, likely, smaller than the issuers of securities relying on Regulation A.[758] We also believe that the "officers" of many issuers relying on Section 4(a)(6) may be only a few individuals, with or without formal titles. As a result, we do not believe that an "officer" test would be more burdensome than the test used for Regulation A purposes, so we do not see a need to deviate from Rule 262 in this context.

The proposed rules also would cover persons who are 20 Percent Beneficial Owners. This threshold differs from the 10 percent threshold specified in Rule 262, but it is the same as the threshold in the Rule 506 disqualification rules. We believe that a 10 percent ownership threshold could impose an undue burden on participants in the Section 4(a)(6) marketplace. In this regard, the potential administrative complexity of monitoring the fluctuating ownership levels and the issuer's inability to control the actions of a shareholder who does not disclose disqualification would be greater under a 10 percent threshold scheme than under a 20 percent threshold scheme. This is the same concern that led us to change the 10 percent threshold in the Rule 506 disqualification rules. A 20 percent threshold would provide greater certainty and ease of compliance than a 10 percent threshold, and it also would be consistent with both the threshold specified in the Rule 506 disqualification rules and the disclosure requirements of Sections 4A(b)(1)(B) and 4A(b)(1)(H)(iii), which require certain disclosures about shareholders based on a 20 percent threshold.[759]

The proposed rules would include the category of compensated solicitor and any director, officer, general partner or managing member of any such compensated solicitor, currently in the

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[758] There is no cap on the amount of proceeds that may be raised in an offering relying on Rule 506, and Regulation A limits offerings to $5 million.

[759] *See* discussion in Section II.B.1.a.i(a) above.

Rule 506 disqualification rules.[760] Regulation A offerings may involve traditional underwritten offerings, but offers and sales made in reliance on Section 4(a)(6), similar to transactions under Rule 506, would not involve underwriters. Thus, the proposed disqualification rules would not apply to underwriters, but would substitute underwriters with the concept of compensated solicitor. The statute and the proposed rules would permit issuers offering and selling securities in reliance on Section 4(a)(6) to compensate persons to promote the issuer's offering through communication channels provided by the intermediary, subject to certain conditions.[761] We believe those individuals receiving compensation to promote the issuer's offering should be covered by the disqualification provisions because they would be subject to conflicts of interest in transactions pursuant to Section 4(a)(6), which would be substantially similar to those of underwriters in Regulation A transactions.[762]

Moreover, the proposed rules would provide that events relating to certain affiliated issuers are not disqualifying if they pre-date the affiliate relationship.[763] Rule 262(a)(5) currently provides that orders, judgments and decrees entered against affiliated issuers before the affiliation arose do not disqualify an issuer from reliance on Regulation A if the affiliated issuer is not: (1) in control of the issuer; or (2) under the common control of a third party that controlled the affiliated issuer at the time such order, judgment or decree was entered. The proposed rules would include a substantially similar provision but would clarify that it applies to

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760 *See* proposed Rule 503(a) of Regulation Crowdfunding.

761 *See* Section 4A(b)(3) and proposed Rule 205 of Regulation Crowdfunding. *See also* Section II.B.5 above.

762 We note that the receipt of transaction-based compensation in connection with the offer and sale of a security could cause a person to be a broker required to register with us under Exchange Act Section 15(a)(1) (15 U.S.C. 78c(a)(1)).

763 *See* proposed Rule 503(c) of Regulation Crowdfunding.

all potentially disqualifying events that pre-date affiliation. We believe this is appropriate because the current placement of this language within paragraph (5) of Rule 262(a) may incorrectly suggest that it applies only to Postal Service false representation orders. This is the same approach we took in the Rule 506 disqualification rules. As in Rule 506(d), the proposed rules would not treat entities differently if they have undergone a change of control or other remedial measures.[764] This should avoid undue complexity in applying the proposed rules, while also avoiding potential abuse by bad actors that may falsely claim to have undergone a change of control.[765]

Request for Comment

256. Should we eliminate or modify any of the proposed categories of covered persons? If so, which ones and why? Would doing so still result in a rule substantially similar to Rule 262? Should we disqualify additional categories of covered persons? If so, which ones and why?

257. The proposed rules would apply to officers of the issuer, mirroring Rule 262, rather than executive officers and other officers participating in the offering, as in Securities Act Rule 506(d). Is this approach appropriate? Why or why not?

258. Should persons compensated to promote the issuer's offering through communication channels provided by the intermediary be covered persons, as is

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764 *See Disqualification Adopting Release*, note 101 (declining to provide different treatment for entities that have undergone a change of control or other remedial measures, such as a change of policy whereby an issuer would have implemented policies and procedures, designed to prevent the occurrence of the kinds of activities that gave rise to disqualification, and such policies and procedures would have been approved by a regulator or a court).

765 Entities that have undergone a change of control or a change of policy could, however, seek a waiver of the disqualification upon a proper showing that there has been a change of control and the persons responsible for the activities resulting in a disqualification are no longer employed by the entity or exercise influence over such entity. *See* Section II.E.6.a.iv below for a discussion of waivers.

the case for the Rule 506 disqualification rules? Why or why not? Would doing so result in a rule substantially similar to Rule 262?

259. The proposed disqualification rules would cover persons who are 20 Percent Beneficial Owners. Is the 20 percent beneficial ownership threshold appropriate? Why or why not? Should the proposed disqualification rules cover persons based on a 10 percent ownership threshold, as in Rule 262? Why or why not?

260. Should orders, judgments and decrees entered against affiliated issuers not be disqualifying if they pre-date the affiliate relationship, as proposed? Should we, as proposed, expand this treatment to entities that have undergone a change of control or a change of policy? Why or why not?

ii. Disqualifying Events

(a) Criminal Convictions

Section 302(d)(2)(B)(ii) provides for disqualification if any covered person "has been convicted of any felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the Commission." This essentially mirrors Rule 262(a)(3), which covers criminal convictions of issuers, and Rule 262(b)(1), which covers criminal convictions of other covered persons. There are, however, two differences between the felony and misdemeanor conviction provisions of Section 302(d)(2)(B)(ii) and Rule 262. First, Section 302(d)(2)(B)(ii) does not include a specific time limit (or "look-back period") on convictions that trigger disqualification, while Rule 262 provides a five-year look-back period for criminal convictions of issuers and a 10-year look-back period for criminal convictions of other covered persons. In light of the time limits on criminal convictions under Rule 262, we are

proposing the same five-year and 10-year look-back periods so the proposed rules would be substantially similar to the existing rules. Second, unlike Rule 262(b)(1), Section 302(d) does not include a reference to criminal convictions "arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer or investment adviser." We are not aware of any legislative history that explains why this type of conviction was not mentioned in Section 302(d). However, because such convictions are covered in Rule 262, we believe that rules substantially similar to the existing rules should cover them.

The proposed rules are based on Rule 262 and differ from the Rule 506 disqualification rules in that the look-back period would be measured from the date of the requisite filing with the Commission, rather than the date of the relevant sale.[766] We noted in the proposing release for the Rule 506 disqualification rules[767] that measuring from the date of the requisite filing, as in Rule 262, would not be appropriate in the context of Rule 506 because no filing is required to be made with the Commission before an offer or sale is made in reliance on Regulation D.[768] Because the proposed rules would require issuers offering securities in reliance on Section 4(a)(6) to file with the Commission the information required by Section 4A(b),[769] the proposed rules would measure the look-back period based on the filing date, similar to Rule 262, rather than the date of sale.

(b) Court Injunctions and Restraining Orders

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766 *See* proposed Rule 503(a)(1) of Regulation Crowdfunding.

767 *See Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings*, Release No. 33-9211 (proposed May 25, 2011) at 18 [76 FR 31518, 31523 (June 1, 2011)].

768 *See also Disqualification Adopting Release*, note 101.

769 *See* Sections II.B.1 and II.B.3 above for a discussion of the disclosure and filing requirements.

Under Rule 262(a)(4), an issuer is disqualified from reliance on Regulation A if it, or any predecessor or affiliated issuer, is subject to a court injunction or restraining order against "engaging in or continuing any conduct or practice in connection with the purchase or sale of any security or involving the making of any false filing with the Commission." Similarly, under Rule 262(b)(2), an issuer is disqualified from reliance on Regulation A if any other covered person is subject to such a court injunction or restraining order or to one "arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer or investment adviser." Disqualification is triggered by temporary or preliminary injunctions and restraining orders that are currently in effect, as well as by permanent injunctions and restraining orders entered within the last five years.[770]

The proposed rules are substantially similar to these two provisions, but in a simplified, combined format.[771] The proposed rules would include the same coverage and look-back periods that apply under the disqualification provisions for Rules 262 and 506, except that the look-back period would be measured from the date of the requisite filing with the Commission, consistent with the approach in Rule 262. The proposed rules also would not impose due process requirements (such as notice and an opportunity to appear) or require that all appeals be exhausted or the time for appeal be expired, as a condition to disqualification. This is the same approach as under the disqualification provisions for Rules 262 and 506. We believe that the risk that disqualification may arise from ex parte proceedings could be better addressed through

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770 The look-back period means that disqualification no longer arises from a permanent injunction or restraining order after the requisite amount of time has passed, even though the injunction or order may still be in effect. In addition, because disqualification is triggered only when a person "is subject to" a relevant injunction or order, injunctions and orders that have expired or are otherwise no longer in effect are not disqualifying, even if they were issued within the relevant look-back period.

771 *See* proposed Rule 503(a)(2) of Regulation Crowdfunding.

the waiver process,[772] rather than through additional requirements for factual inquiry that would affect all offerings. As for appealable orders, we believe that suspending disqualification during the pendency of a potentially lengthy appeals process could significantly undermine the intended protections in the rules, and therefore, the proposed rules would disqualify covered persons during the pendency of the appeals.

With regard to who would be viewed as subject to an order, we believe the proposed rules should be applied consistently with the way the staff has applied Rule 262. For disqualification purposes, the staff has interpreted Rule 262 to limit those considered "subject to" an order to only the persons specifically named in the order. Others who are not specifically named but who come within the scope of an order (such as, for example, agents, attorneys and persons acting in concert with the named person) would not be treated as "subject to" the order for purposes of disqualification.

(c) Final Orders of Certain Regulators

Section 302(d)(2)(B) provides that the disqualification rules for transactions made in reliance on Section 4(a)(6) must disqualify any covered person that:

(i) is subject to a final order of a State securities commission (or an agency or officer of a State performing like functions), a State authority that supervises or examines banks, savings associations, or credit unions, a State insurance commission (or an agency or officer of a State performing like functions), an appropriate Federal banking agency, or the National Credit Union Administration, that—

(I) bars the person from—

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[772] *See* Section II.E.6.a.iv below for a discussion of the waiver process.

(aa) association with an entity regulated by such commission, authority, agency, or officer;

(bb) engaging in the business of securities, insurance, or banking; or

(cc) engaging in savings association or credit union activities; or

(II) constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct within the 10-year period ending on the date of filing of the offer or sale.

Section 302(d)(2)(B) is substantively identical to Exchange Act Section 15(b)(4)(H) and Section 203(e)(9) of the Investment Advisers Act of 1940 ("Advisers Act"). Section 302(d)(2)(B) contains a 10-year look-back period for final orders based on violations of laws and regulations that prohibit fraudulent, manipulative and deceptive conduct, while the Exchange Act and Advisers Act provisions have no time limit for such orders.

The proposed rules would reflect the text of Section 302(d)(2)(B) with two clarifications.[773] First, the proposed rules would specify that an order must bar the covered person "at the time of the filing of the information required by Section 4A(b) of the Securities Act of 1933," to clarify that a bar would be disqualifying only for as long as it has continuing effect. Second, the proposed rules would require that orders must have been "entered" within the look-back period, to clarify that the date of the order, and not the date of the underlying conduct, was relevant for that determination. We believe these clarifications would eliminate potential ambiguities and allow for more appropriate application of the rules. These clarifications also are consistent with the approach in the Rule 506 disqualification rules, except that under Securities

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[773] *See* proposed Rule 503(a)(3) of Regulation Crowdfunding.

Act Rule 506(d), the order must bar the covered person at the time of the relevant sale, rather than at the time of the filing, because no filing is required to be made with the Commission prior to the time of a sale made pursuant to Rule 506.

The proposed rules also would include the U.S. Commodity Futures Trading Commission ("CFTC") in the list of regulators whose regulatory bars and other final orders will trigger disqualification. This is consistent with the approach in the Rule 506 disqualification rules. As we noted in the adopting release for Securities Act Rule 506(d),[774] the conduct that would typically give rise to CFTC sanctions is similar to the type of conduct that would result in disqualification if it were the subject of sanctions by another financial regulator. For that reason, CFTC orders trigger consequences under other Commission statutes[775] (for example, both registered broker-dealers and investment advisers may be subject to Commission disciplinary action based on violations of the Commodity Exchange Act[776]). We believe that including CFTC orders would make the disqualification rules for transactions made in reliance on Section 4(a)(6) more internally consistent, treating relevant sanctions similarly for disqualification purposes, which should enhance the effectiveness of the disqualification rules to screen out felons and bad actors.

In our view, bars are orders issued by one of the specified regulators that have the effect of barring a person from: (1) associating with certain regulated entities; (2) engaging in the business of securities, insurance or banking; or (3) engaging in savings association or credit union activities. We believe that any such order that has one of those effects would be a bar,

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774 *Disqualification Adopting Release*, note 101.

775 *See, e.g.*, Exchange Act Section 15(b)(4)(D) [15 U.S.C. 78*o*(b)(4)(D)] and Advisers Act Section 203(e)(5) [15 U.S.C. 80b-3(e)(5)].

776 7 U.S.C. 1 *et seq*.

regardless of whether it uses the term "bar."[777] Under the proposed rules, a disqualifying order is one that bars the person "at the time of the filing of the information required by Section 4A(b) of the Securities Act of 1933" from one or more of the specified activities. Thus, for example, a person who was barred permanently, with the right to apply to reassociate after three years, would be disqualified until such time as he or she successfully applied to reassociate, assuming that the bar had no continuing effect after reassociation. Bars would be disqualifying for as long as they are in effect but no longer, matching the period of disqualification to the duration of the regulatory sanction. The treatment of regulatory bars and orders[778] is different in one relevant respect from court injunctions and restraining orders.[779] Court injunctions and restraining orders would be subject to a five-year look-back period, which would function as a cut-off (*i.e.*, injunctions and restraining orders issued more than five years before the filing required by Section 4A(b) would no longer be disqualifying, even if they are still in effect or permanent). This is the same approach as under the Rules 262 and 506 disqualification rules, and we do not believe that the shift from Regulation A and Rule 506 offerings to offerings pursuant to Section 4(a)(6) justifies extending the time period for disqualifications associated with court injunctions and restraining orders.

The proposed rules would define a "final order" as "a written directive or declaratory statement issued by a federal or state agency, described in proposed Rule 503(a)(3) of Regulation Crowdfunding, under applicable statutory authority that provides for notice and an opportunity

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777 Orders that do not have any of those effects are not bars, although they may be disqualifying "final orders."

778 *See* proposed Rule 503(a)(3) of Regulation Crowdfunding.

779 *See* proposed Rule 503(a)(2) of Regulation Crowdfunding.

for hearing, which constitutes a final disposition or action by that federal or state agency."[780] This definition is based on the definition that FINRA uses in forms related to Exchange Act Section 15(b)(4)(H), which is identical to provisions of Section 302(d). Section 302(d) provides that disqualification must result from final orders of the relevant regulators that are "based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct." The proposed rules would not, similar to the Rule 506 disqualification rules, limit "fraudulent, manipulative or deceptive conduct" to matters involving scienter. Scienter is not a requirement under Exchange Act Section 15(b)(4)(H) or Advisers Act Section 203(e)(9). Commission orders are issued under these sections based only on the existence of a relevant state or federal regulatory order. The Commission has stated that, while the degree of scienter involved is a factor in determining what sanction is appropriate,[781] the Commission can order sanctions even where scienter is not an element of the underlying state antifraud law violation.[782] We do not believe it would be appropriate to limit the provision to matters involving scienter absent a clear statutory directive to do so, particularly when the relevant language has been construed in other contexts not to be so limited. Moreover, imposing such a limitation may result in excluding regulatory orders that are explicitly mandated to be covered by the new rules.

(d) Commission Disciplinary Orders

Rule 262(b)(3) of Regulation A disqualifies an issuer if any covered person is subject to a Commission order "entered pursuant to [S]ection 15(b), 15B(a), or 15B(c) of the Exchange Act, or [S]ection 203(e) or (f) of the Investment Advisers Act." Under these provisions (other than

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780 The federal or state agencies described in proposed Rule 503(a)(3) of Regulation Crowdfunding are the ones identified in Section 302(d)(2)(B)(i), with the addition of the CFTC.

781 *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

782 *See In the Matter of Mitchell M. Maynard and Dorice A. Maynard*, Release No. IA-2875 (May 15, 2009).

Section 15B(a), discussed below), the Commission has authority to order a variety of sanctions against registered brokers, dealers, municipal securities dealers and investment advisers and their associated persons, including suspension or revocation of registration, censure, limiting their activities, imposing civil money penalties and barring individuals from being associated with specified entities and from participating in the offering of any penny stock.

The proposed rules are based on Rule 262(b)(3) but would not include the reference to Section 15B(a) (the basic registration requirements for municipal securities dealers).[783] Section 15B(a) is not generally a source of sanctioning authority, and we do not believe it is appropriate to refer to it in the context of the proposed disqualification rules. This is consistent with the approach in the Rule 506 disqualification rules. Under the proposed rules, the disqualification would continue only for as long as some act is prohibited or required to be performed pursuant to the order (with the consequence that censures and orders to pay civil money penalties, assuming the penalties are paid in accordance with the order, would not be disqualifying, and a disqualification based on a suspension or limitation of activities would expire when the suspension or limitation expires).

(e) Certain Commission Cease-and-Desist Orders

Section 302(d) mandates that disqualification result from final orders issued within a 10-year period by the state and federal regulators identified in Section 302(d)(2)(B)(i). These regulators include state authorities that supervise banks, savings associations or credit unions; state insurance regulators; appropriate federal banking agencies; and the National Credit Union Administration. The Commission is not included in the list of regulators, and orders issued in

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783 *See* proposed Rule 503(a)(4) of Regulation Crowdfunding.

stand-alone Commission cease-and-desist proceedings[784] are not disqualifying under Rule 262.[785] The reason for this omission appears to be largely historical: the Commission did not have authority to bring cease-and-desist proceedings when Rule 262 was originally adopted, and the rule has not been amended to take that authority into account. We believe that adding certain Commission cease-and-desist orders to the disqualification provisions would further enhance the investor protection intent of the disqualification provisions. This approach also would be consistent with the disqualification provisions for Rule 506. We believe an injunctive or restraining order issued by a federal court and a Commission cease-and-desist order arising out of the same legal violation demonstrate equally disqualifying conduct and should have the same consequences under our proposed disqualification rules. We believe that the determination of disqualification should not depend on whether a particular enforcement action is brought in court or through a Commission cease-and-desist proceeding. Commission cease-and-desist orders would be an additional disqualification trigger not provided for in Section 302(d). In our view, Section 302(d) does not limit the existing authority we previously used to create other bad actor provisions, and based on the foregoing reasons, we believe it would be appropriate to add Commission cease-and-desist orders to the disqualification triggers.

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784 In cease-and-desist proceedings, the Commission can issue orders against "any person," including entities and individuals outside the securities industry, imposing sanctions such as penalties, accounting and disgorgement or officer and director bars. In contrast, administrative proceedings generally are limited to regulated entities and their associated persons.

785 The disqualification provisions under Rule 262 also do not cover other types of Commission actions. For example, the Commission has authority under Section 9(b) of the Investment Company Act to bring proceedings against "any person" and may impose investment company bars, civil penalties and disgorgement under Sections 9(d) and (e) of the Investment Company Act. 15 U.S.C. 80a-9(b), (d) and (e). The Commission also has authority under Rule 102(e) of its Rules of Practice to censure persons (such as accountants and attorneys) who appear or practice before it, or to deny them the privilege of appearing before the Commission temporarily or permanently. 17 CFR 201.102(e). Orders under these sections are not disqualifying under Rule 262.

The proposed rules, consistent with the approach for the Rule 506 disqualification rules, would not include administrative cease-and-desist orders that do not require any showing or finding of scienter, with one exception.[786] The proposed disqualification trigger only would cover Commission orders to cease and desist from violations and future violations of the scienter-based anti-fraud provisions of the federal securities laws (including, without limitation, Securities Act Section 17(a)(1),[787] Exchange Act Section 10(b)[788] and Rule 10b-5 thereunder,[789] Exchange Act Section 15(c)(1)[790] and Advisers Act Section 206(1)[791]). The only additional disqualification trigger not requiring scienter would be Section 5 violations.[792] Section 5 imposes a strict liability standard, which does not require a finding of scienter.[793] As a matter of policy, we do not believe that the exemption from registration under Section 4(a)(6) should be made available to persons whose prior conduct has resulted in an order to cease and desist from violations of the registration requirements of Section 5.

A disqualification based on a Commission cease-and-desist order would be subject to the same five-year look-back period that applies to court restraining orders and injunctions, rather than the 10-year look-back that is mandated to apply to other final regulatory orders under Section 302(d), which would provide consistent Commission treatment of cease-and-desist

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786 *See* proposed Rule 503(a)(5) of Regulation Crowdfunding.

787 15 U.S.C. 77q(a)(1).

788 15 U.S.C. 78j(b).

789 17 CFR 240.10b-5.

790 15 U.S.C. 78*o*(c)(1).

791 15 U.S.C. 80b-6(1).

792 15 U.S.C. 77e.

793 *See SEC v. Ross*, 504 F.3d 1130, 1137 (9th Cir.2007); *Swenson v. Engelstad*, 626 F.2d 421, 424 (5th Cir. 1980); *SEC v. N. Am. Research and Dev. Corp.*, 424 F.2d 63, 81-82 (2d Cir.1970); *SEC v. Pearson*, 426 F.2d 1339, 1343 (10th Cir.1970).

orders with court orders that we seek. This approach is also consistent with the Rule 506 disqualification rules.

(f) Suspension or Expulsion from SRO Membership or Association with an SRO Member

Rule 262(b)(4) disqualifies an offering if any covered person is suspended or expelled from membership in, or suspended or barred from association with a member of, a self-regulatory organization or "SRO" (*e.g.*, a registered national securities exchange or national securities association) for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade.[794]

The proposed rules would include a reference to a registered affiliated securities association[795] and would apply the standard to all covered persons,[796] but they would not otherwise change the substance of Rule 262(b)(4).[797] Including these changes is the same approach as in the Rule 506 disqualification rules.

(g) Stop Orders and Orders Suspending the Regulation A Exemption

Paragraphs (a)(1) and (2) of Rule 262 disqualify an offering if the issuer, or any predecessor or affiliated issuer, has filed a registration statement or Regulation A offering statement that was the subject of a Commission refusal order, stop order or order suspending the Regulation A exemption within the last five years, or is the subject of a pending proceeding to

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794 *See* 17 CFR 230.262(b)(4).

795 An association of brokers and dealers may be registered as an affiliated securities association under Exchange Act Section 15A. 15 U.S.C. 78*o*-3.

796 Rule 262(b)(4) does not apply to issuers, their predecessors or affiliated issuers. 17 CFR 230.262(b)(4).

797 *See* proposed Rule 503(a)(6) of Regulation Crowdfunding.

determine whether such an order should be issued.[798] Similarly, paragraphs (c)(1) and (2) of Rule 262 disqualify an offering if any underwriter of the securities proposed to be issued was, or was named as, an underwriter of securities under a registration statement or Regulation A offering statement that was the subject of a Commission refusal order, stop order or order suspending the Regulation A exemption within the last five years, or is the subject of a pending proceeding to determine whether such an order should be issued.[799]

The proposed rules would incorporate the substance of paragraphs (a)(1), (a)(2), (c)(1) and (c)(2) of Rule 262 in a single paragraph that applies to all covered persons,[800] resulting in rules that are substantially similar to Rule 262. This is the same as the approach in the Rule 506 disqualification rules.

(h) United States Postal Service False Representation Orders

Paragraphs (a)(5) and (b)(5) of Rule 262 disqualify an offering if the issuer or another covered person is subject to a United States Postal Service false representation order, entered within the preceding five years, or to a temporary restraining order or preliminary injunction with respect to conduct alleged to have violated the false representation statute that applies to U.S. mail.[801]

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798 17 CFR 230.262(a)(1) and (2).

799 17 CFR 230.262(c)(1) and (2).

800 *See* proposed Rule 503(a)(7) of Regulation Crowdfunding.

801 Paragraph (a)(5) of Rule 262 relates to issuers and their predecessors and affiliated issuers, and paragraph (b)(5) of Rule 262 relates to other covered persons. Disqualification results if any covered person "is subject to a United States Postal Service false representation order entered under 39 U.S.C. 3005, within 5 years prior to the filing of the offering statement, or is subject to a temporary restraining order or preliminary injunction entered under 39 U.S.C. 3007 with respect to conduct alleged to have violated 39 U.S.C. 3005." [17 CFR 230.262(a)(5) and (b)(5)].

The proposed rules would incorporate the substance of paragraphs (a)(5) and (b)(5) of Rule 262 in a single paragraph,[802] resulting in rules that are substantially similar to Rule 262. This is the same as the approach in the Rule 506 disqualification rules.

Request for Comment

261. Should we eliminate or modify any of the proposed disqualification events? If so, which ones and why? Should additional events be disqualifying events? If so, what should constitute a disqualifying event and why?

262. The proposed disqualification for certain criminal convictions contemplates a look-back period of five years for criminal convictions of issuers (including predecessors and affiliated issuers) and 10 years for other covered persons. Should we modify the proposed five- and 10-year look-back periods? If so, what should the look-back periods be? Should the look-back periods be measured from the date of the requisite filing with the Commission, as proposed, or the date of the relevant sale? Why?

263. Should we expand or narrow the scope of the coverage of criminal convictions? Why or why not?

264. Is the proposed coverage and look-back period for disqualification events relating to court injunctions and restraining orders appropriate? Why or why not? Should we impose any due process requirements as a condition to disqualification? If so, what should those requirements be and why? Should we

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802 *See* proposed Rule 503(a)(8) of Regulation Crowdfunding.

expand or narrow our proposed approach of who would be viewed as subject to an order? Why or why not?

265. Are the proposed disqualification provisions relating to final orders of certain regulators appropriate? Why or why not? The proposed rules would add the CFTC to the list of regulators whose regulatory bars and other final orders will trigger disqualification. Is this addition appropriate? Why or why not? Should we define or provide additional guidance about what constitutes a "bar"? Why or why not? Is our proposed definition of "final order" appropriate? If not, why not and what should it be? Should we limit "fraudulent, manipulative or deceptive conduct" to matters involving scienter? Why or why not?

266. Are the proposed disqualification provisions relating to Commission disciplinary orders appropriate? Why or why not? Should the disqualification continue only for as long as some act is prohibited or required to be performed pursuant to the order, as proposed, or should we impose a look-back period for Commission disciplinary orders? If we should impose a look-back period, how long should that look-back period be (*e.g.* five years, 10 years)?

267. The proposed disqualification provisions would make certain Commission cease-and-desist orders a disqualifying event. Is this approach appropriate? Why or why not? Should we create a new disqualification trigger for orders of any other regulator not identified in Section 302(d)? If so, which regulator and why?

268. Are the proposed disqualification provisions relating to suspension or expulsion from SRO membership or association with an SRO member appropriate? Why or why not?

269. Are the proposed disqualification provisions relating to stop orders and orders suspending the Regulation A exemption appropriate? Why or why not?

270. Are the proposed disqualification provisions relating to United States Postal Service false representation orders appropriate? Why or why not?

iii. Reasonable Care Exception

The proposed rules would include an exception from disqualification for offerings in which the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed because of the presence or participation of another covered person.[803] This is the same as the approach in the Rule 506 disqualification rules. The proposed reasonable care exception should help address the potential difficulty for issuers in establishing whether any covered persons are the subject of disqualifying events,[804] particularly given that there is no central repository that aggregates information from all the federal and state courts and regulatory authorities that would be relevant in determining whether covered persons have a disqualifying event in their past. We are proposing a reasonable care exception out of concern that the benefits of the new exemption under Section 4(a)(6) – which, among other things, is intended to alleviate the funding gap and accompanying regulatory concerns faced by startups and small businesses in connection with raising capital in relatively low dollar amounts

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803 *See* proposed Rule 503(b)(4) of Regulation Crowdfunding.

804 *See also* Applied Dynamite Letter (discussing difficulties associated with satisfying certain disqualification criteria with confidence).

– may otherwise be substantially reduced. Issuers may be reluctant to offer or sell securities in reliance on an exemptive rule if the exemption could later be found, despite the issuer's exercise of reasonable care, not to have been available. On the other hand, issuers must have a responsibility to screen bad actors out of their offerings made in reliance on Section 4(a)(6). We believe that providing a reasonable care exception would help to preserve the intended benefits of the Section 4(a)(6) exemption and avoid creating an undue burden on capital-raising activities, while giving effect to the disqualification provisions. Although Rule 262 does not contain a reasonable care exception, we believe that even with its inclusion, the proposed rules would be substantially similar to Rule 262.

We are proposing that in order for an issuer to establish that it had exercised reasonable care, it would need to make a factual inquiry into whether any disqualifications existed. The nature and scope of the factual inquiry would vary based on the circumstances of the issuer and the other offering participants. For example, we believe that issuers should have an in-depth knowledge of their own officers and directors, which could be gained through the recruiting process and in the course of performing their duties. When relevant inquiry has already been made, further steps may not be required in connection with a particular offering. In the absence of other factors, factual inquiry by means of questionnaires or certifications, perhaps accompanied by contractual representations, covenants and undertakings, may be sufficient. If the circumstances give an issuer reason to question the veracity or accuracy of the responses to its inquiries, we believe reasonable care would require the issuer to take further steps or undertake additional inquiry to provide a reasonable level of assurance that no disqualifications apply.

The timeframe for inquiry also should be reasonable in relation to the circumstances of the offering and the participants. The objective would be for the issuer to gather information that is complete and accurate as of the time of the relevant transactions without imposing an unreasonable burden on the issuer or the other offering participants. With that in mind, we would expect issuers to determine the appropriate cut-off dates to apply when they make a factual inquiry, based upon the particular facts and circumstances of the offering and the participants involved, to determine whether any covered persons are subject to disqualification before seeking to rely on the exemption.

Request for Comment

271. Is it appropriate to have a reasonable care exception from disqualification? Why or why not?

272. In order for an issuer to establish that it had exercised reasonable care, the proposed rules would require the issuer to make a factual inquiry into whether any disqualifications existed. Is this approach appropriate? Why or why not? Should we include in the proposed rules additional guidance on what types of factual inquiries should be undertaken under the reasonable care standard? If so, what should that guidance include? Should we create a cut-off date to apply when issuers make a factual inquiry? If so, what should that cut-off date be?

iv. Waivers

The proposed rules would include a waiver provision based on Rule 262 under which the Commission could grant a waiver of disqualification if it determined that the issuer had shown good cause "that it is not necessary under the circumstances that the [registration] exemption . . . be denied." Depending on the specific facts, we believe a number of circumstances (such as a

change of control, change of supervisory personnel, absence of notice and opportunity for hearing and relief from a permanent bar for a person who does not intend to apply to reassociate with a regulated entity) could be relevant to the evaluation of a waiver request. The Commission has delegated authority to the Director of the Division of Corporation Finance to grant disqualification waivers under Regulation A.[805] Given the expectation of a short timeframe for crowdfunding offerings conducted pursuant to Section 4(a)(6), we are sensitive to the timeliness of the waiver application process and the risk that a lengthy review process may disadvantage issuers seeking speedy access to capital. We believe the staff has managed the process of granting waivers from Regulation A and Rule 505 disqualification appropriately in the past. Accordingly, we are proposing to clarify the existing delegation of authority to the Director of the Division of Corporation Finance by amending it to cover disqualification waivers under Section 4(a)(6).[806] This also is the same approach we took in the context of waivers for the Rule 506 disqualification rules.

The proposed rules would provide that disqualification would not arise if, before the filing of the information required by Section 4A(b), the court or regulatory authority that entered the relevant order, judgment or decree advises in writing, whether contained in the relevant judgment, order or decree or separately to the Commission or its staff, that disqualification under Section 4(a)(6) should not arise as a consequence of such order, judgment or decree. Because disqualification would not arise in those circumstances, no waiver would be needed. This automatic exception from disqualification is similar to that in NASAA's approved Model Accredited Investor Exemption ("MAIE"), adopted in 1997, and Uniform Limited Offering

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805 *See* Rule 30-1(b) of our Rules of Organization and Program Management [17 CFR 200.30-1(b)].

806 *See* proposed paragraph (d) to Rule 30-1 of our Rules of Organization and Program Management.

Exemption ("ULOE"), adopted in 1983 and again in 1989. Under both the MAIE and ULOE, disqualification is waived if, among other things, the regulator issuing the relevant order determines that disqualification is not necessary under the circumstances.[807] We believe that including this automatic exception from disqualification is appropriate because it allows the relevant authorities to determine the impact of their roles, and it conserves Commission resources (which might otherwise be devoted to consideration of waiver applications) in cases where the relevant authority determines that disqualification from offerings made in reliance on Section 4(a)(6) is not warranted. This is the same as the approach in the Rule 506 disqualification rules.

Request for Comment

273. The proposed rules contemplate that the Commission could grant a waiver of disqualification under certain circumstances. Is this approach appropriate? Why or why not? What should constitute "good cause" for purposes of seeking a waiver? Are there specific circumstances under which a waiver is appropriate (*e.g.* change of control, change of supervisory personnel, absence of notice and opportunity for a hearing)? If so, what are they?

274. Should we delegate authority to the Director of the Division of Corporation Finance to grant disqualification waivers under Section 4(a)(6), as proposed? Why or why not?

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807 *See* MAIE paragraph (D)(2)(b), *available at* http://www.nasaa.org/wp-content/uploads/2011/07/24-Model_Accredited_Investor_Exemption.pdf; Peter M. Fass and Derek A. Wittner, *Blue Sky Practice for Public and Private Direct Participation Offerings*, Appendix 9A, paragraph B.6 (Thompson Reuters/West 2008).

275. Is it appropriate to include an automatic exception from disqualification where the relevant authority concludes that disqualification under Section 4(a)(6) should not arise as a consequence of such order, judgment or decree, as proposed? If not, why not? Should we expand or limit this automatic exception? Please explain.

v. Transition Issues

The proposed rules would specify that disqualification under Section 4(a)(6) would not arise as a result of events occurring before the effective date of Regulation Crowdfunding, when adopted.[808] This is consistent with the approach we took with respect to the Rule 506 disqualification rules. We believe this approach would address concerns about the potential unfairness of a retroactive application of the disqualification provisions, such as to persons who settled actions prior to the enactment of the JOBS Act and the adoption of rules to implement the JOBS Act.

In lieu of imposing disqualification for pre-existing events, the proposed rules would require disclosure in the offering materials of matters that would have triggered disqualification had they occurred after the effective date of proposed Regulation Crowdfunding.[809] We believe this disclosure would put investors on notice of events that would, but for the timing of such events, disqualify offerings under Section 4(a)(6) that they are evaluating as potential investments. We also believe that this disclosure is particularly important because, as a result of the implementation of Section 302(d), investors may have the impression that all bad actors would now be disqualified from participating in offerings under Section 4(a)(6). We expect that

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808 *See* proposed Rule 503(b)(1) of Regulation Crowdfunding.

809 *See* proposed Rule 201(u) of Regulation Crowdfunding.

issuers would give reasonable prominence to the disclosure to ensure that information about pre-existing bad actor events would be appropriately presented in the total mix of information available to investors. If disclosure of a pre-existing, otherwise disqualifying event is required and not adequately provided to an investor, we do not believe relief would be available under the proposed rules,[810] which provide that insignificant deviations from Regulation Crowdfunding requirements would not necessarily result in loss of the exemption.

Request for Comment

276. Should we impose disqualification for all pre-existing events, regardless of whether they occurred before the effectiveness of the final rules, or only for events after effectiveness? Why or why not? Should we treat different types of pre-existing events differently? Why or why not? If so, in either case, how should we address concerns about the fairness of retroactive application of the disqualification provisions to actions that took place prior to the enactment of the JOBS Act and the adoption of rules implementing the JOBS Act?

277. The proposed rules would specify that disqualification under Section 4(a)(6) would not arise as a result of events occurring before the effective date of proposed Regulation Crowdfunding. Should we limit disqualification to events occurring after the enactment of the JOBS Act instead? Why or why not?

278. Is it appropriate to require disclosure of matters that would have triggered disqualification had they occurred after the effective date of proposed Regulation Crowdfunding? Is there a better method of putting investors on

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[810] *See* proposed Rule 502 of Regulation Crowdfunding.

notice of bad actor involvement? If so, what method? If disclosure of a pre-existing triggering event is required and not adequately provided to an investor, should relief for insignificant deviations from Regulation Crowdfunding requirements be available? Why or why not?

b. Intermediaries and Certain Other Associated Persons

As noted above, Section 302(d)(1)(B) requires the Commission to establish disqualification provisions under which an intermediary would not be eligible to effect or participate in transactions conducted pursuant to Securities Act Section 4(a)(6). Section 302(d)(2) requires that the disqualification provisions we propose be substantially similar to the provisions of Securities Act Rule 262, which applies to issuers. Exchange Act Section 3(a)(39)[811] currently defines the circumstances in which a broker would be subject to a "statutory disqualification" with respect to membership or participation in a self-regulatory organization such as FINRA or any other registered national securities association. We believe that the definition of "statutory disqualification" under Section 3(a)(39) is substantially similar to, while somewhat broader than, the provisions of Rule 262.[812]

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811 15 U.S.C. 78c(39).

812 There are certain differences between Exchange Act Section 3(a)(39) and Rule 262. For example, while Rule 262 refers to orders that had been entered into within five years prior to a filing, there is no similar time restriction in Section 3(a)(39). Unlike Rule 262, Section 3(a)(39) extends disqualification to persons who, by their conduct while associated with brokers or dealers (among other types of regulated entities), have been found to be a cause of any effective, relevant suspension, expulsion or order. Section 3(a)(39) also subjects persons to disqualification if they had been convicted of, in addition to certain specified offenses related to securities and funds, any felony within ten years of filing to apply for membership or participation in, or to become associated with a member of, an SRO; the comparable provisions of Rule 262 are, in contrast, limited to felonies or misdemeanors relating to the purchase or sale of securities. Section 3(a)(39) covers suspensions, expulsions and orders by both U.S. and non-U.S. regulators and SROs (or their equivalents), whereas Rule 262 covers suspensions, expulsions and orders by only U.S.-registered SROs, as well as orders, judgments and decrees of any court of competent jurisdiction. Finally, Rule 262 disqualifies a person, while Section 3(a)(39) does not, for being subject to a U.S. Postal Service false representation order, or subject to a temporary restraining order or preliminary injunction, entered under 39

The proposed rules would prohibit any person subject to a statutory disqualification as defined in Exchange Act Section 3(a)(39) from acting as, or being an associated person of, an intermediary unless permitted to do so by Commission rule or order.[813] The term "subject to a statutory disqualification" has an established meaning under Exchange Act Section 3(a)(39) and defines circumstances that would subject a person to a statutory disqualification with respect to membership or participation in, or association with a member of, a self-regulatory organization.[814] Because funding portals, like broker-dealers, would be members of FINRA or any other registered national securities association, we anticipate that they would take appropriate steps to check the background of any person seeking to become associated with them, including whether such person is subject to a statutory disqualification. In addition, we propose to clarify that associated persons of intermediaries engaging in transactions in reliance on Section 4(a)(6) must comply with Exchange Act Rule 17f-2, relating to the fingerprinting of securities industry personnel. Exchange Act Rule 17f-2 would apply to all brokers, including registered funding portals. The proposed instructions to Rule 503(d) would clarify that Rule 17f-2 requires that, unless subject to an exemption, every broker shall require that each of its partners, directors, officers and employees be fingerprinted and shall submit, or cause to be

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U.S.C. 3005 or 39 U.S.C. 3007, respectively, within 5 years prior to a filing. Despite these differences, we believe that Section 3(a)(39) and Rule 262 are substantially similar in particular with regard to the persons and events they cover, their scope and their purpose.

813 *See* proposed Rule 503(d) of Regulation Crowdfunding.

814 Events that could result in a statutory disqualification for an associated person under Section 3(a)(39) include, but are not limited to: certain misdemeanor and all felony criminal convictions; temporary and permanent injunctions issued by a court of competent jurisdiction involving a broad range of unlawful investment activities; expulsions (and current suspensions) from membership or participation in an SRO; bars (and current suspensions) ordered by the Commission or an SRO; denials or revocations of registration by the CFTC; and findings by the Commission, CFTC or an SRO that a person: (1) "willfully" violated the federal securities or commodities laws, or the Municipal Securities Rulemaking Board (MSRB) rules; (2) "willfully" aided, abetted, counseled, commanded, induced or procured such violations; or (3) failed to supervise another who commits violations of such laws or rules. 15 U.S.C. 78c(a)(39).

submitted, the fingerprints of such persons to the Attorney General of the United States or its designee for identification and appropriate processing. We believe that consistent standards for all intermediaries would assist FINRA or any other registered national securities association in monitoring compliance and enforcing its rules across its members.

We are proposing to apply to intermediaries the standard of Section 3(a)(39) rather than Rule 262 or the disqualification rules we are proposing for issuers, in part because the Section 3(a)(39) standard is already an established one among financial intermediaries and their regulators. We believe that the practices that have evolved around the Section 3(a)(39) standards have evolved in a manner appropriate to intermediaries, and that to impose a new or different standard only for those intermediaries that engage in transactions in reliance on Section 4(a)(6), could create confusion and unnecessary burdens on market participants. Unnecessary burdens would arise in particular for brokers that act as intermediaries in transactions in reliance on Section 4(a)(6), as they and their associated persons would become subject to two distinct standards for disqualification. Consistent standards for all brokers and funding portals would also assist FINRA or any other registered national securities association in monitoring compliance and enforcing its rules across its members.

Request for Comment

279. Is the standard for "subject to a statutory disqualification" as defined in Exchange Act Section 3(a)(39) appropriate for purposes of establishing disqualification provisions for intermediaries in crowdfunding transactions made in reliance on Section 4(a)(6)? Why or why not? If another standard would be appropriate, why should that standard be used instead of Section 3(a)(39)? If we were to use another standard for funding portals, should we also use that

standard for brokers' crowdfunding activities? Or, should brokers adhere to the Section 3(a)(39) standard for all their activities, including crowdfunding?

280. Should we instead propose rules that mirror the disqualification rules we are proposing for issuers? If we were to take this approach, would any particular disqualification provision need to be tailored for intermediaries engaging in crowdfunding transactions? Are there unintended consequences of having different disqualification standards for issuers and for intermediaries? Please explain.

281. Should any of the differences between Rule 262 and Section 3(a)(39) be addressed? Why or why not? If so, how should we address them?

282. Should we permit intermediaries to determine how best to screen associated persons to ensure they are not subject to a statutory disqualification? Why or why not? If so, should we propose particular standards, or a level of care, applicable to this screening?

283. Should we prescribe specific steps that an intermediary must take to ascertain whether an associated person should be prohibited from participating in or effecting crowdfunding transactions in reliance on Section 4(a)(6)? If so, what should those steps be?

284. Should we permit intermediaries to reasonably rely on the representations of associated persons regarding statutory disqualification if the intermediary otherwise has conducted a background check on the associated person?

F. General Request for Comment

We request and encourage any interested person to submit comments regarding the proposed rules and form amendments, specific issues discussed in this release and other matters that may have an effect on the proposed rules. We particularly welcome comments from issuers, investors, state regulators and other market participants. With regard to any comments, we note that such comments are of particular assistance to us if accompanied by supporting data and analysis of the issues addressed in those comments. We urge commenters to be as specific as possible.

III. Economic Analysis

Title III sets forth a comprehensive regulatory structure for startups and small businesses to raise capital through securities offerings using the Internet through crowdfunding. In particular, Title III provides an exemption from registration for certain offerings of securities by adding Securities Act Section 4(a)(6). In addition, Title III:

- adds Securities Act Section 4A, which requires, among other things, that issuers and intermediaries that facilitate transactions between issuers and investors provide certain information to investors and potential investors, take certain actions and provide notices and other information to the Commission;
- adds Exchange Act Section 3(h), which requires the Commission to adopt rules to exempt, either conditionally or unconditionally, funding portals from having to register as brokers or dealers pursuant to Exchange Act Section 15(a)(1);
- includes disqualification provisions under which an issuer would not be able to avail itself of the exemption for crowdfunding if the issuer or other related parties, including an intermediary, were subject to a disqualifying event; and

- adds Exchange Act Section 12(g)(6), which requires the Commission to adopt rules to exempt from Section 12(g), either conditionally or unconditionally, securities acquired pursuant to an offering made in reliance on Section 4(a)(6).

As discussed in detail above, we are proposing Regulation Crowdfunding to implement the requirements of Title III. The proposed rules would implement the new exemption for the offer and sale of securities pursuant to the requirements of Section 4(a)(6) and provide a framework for the regulation of issuers and intermediaries, which includes brokers and funding portals engaging in such transactions. The proposed rules also would exempt securities offered and sold in reliance on Section 4(a)(6) from the registration requirements of Exchange Act Section 12(g).

We are mindful of the costs imposed by, and the benefits to be obtained from, our rules. Securities Act Section 2(a) and Exchange Act Section 3(f) require us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation. Exchange Act Section 23(a)(2) requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition and to not adopt any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. The discussion below addresses the economic effects of the proposed rules, including the likely costs and benefits of proposed Regulation Crowdfunding, as well as the likely effect of the proposed rules on efficiency, competition and capital formation. Given the specific language of the statute and our understanding of Congress's objectives, we believe that it is appropriate for the proposed rules to follow the statutory provisions closely. We nonetheless

also rely on our discretionary authority to propose certain additional provisions. While the costs and benefits of the proposed rules in large part stem from the statutory mandate of Title III, certain costs and benefits are affected by the discretion we propose to exercise in connection with implementing this mandate. For purposes of this economic analysis, we address the costs and benefits resulting from the mandatory statutory provisions and our exercise of discretion together, because the two types of benefits and costs are not separable.

We request comment on all aspects of our economic analysis, including the potential costs and benefits of the proposed rules.

A. Economic Baseline

The baseline for our economic analysis of proposed Regulation Crowdfunding, including the baseline for our consideration of the effects of the proposed rules on efficiency, competition and capital formation, is the situation in existence today, in which startups and small businesses seeking to raise capital through securities offerings must register the offer and sale of securities under the Securities Act unless they can rely on an existing exemption from registration under the federal securities laws. Moreover, under existing requirements, intermediaries intending to facilitate such transactions generally are required to register with the Commission as broker-dealers under Exchange Act Section 15(a). Finally, under existing exemptions from the registration requirements of the Securities Act, small investors may be limited in their ability to participate in offerings of securities of nonpublic companies.[815]

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[815] For example, only up to 35 non-accredited investors are allowed to participate in the most frequently used Regulation D exemption, Securities Act Rule 506(b) (17 CFR 230.506(b)), and these investors must meet certain sophistication requirements.

1. Existing Funding Sources Available to Startups and Small Businesses

The potential economic impact of the proposed rules, including their effect on efficiency, competition and capital formation, will depend on how the crowdfunding method of raising capital compares to existing methods that startups and small businesses currently use for raising capital. Startups and small businesses can potentially tap a variety of financing sources in the capital markets: debt, equity or hybrid security offerings; registered or unregistered offerings; and bank loans. The figure below plots the capital raising by various sources for the period 2009-2012.[816] As evident from the data, significant fundraising in the capital markets takes place via public debt, Regulation D offerings (which include equity, debt and hybrid security offerings) and Rule 144A offerings (which include predominantly debt securities).

816 These statistics are based on a review of Form D electronic filings with the Commission – specifically, the "total amount sold" as reported in the filings – and data regarding other types of offerings (*e.g.*, public debt offerings and Rule 144A offerings) from Securities Data Corporation's New Issues database (Thomson Financial). *See* Vladimir Ivanov and Scott Bauguess, *Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009-2012* (July 2013) ("*Ivanov/Bauguess Study*"), *available at* http://www.sec.gov/divisions/riskfin/whitepapers/dera-unregistered-offerings-reg-d.pdf. Data on new bank loans per year is not available.

Startups and small businesses seeking to raise capital can register the offer and sale of securities under the Securities Act. Registered offerings, however, are generally too costly to be viable alternatives for startups and small businesses. In particular, issuers conducting registered offerings must usually pay underwriter commissions, which are, on average, 7% for initial public offerings, 5.4% for follow-on equity offerings and between 0.9% and 1.5% for issuers raising capital through public bond issuances.[817] Issuers conducting registered offerings also must pay Commission registration fees and FINRA or any other registered national securities association filing fees, legal and accounting fees and expenses, transfer agent and registrar fees, costs associated with periodic reporting requirements and other regulatory requirements and various other fees. Two surveys concluded that the average cost of achieving initial regulatory compliance for an initial public offering is $2.5 million, followed by an ongoing compliance cost, once public, of $1.5 million per year.[818] Hence, for an issuer seeking to raise less than $1 million, a registered offering is not economically feasible if it would cost an estimated $2.5 million, on average, to achieve initial regulatory compliance for an initial public offering.[819]

The alternative to raising capital via registered offerings is for startups and small businesses to offer and sell securities by relying on an existing exemption from registration under the federal securities laws. For example, they could rely on current exemptions from registration

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817 *See, e.g.*, Hsuan-Chi Chen and Jay R. Ritter, *The Seven Percent Solution*, 55 J. FIN. 1105−1131 (2000); Shane A. Corwin, *The Determinants of Underpricing for Seasoned Equity Offers*, 58 J. FIN. 2249−2279 (2003); Lily Hua Fang, *Investment Bank Reputation and the Price and Quality of Underwriting Services*, 60 J. FIN. 2729−2761 (2005); Stephen J. Brown, Bruce D. Grundy, Craig M. Lewis and Patrick Verwijmeren, *Convertibles and Hedge Funds as Distributors of Equity Exposure*, 25 REV. FIN. STUD. 3077-3112 (2012).

818 *See* IPO Task Force, *Rebuilding the IPO On-Ramp*, at 9 (Oct. 20, 2011), *available at* http://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf ("IPO Task Force").

819 *See id.*

under the Securities Act, such as Section 3(a)(11), Section 4(a)(2),[820] Regulation D[821] and Regulation A.[822] While we do not have complete data on offerings relying on an exemption under Section 3(a)(11) or Section 4(a)(2), certain data available from Regulation D and Regulation A filings allow us to gauge how frequently issuers use these exemptions when raising capital. Based on Regulation D filings by non-fund issuers[823] from 2009 to 2012, there are a substantial number of issuers who choose to raise capital by relying on Rule 506 even though their offering size would qualify for an exemption under Rule 504 or Rule 505.[824] With the recent amendment to Rule 506 of Regulation D that permits an issuer to engage in general solicitation or general advertising in offering and selling securities pursuant to Rule 506, subject to certain conditions,[825] we expect to see an even higher percentage of issuers relying on that rule. As shown in the table below reporting the number of Regulation D and Regulation A offerings by non-fund issuers, from 2009 to 2012, relatively few issuers rely on Regulation A.

	Offering size			
	< $1 Million	$1-5 million	$5-50 million	>$50 million
Rule 504	1,997	--	--	--
Rule 505	705	229	--	--
Rule 506	19,424	11,957	8,103	1,268

820 Securities Act Section 4(a)(2) provides that the provisions of the Securities Act shall not apply to "transactions by an issuer not involving a public offering."

821 Regulation D provides a nonexclusive safe harbor from registration for certain types of securities offerings.

822 Regulation A provides a conditional exemption from registration for certain small issuances.

823 These are issuers that are not pooled investment vehicles.

824 This tendency could, in part, be attributed to two features of Rule 506: Blue Sky law preemption and an unlimited offering amount. *See also* U.S. Government Accountability Office, *Factors That May Affect Trends in Regulation A Offerings*, GAO-12-839 (Jul. 3, 2012), *available at* http://www.gao.gov/products/GAO-12-839 ("GAO Report").

825 *See General Solicitation Adopting Release*, note 12.

Regulation A	2	14	--	--

Note: Data comes from Form D and Form 1-A filings from 2009 to 2012. We consider only new offerings and exclude offerings with amount sold reported as $0 on Form D. We also use the maximum amount indicated in Form 1-A to determine offering size for Regulation A offerings.

Each of these exemptions, however, includes restrictions that may limit its suitability for startups and small businesses. The table below lists the main requirements of these exemptions. For example, the exemption under Securities Act Section 3(a)(11) is limited to intrastate offerings,[826] and an issuer seeking to offer and sell securities pursuant to Regulation A may be required to register in all 50 states if it intends to offer and sell the securities in all 50 states using the Internet. An issuer relying on Regulation A also would need to file with the Commission an offering document, which, coupled with the potential review of such document by the staff, has been cited as a reason why Regulation A is not widely used.[827] Issuers of securities pursuant to Securities Act Section 4(a)(2) and Rules 504, 505 and 506(b) under Regulation D generally may not engage in general solicitation and general advertising to reach potential investors, which also could place a significant limitation on offerings by startups and small businesses. Although an issuer may avoid the restriction on general solicitation and general advertising by using the services of a financial intermediary, those services may be costly.[828] While Rule 506 under Regulation D preempts the applicability of state laws regarding the offer and sale of securities

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826 Under Securities Act Section 3(a)(11), except as expressly provided, the provisions of the Securities Act (including the registration requirement under Securities Act Section 5) do not apply to a security that is "part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory."

827 *See* Rutheford B. Campbell, Jr., *Regulation A: Small Businesses' Search for "A Moderate Capital"*, 31 DEL. J. CORP. L. 77, 106 (2006). *See also* GAO Report, note 824.

828 An internal study by our Division of Economic and Risk Analysis covering 2009 to 2012 found that the average sales commission for Regulation D offerings for up to $1 million was 6.5%, almost three times larger than that for offerings of more than $50 million (1.9%). *See Ivanov/Bauguess Study*, note 816.

and new Rule 506(c) permits general solicitation and general advertising, an issuer seeking to rely on Rule 506(c) would be limited to selling securities only to accredited investors.[829]

Type of Offering	Dollar Limit	Manner of Offering	Issuer and Investor Requirements	Filing Requirement	Restriction on Resale	Blue Sky Exemption
Section 3(a)(11)	None.	No limitation other than to maintain intrastate character of offering.	All issuers and investors must be resident in state. No limitation on number.	None.	Rests within the state (generally a one-year period for resales within state).	Need to comply with state blue sky law by registration or state exemption.
Section 4(a)(2)	None.	No general solicitation or advertising.	All issuers and investors must meet sophistication and access to information test so as not to need protection of registration.	None.	Restricted securities.	Need to comply with state blue sky law.
Regulation A	$5,000,000 within prior 12 months, but no more than $1,500,000 by selling security holders.	"Testing the waters" permitted before filing Form 1-A. Sales permitted after Form 1-A qualified.	No requirements.	File test the waters documents, Form 1-A, any sales material and Form 2-A report of sales and use of proceeds with the Commission.	None; freely resalable.	Need to comply with state blue sky law.
Rule 504 Regulation D	$1,000,000 within prior 12 months.	No general solicitation or advertising unless registered in a state requiring use of a substantive disclosure document or sold under state exemption for	No requirements.	File Form D with the Commission not later than 15 days after first sale. Filing not a condition of the exemption.	Restricted unless registered in a state requiring use of a substantive disclosure document or sold under state exemption for sale to	Need to comply with state blue sky law by registration or state exemption.

[829] *See General Solicitation Adopting Release*, note 12.

		sales to accredited investors with general solicitation.			accredited investors with general solicitation.	
Rule 505 Regulation D	$5,000,000 within prior 12 months.	No general solicitation or advertising.	Unlimited accredited investors and 35 non-accredited investors.	File Form D with the Commission not later than 15 days after first sale. Filing not a condition of the exemption.	Restricted securities.	Need to comply with state blue sky law.
Rule 506 Regulation D	None.	No general solicitation or advertising under Rule 506(b). General solicitation and general advertising permitted under Rule 506(c), provided all purchasers are accredited investors.	Under Rule 506(b), unlimited accredited investors and 35 non-accredited investors. Under Rule 506(c), all purchasers must be accredited investors.	File Form D with SEC not later than 15 days after first sale. Filing not a condition of the exemption.	Restricted securities.	Exempt as "covered security" pursuant to Securities Act Section 18 [15 U.S.C. 77r].

2. Current Sources of Funding for Startups and Small Businesses that Could Be Substitutes or Complements to Crowdfunding

At present, startups and small businesses can raise capital through several sources that could be close substitutes or complements to crowdfunding transactions that rely on Section 4(a)(6). These sources are either based on unregistered securities offerings or involve lending by financial institutions.

a. Family and Friends

Family and friends are sources through which startups and small businesses can raise capital. This source of capital is usually available early in the lifecycle of a small business, before the business approaches arm's-length formal financial channels.[830] Among other things, family and friends may donate funds, loan funds or acquire an equity stake in the business. A recent study of the financing choices of startups finds that most of the capital supplied by friends and family is in the form of loans.[831] In contrast to a commercial lender that, for example, would need to assess factors such as the willingness and ability of a borrower to repay the loan and the viability of its business, family and friends may be willing to assist based primarily or solely upon personal relationships. Family and friends, however, may be able to provide only a limited amount of capital compared to other sources. In addition, financial arrangements with family and friends may not be an optimal source of funding if any of the parties is untrained in the structuring of loan agreements, equity investments or in related areas of accounting. Unfortunately, there is no available data on these financing sources that could allow us to quantify their magnitude and compare them to other current sources of capital.

b. Commercial Loans, Peer-to-Peer Loans and Microfinance

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830 *See* Paul Gompers and Josh Lerner, THE VENTURE CAPITAL CYCLE (MIT Press 2006) ("Gompers"); Alicia M. Robb and David T. Robinson, *The Capital Structure Decisions of New Firms*, REV. FIN. STUD. (forthcoming), *available at* http://rfs.oxfordjournals.org/content/early/2012/07/07/rfs.hhs072.full.pdf+html ("Robb").

831 *See* Robb, note 830.

Startups and small businesses also may seek loans from financial institutions.[832] A recent study of the financing choices of startups suggests that they resort to bank financing early in their lifecycle.[833] The study finds that businesses rely heavily on external debt sources such as bank financing in the first year after being formed, which comes mostly in the form of personal and commercial bank loans, business credit cards and credit lines. Another recent report, however, suggests that bank lending to small businesses fell by $100 billion from 2008 to 2011 and that by 2012, less than one-third of small businesses reported having a business bank loan.[834] Our analysis of lending data from FDIC-insured depository institutions from June 30, 2006 until June 30, 2013 also shows that both small business loans (those for up to a $1 million) and large business loans (those greater than $1 million) experienced a decline from the peak in 2008.[835] Small business loans, however, declined continuously over the period by approximately 18% from 2008 until 2013. Large business loans, on the other hand, range from a high of $2,440 billion in 2008 to a low of $1,924 billion in 2010. The figure shows that this segment of the loan market has shown steady increases since 2010.

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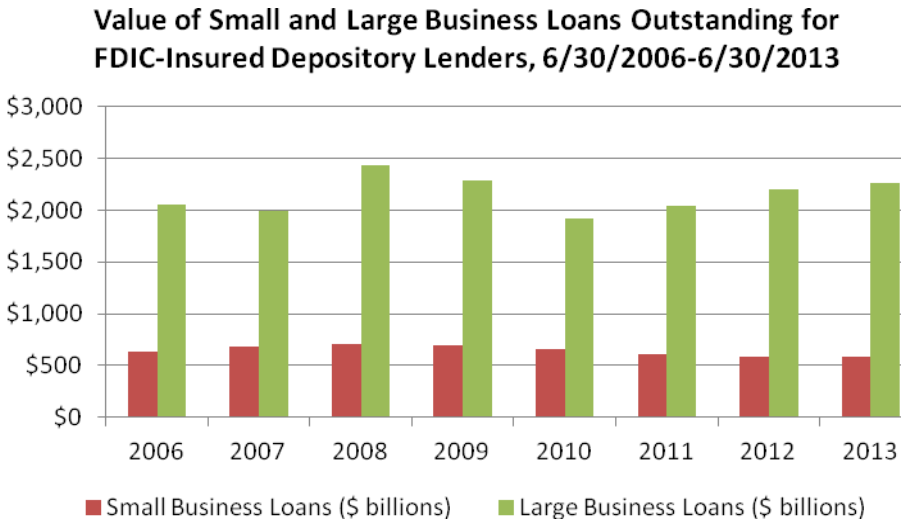
832 Using data from the 1993 Survey of Small Business Finance, one seminal study indicates that financial institutions account for approximately 27% of small firms' borrowings. *See* Allen N. Berger and Gregory F. Udell, *The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets in the Financial Growth Cycle*, 22 J. BANKING & FIN. 613 (1998). *See also* 1987, 1993, 1998 and 2003 Surveys of Small Business Finances, *available at* http://www.federalreserve.gov/pubs/oss/oss3/nssbftoc.htm. The Survey of Small Business Finances was discontinued after 2003. Using data from the Kauffman Foundation Firm Surveys, one study finds that 44% of startups use loans from financial institutions. *See* Rebel A. Cole and Tatyana Sokolyk, *How Do Start-Up Firms Finance Their Assets? Evidence from the Kauffman Firm Surveys* (2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2028176.

833 *See* Robb, note 830.

834 *See* The Kauffman Foundation, *2013 State of Entrepreneurship Address* (Feb. 5, 2013), *available at* http://www.kauffman.org/uploadedFiles/DownLoadableResources/SOE%20Report_2013pdf.pdf. The report cautions against prematurely concluding that banks are not lending enough to small businesses as the sample period of the study includes the most recent recession.

835 We define business loans to include commercial and industrial loans and commercial real estate loans. *See* Federal Deposit Insurance Corporation, *Statistics on Banking*, *available at* http://www2.fdic.gov/SDI/SOB/.



Additionally, although covering the pre-recessionary period, a Federal Reserve Board staff study analyzing data from the 2003 Survey of Small Business Finance suggests that 60 percent of small businesses have outstanding credit in the form of a credit line, a loan or a capital lease.[836] These loans were borrowed from two types of financial institutions – depositary and non-depositary institutions (*e.g.*, finance companies, factors or leasing companies).[837] Lines of credit were the most widely used type of credit.[838] Other types of loans included mortgage loans, equipment loans and motor vehicle loans.[839]

Various loan guarantee programs of the Small Business Administration ("SBA") make credit more accessible to small businesses by either lowering the interest rate of the loan or

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836 *See* Federal Reserve Board, *Financial Services Used by Small Businesses: Evidence from the 2003 Survey of Small Business Finances* (October 2006), *available at* http://www.federalreserve.gov/pubs/bulletin/2006/smallbusiness/smallbusiness.pdf ("2003 Survey").

837 *See* Rebel Cole, *What Do We Know About the Capital Structure of Privately Held Firms? Evidence from the Surveys of Small Business Finance* (Working Paper) (Feb. 2013), *available at* http://onlinelibrary.wiley.com/doi/10.1111/fima.12015/pdf.

838 *See* 2003 Survey, note 836 (estimating that 34% of small businesses use lines of credit).

839 *Id.*

enabling a market-based loan that a lender would not otherwise be willing to provide, absent a guarantee.[840] Although the SBA does not itself act as a lender, the agency guarantees a portion of loans made and administered by commercial lending institutions. SBA loan programs include 7(a) loans,[841] CDC/504 loans[842] and Microloans.[843] For example, in fiscal year 2011, the SBA approved approximately $30.5 billion in 7(a) and CDC/504 loans, which were distributed to approximately 54,500 small businesses.[844] The SBA, however, currently accounts for a small part of the overall small business lending in the United States, administering less than 2 percent of all small business loans.[845]

Many startups and small businesses may find loan requirements imposed by financial institutions difficult to meet and may not be able to rely on these institutions to secure funding. For example, financial institutions generally require a borrower to provide collateral and/or a

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840 Numerous states also offer a variety of small business financing programs, such as Capital Access Programs, collateral support programs and loan guarantee programs. These programs are eligible for support under the State Small Business Credit Initiative, *available at* http://www.treasury.gov/resource-center/sb-programs/Pages/ssbci.aspx.

841 15 U.S.C. 631 *et seq*. The 7(a) loans provide small businesses with financing guarantees for a variety of general business purposes through participating lending institutions.

842 15 U.S.C. 695 *et seq*. The CDC/504 loans are made available through "certified development companies" or "CDCs", typically structured with the SBA providing 40% of the total project costs, a participating lender covering up to 50% of the total project costs and the borrower contributing 10% of the project costs.

843 15 U.S.C. 631 *et seq*. The Microloan program provides small, short-term loans to small businesses and certain types of not-for-profit childcare centers. The maximum loan amount is $50,000, but the average microloan is about $13,000. *See Microloan Program,* U.S. Small Business Administration, *available at* http://www.sba.gov/content/microloan-program.

844 *See* U.S. Small Business Administration, *FY 2013 Congressional Budget Justification And FY 2011 Annual Performance Report* ("*2011 Annual Performance Report*"), *available at* http://www.sba.gov/sites/default/files/files/1-508%20Compliant%20FY%202013%20CBJ%20FY%202011%20APR%281%29.pdf.

845 One article notes that as of September 2012, the SBA managed 318,396 ($79 billion) loans, while there were 17,249,884 ($646 billion) small-business loans on the books of banks insured by the FDIC. By this measure, the SBA managed 1.85% (12.23% in dollar volume) of all small-business loans. *See* Ami Kassar, *Putting the S.B.A. Into Perspective*, N.Y. TIMES, Sept. 14, 2012, *available at* http://boss.blogs.nytimes.com/2012/09/14/putting-the-s-b-a-into-perspective/. The SBA recently proposed rule amendments to increase eligibility for loans under the SBA's business loan programs. *See* SBA 504 and 7(a) Regulatory Enhancements, 13 CFR 120 (proposed Feb. 25, 2013).

guarantee,[846] which startups, small businesses and their owners may not be able to provide. Collateral may be required even for loans guaranteed by the SBA.

Another source of debt financing for startups and small businesses is peer-to-peer lending, which, according to one study, began developing in 2005.[847] Peer-to-peer lending websites facilitate debt transactions by directly connecting borrowers and lenders over the Internet. While data on the size of the overall industry is sparse, peer-to-peer lending was estimated to have reached approximately $647 million in 2009 and was expected to grow to $5.8 billion by 2010.[848] Although this source of funding is small relative to the role of financial institutions, peer-to-peer lending sites may offer small businesses more flexibility with regard to pricing, terms of credit, repayment schedules and other conditions. Moreover, peer-to-peer lending sites may not require borrowers to post collateral or a guarantee, and some market participants offer a secondary market for loans originated on their own sites.[849] At least one of the existing peer-to-peer platforms sells third-party issued securities to multiple individual investors, thus improving the liquidity of these securities.[850] Like any traditional lending arrangement, however, borrowers on peer-to-peer lending sites are required to make fixed regular payments to their lenders, which might make it a less attractive option for small

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846 Approximately 92% of all small business debt to financial institutions is secured, and about 52% of that debt is guaranteed, primarily by the owners of the firm. *See* Berger, note 832.

847 *See* Ian Galloway, *Peer-to-Peer Lending and Community Development Finance*, Federal Reserve Bank of San Francisco (Working Paper) (2009), *available at* http://www.frbsf.org/publications/community/wpapers/2009/wp2009-06.pdf.

848 *Id.*

849 *Id.*

850 *Id.* We note that under current law, this activity would require broker-dealer registration.

businesses with negative cash flows and short operating histories, both of which may make it more difficult for such businesses to demonstrate their ability to repay loans.

Microfinance also is another source of debt financing for startups and small businesses. Microfinance consists of small, working capital loans provided by microfinance institutions ("MFIs") that are invested in microenterprises or income-generating activities.[851] The typical users of microfinance services and, in particular, of microcredits are family-owned enterprises or self-employed, low-income entrepreneurs, such as street vendors, farmers, service providers, artisans and small producers, who live close to the poverty line in both urban and rural areas.[852]

The microfinance market has evolved and grown considerably in the past decades. While data on the size of the overall industry is sparse, in 2008, it was estimated that there were between 7,000 and 10,000 MFIs globally that supplied an estimated $15 to $25 billion in loans.[853] In the U.S., there were about 362 MFIs who disbursed 9,100 loans for a total value of $100 million.[854] On average, U.S. microloans are relatively larger with lower interest rates than those of microloans in developing countries. One distinctive characteristic of the U.S. model of microfinance is that MFIs provide borrowers not only with funds, but also with educational services to build entrepreneurial and leadership skills.[855]

c. Venture Capitalists and Angel Investors

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851 *See* Craig Churchill and Cheryl Frankiewicz, *Making Microfinance Work: Managing for Improved Performance*, Geneva International Labor Organization (2006).

852 *See* Joanna Ledgerwood, *Microfinance Handbook: An Institutional and Financial Perspective*, Washington DC, World Bank Publications (1999).

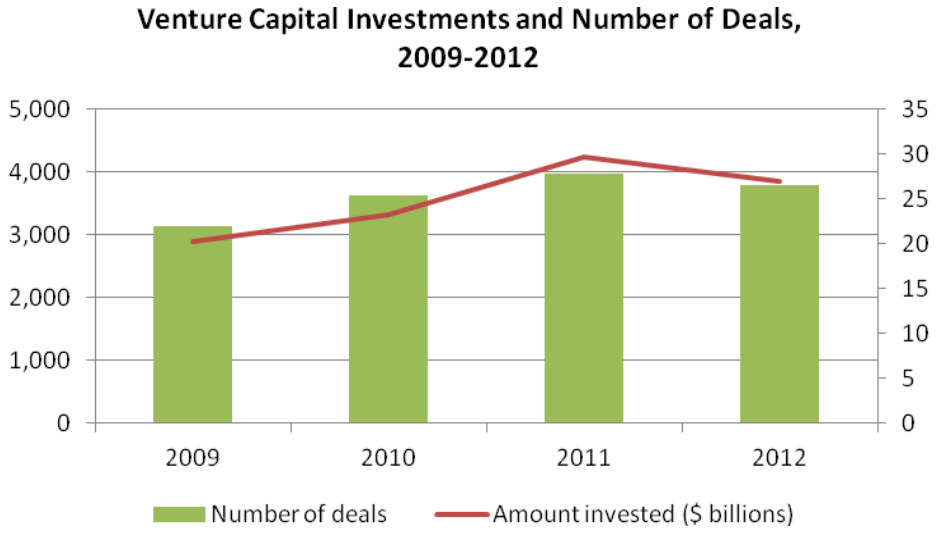
853 *See* Sam Daley-Harris, *State of Microcredit Summit Campaign Report 2009*, Washington DC, Microcredit Summit Campaign (2009).

854 *See* FIELD at the Aspen Institute, *Key Data on the Scale of Microlending in the U.S.* (February 2011).

855 *Id.* at 4 and 13.

Startups and small businesses also may seek funding from venture capitalists ("VCs") and angel investors. Entrepreneurs seek VC and angel financing usually after they have exhausted other sources of capital that generally do not require the entrepreneurs to relinquish control rights (for example, personal funds and funds from family and friends, if available).

As the chart below shows, according to data from the National Venture Capital Association, in 2012, VCs invested approximately $27 billion in approximately 3,800 deals that included seed, early-stage, expansion, and late-stage companies.[856]



Some startups, however, may struggle to attract funding from VCs because VCs tend to invest in startups with certain characteristics. A defining feature of VCs is that they tend to focus exclusively on startup companies with high-growth potential and a high likelihood of going public after a few years of financing. VCs also tend to invest in companies that have already used some other sources of financing, tend to be concentrated in certain geographic regions (*e.g.*,

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856 *See* National Venture Capital Association, *Recent Stats & Studies*, *available at* http://www.nvca.org/index.php?option=com_content&view=article&id=344&Itemid=103.

California and Massachusetts) and often require their investments to have an attractive business plan, meet certain growth benchmarks or fill a specific portfolio or industry niche.[857] In addition, when investing in companies, VCs tend to acquire significant control rights (*e.g.*, board seats, rights of first refusal, etc.), which they gradually relinquish as the company approaches an initial public offering.[858]

According to a trade association, the Angel Capital Association, in 2006, the 5,632 accredited angel investors in its member groups made 947 investments in 512 companies, providing startups with a total of $228.8 million.[859] A study suggests that angel investors tend to invest in younger companies than VCs.[860] We do not have more detailed data on the amount of angel investments in more recent years.

d. Current Crowdfunding Practices

Currently in the United States, crowdfunding activity generally is lending-based, "reward-based" or "donation-based," as defined by a recent crowdfunding industry report.[861] The report defines reward-based crowdfunding as a model where funders receive a "reward," such as a token or a manufactured product sample, and it defines donation-based crowdfunding as a model where funders donate to causes that they want to support, with no expected

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857 *See* Gompers, note 830.

858 *See* Steven N. Kaplan and Per Stromberg, *Financial Contracting Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 REV. ECON. STUD. 281-316 (2003).

859 *See* Scott Shane, *The Importance of Angel Investing in Financing the Growth of Entrepreneurial Ventures*, 2 Q. J. OF FIN. (2012).

860 *See* Gompers, note 830.

861 *See* Massolution, *Crowdfunding Industry Report: Market Trends, Composition and Crowdfunding Platforms* (Abridged) (May 2012), *available at* http://www.crowdsourcing.org/document/crowdfunding-industry-report-abridged-version-market-trends-composition-and-crowdfunding-platforms/14277 ("Massolution"). Lending-based crowdfunding includes peer-to-peer lending, a funding source that is discussed above. *Id.*

compensation or return on their investment. Many of the current domestic crowdfunding offerings relate to individual projects and may not have a defined or sustained business model commensurate with typical issuers of securities. The industry report finds that more than half of all projects on one of the largest domestic crowdfunding sites during the period 2009 through 2011 involved film and musical endeavors.[862]

According to the industry report, approximately $1.5 billion in financing was raised through crowdfunding platforms during 2011, with over half of that amount raised in the United States, although only approximately $174 million was attributable to "equity-based" (or the equity model of crowdfunding) and "reward-based" crowdfunding.[863] The industry report further states that equity-based crowdfunding is the fastest-growing of all the crowdfunding categories, at a 114% compound annual growth rate ("CAGR") in 2011.[864] According to the report, the rapid growth in equity-based crowdfunding has been driven largely by European platforms.[865]

According to the industry report, most current crowdfunding projects solicit low levels of funding, with the average successful project receiving less than $10,000.[866] The industry report

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862 *Id.*

863 One observer stated that most of the $1.5 billion in financing cited in the Massolution industry report was attributable to "donation-based" and "lending-based" crowdfunding. *See* Felix Salmon, *Annals of Dubious Statistics, Crowdfunding Edition*, REUTERS (July 27, 2012), *available at* http://blogs.reuters.com/felix-salmon/2012/07/27/annals-of-dubious-statistics-crowdfunding-edition. Another observer reported that Massolution CEO Carl Esposti clarified that the amount directly attributed to reward-based and equity-based crowdfunding is $174 million. *See* Liz Gannes, *Widely Cited Crowdfunding Market Estimates Are Probably Too Optimistic*, ALLTHINGSD (July 28, 2012), *available at* http://allthingsd.com/20120728/crowdfunding-market-nearly-10-times-smaller-than-widely-cited-estimate.

864 *See* Massolution, note 861 at 17. By comparison, "reward-based" crowdfunding had a 79% CAGR in 2011, while "lending-based" crowdfunding and "donation-based" crowdfunding had CAGRs of 50% and 41%, respectively.

865 *Id.*

866 *Id.* at 20-21.

also states that, in 2011, equity-based offerings were, on average, much larger than donation-based offerings, with 68% of total funds raised on equity-based crowdfunding platforms drawing $50,000 or more in financing, suggesting that the types of ventures financed through equity-based crowdfunding could be different than those financed through other crowdfunding methods.[867] Because the prohibition on general solicitation and general advertising (which was recently lifted for offerings made in reliance on Rule 506(c) of Regulation D[868]) would have made equity-based crowdfunding difficult in the United States, we assume that the data for equity-based crowdfunding comes from offerings outside the United States.

We are unaware of any domestic issuers and investors that are currently participating in securities-based crowdfunding offerings on Internet-based crowdfunding platforms that are operating outside of the United States (other than offerings made in reliance on Rule 506(c) of Regulation D), although we recognize that these platforms may represent an additional source of funding for startups and small businesses.

3. Survival Rates for Startups and Small Businesses

Startups and small businesses that lack tangible assets or business experience needed to obtain conventional financing might turn to securities-based crowdfunding in reliance on Section 4(a)(6) as an attractive potential source of financing. There is broad evidence that many of these potential issuers are likely to fail after receiving funding. For example, a 2010 study reports that of a random sample of 4,022 new high-technology businesses started in 2004, only 68% survived

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867 *Id.* at 20-21.

868 *See General Solicitation Adopting Release*, note 12.

by the end of 2008.[869] Other studies also have documented high failure rates for small newly listed companies. For example, the ten-year delist rate for newly listed firms during the period 1981-1991 is 44.1%, compared to 16.9% for newly listed firms in the 1970s.[870]

Similarly, other studies suggest that startups and small businesses financed by venture capitalists also tend to have high failure rates. One study finds that for 16,315 VC-backed companies that received their first institutional funding round between 1980 and 1999, approximately one-third failed after the first funding round.[871] Additionally a recent study of more than 2,000 companies that received at least $1 million in venture funding, from 2004 through 2010, finds that almost three-quarters of these companies failed.[872] These failure rates are high, despite the involvement of sophisticated investors like VCs that are likely better equipped than the average retail investor to deal with uncertainty and risk associated with investments in startups and that generally specialize in selecting firms with good prospects, have direct access to management, have board representation and have at least some degree of control over operating decisions.

Because we expect that issuers that would engage in offerings made in reliance on Section 4(a)(6) would potentially be in an earlier stage of business development than the

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869 *See* Alicia Robb, E.J. Reedy, Janice Ballou, David DesRoches, Frank Potter and Zhanyun Zhao, *An Overview of the Kauffman Firm Survey: Results from the 2004-2008 Data*, Kauffman Foundation ("Kauffman Firm Survey"), *available at* http://www.kauffman.org/uploadedFiles/kfs_2010_report.pdf.

870 *See* Eugene F. Fama and Kenneth R. French, *New Lists: Fundamentals and Survival Rates*, 73 J. OF FIN. ECON. 229-269 (2004).

871 *See* Yael V. Hochberg, Alexander Ljungqvist and Yang Lu, *Whom You Know Matters: Venture Capital Networks and Investment Performance*, 62 J. OF FIN. 251-301 (2007).

872 *See* Deborah Gage, *The Venture Capital Secret: 3 Out of 4 Start-Ups Fail*, WALL ST. J., Sept. 19, 2012.

businesses included in the above studies, we believe that issuers that engage in securities-based crowdfunding may have higher failure rates than those in the studies cited above.[873]

4. Market Participants

The proposed rules will have their most significant impact on the market for the financing of startups and small businesses. The number of participants in this market and the amounts raised through alternative sources indicate that this is a large market. In 2011, there were almost 5 million small businesses, defined by the U.S. Census Bureau as having fewer than 500 paid employees.[874] In the same year, FDIC-insured depositary institutions held approximately $626 billion in small business loans,[875] and VCs contributed an additional $30 billion of capital to startups and small businesses.[876]

We analyze the economic effect of the proposed rules on the following parties: (1) issuers, typically startups and small businesses seeking to raise capital by issuing securities; (2) intermediaries, through which issuers seeking to engage in transactions in reliance on Section 4(a)(6) will offer and sell their securities; (3) investors who purchase or may consider purchasing securities in such offerings; and (4) other capital providers, broker-dealers and finders who currently participate in private offerings. The potential economic impact of the proposed rules will depend on how these market participants respond to the proposed rules. Each party is discussed in further detail below.

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873 *See* Rajshree Agarwal and Michael Gort, *Firm and Product Life Cycles and Firm Survival*, 92 AM. ECON. REV. 184−190 (2002) ("Agarwal").

874 *See* U.S. Department of Commerce, United States Census Bureau, *Business Dynamics Statistics, Data: Firm Characteristics* (2011), *available at* http://www.census.gov/ces/dataproducts/bds/data_firm.html.

875 Small business loans are defined as loans secured by nonfarm nonresidential properties and commercial and business loans of $1,000,000 or less. *See* Federal Deposit Insurance Corporation, note 835.

876 *See* National Venture Capital Association, *Recent Stats & Studies*, *available at* http://www.nvca.org/index.php?option=com_content&view=article&id=344&Itemid=103.

a. Issuers

The proposed rules would permit certain entities to raise capital by issuing securities for the first time. The number, type and size of the potential issuers that would seek to use crowdfunding to offer and sell securities in reliance on Section 4(a)(6) is uncertain, but data regarding current market practices may help identify the number and characteristics of potential issuers.

Although it is not possible to predict the number of future securities offerings that might rely on Section 4(a)(6), particularly because rules governing the process are not yet in place, we estimate that the number could be in the thousands per year. We base this estimate on the current number of businesses pursuing similar levels of financing through alternate capital raising methods: small business loans, reward-based and donation-based crowdfunding and Regulation D offerings. According to the SBA's fiscal year 2011 annual performance report, 54,500 small businesses received funding in 2011 through SBA's main lending programs, 7(a) and 504 loans.[877] A crowdfunding industry report estimates that there were 430,920 donation-based or reward-based campaigns in the U.S., which we estimate were conducted by 181,440 unique issuers.[878] Finally, a large number of Regulation D offerings are within the offer limits established for crowdfunding under Section 4(a)(6). According to filings made with the Commission, from 2009 to 2012, there were 25,274 new Regulation D offerings with offer sizes

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877 *See 2011 Annual Performance Report*, note 844.

878 The estimated number of campaigns is based on 532,000 successful fundraising campaigns in North America, 90% of which were in the U.S. and most of which (90%) were either rewards-based or donation-based. According to the industry report, 69% of issuers engaged in one to two campaigns, 26% in three to five campaigns and 5% in more than five campaigns. To estimate the number of unique issuers, we used the midpoint from the first two groupings and assumed that issuers in the third grouping engage in six campaigns. The number of unique issuers is thus estimated as follows: (90% × 90% × 532,000) / ((69% × 1.5) + (26% × 4) + (5% × 6)) = 181,440. *See* Massolution, note 861.

of $1 million or less. These offerings involved 19,652 unique issuers. When excluding hedge funds and investment companies, entities that generally would not be eligible to raise capital in reliance on the exemption in Section 4(a)(6),[879] the number of unique issuers was 15,616. Among these issuers, 24% reported no revenue, while approximately 20% had revenues of less than $1 million.[880] Approximately 92% of these issuers were organized as either a corporation or a limited liability company.

It is expected that many future issuers of securities in crowdfunding offerings would have otherwise raised capital from one of these alternative sources of financing, while others would have been financed by friends and family or not financed at all. Hence, while the total number of businesses using these alternative funding sources provides a basis for the potential number of issuers offering and selling securities in reliance on Section 4(a)(6) in the future, we cannot know how many of these businesses would elect securities-based crowdfunding in reliance on Section 4(a)(6) once it becomes available, nor can we know how many future businesses may not be financed at all. Further, SBA loan programs and other government contracting programs classify "small businesses" as those with fewer than 500 employees,[881] and we expect that some of these businesses might be too large for crowdfunding in reliance on Section 4(a)(6) to be an effective capital-raising option. Separately, many of the current rewards-based or donations-based crowdfunding projects likely entail applications that may not be suitable to a long-lived security

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879 *See* discussion in Section II.A.3 above.

880 These percentages could be higher because almost 45% of the Regulation D issuers declined to disclose their size.

881 *See, e.g.*, 13 CFR 121.406(b) (a non-manufacturing business may qualify as a small business concern under Small Business Administration regulations, in part, if it does not exceed 500 employees); 7 CFR 3403.2 (defining small business concern under U.S. Department of Agriculture regulations, in part, as a concern that has not more than 500 employees).

issuance (*e.g.*, certain artistic endeavors or artistic projects). Nevertheless, these data show that the potential number of businesses that might seek to offer and sell securities in reliance on Section 4(a)(6) is large, particularly when compared to the current number of Exchange Act reporting issuers, which is less than 10,000.[882]

We believe that many potential issuers of securities through crowdfunding would be startups and small businesses that are close to the "idea" stage of the business venture and that have business plans that are not sufficiently well-developed or do not offer the profit potential or business model to attract VCs or angel investors that otherwise specialize in investing in high risk ventures. In this regard, a study of one large platform revealed that relatively few companies on that platform operate in technology sectors that typically attract VC investment activity.[883]

b. Crowdfunding Intermediaries

Section 4(a)(6)(C) requires that an offer and sale of securities in reliance on Section 4(a)(6) be conducted through a registered funding portal or a broker. Registered brokers, both those that are already registered with the Commission and those that would register, might wish to facilitate securities-based crowdfunding transactions. New entrants that do not wish to register as brokers might decide to register as funding portals to facilitate securities-based crowdfunding transactions in reliance on Section 4(a)(6). Donation-based or reward-based crowdfunding platforms with established customer relations might seek to leverage these relations and register as funding portals, or register as or associate with registered broker-dealers.

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882 In fiscal year 2012, there were approximately 9,140 reporting companies. U.S. Securities and Exchange Commission, *FY 2014 Congressional Budget Justification, 2014 Annual Performance Plan, FY 2012 Annual Performance Report*, at 80, *available at* http://www.sec.gov/about/reports/secfy14congbudgjust.pdf.

883 *See* Ethan R. Mollick, *The Dynamics of Crowdfunding: An Exploratory Study* (Working Paper) (June 26, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2088298.

Although the number of potential intermediaries that would fill these roles is uncertain, practices of existing brokers and crowdfunding platforms provide insight into how the market might develop.

As of December 2012, there were 4,450 broker-dealers registered with the Commission, with average total assets of approximately $1.1 billion per broker-dealer. The aggregate total assets of these registered broker-dealers are approximately $4.9 trillion. Of these registered broker-dealers, 410 also are dually registered as investment advisers.

Existing crowdfunding platforms are diverse and actively involved in financing, allowing thousands of projects to search for capital. A recent industry survey of crowdfunding platforms reports that 191 platforms were estimated to be operating in the U.S. as of 2012.[884] Additionally, based on 135 participants in the survey worldwide (including the U.S.), 15% of platforms were engaged in equity-based crowdfunding, 11% in lending-based crowdfunding, 27% in donation-based crowdfunding and 47% in reward-based crowdfunding.[885] Moreover, the industry survey stated that current crowdfunding portals typically charge entrepreneurs a listing fee that is based on how large the target amount is and/or upon reaching the target. According to the survey, fees from survey participants worldwide ranged from 2% to 25%, with an average of 7% in North America and Europe.[886]

We do not know at present which market participants would become intermediaries under Section 4(a)(6) after final rules are adopted, but we believe that existing crowdfunding platforms might seek to leverage their already-existing Internet-based platforms, brand recognition and

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884 *See* Massolution, note 861 at 16.

885 *Id.* at 17.

886 *Id.* at 23.

user bases to facilitate offerings in reliance on Section 4(a)(6).[887] Industry participants have suggested that they expect three to four of the crowdfunding platforms that currently have the majority of market share in rewards-based and donation-based crowdfunding to obtain the majority of market share in the newly-developed securities-based crowdfunding market that relies on Section 4(a)(6).[888]

Under the statute and the proposed rules, funding portals are constrained in the services they could provide, and persons (or entities) seeking the ability to participate in activities unavailable to funding portals, such as offering investment advice or holding, managing, possessing or otherwise handling investor funds, would instead need to register as brokers or investment advisers, depending on their activities. Although we believe, based on conversation with industry participants, that initially, upon adoption of the final rules, more new registrants would register as funding portals than as broker-dealers, our conversations with industry participants[889] indicate that market competition to offer broker-dealer services as part of intermediaries' service capabilities might either drive more broker-dealer growth in the longer term or provide registered funding portals with the incentive to form long-term partnerships with registered broker-dealers. For example, crowdfunding platforms could have incentives to partner with broker-dealers because of broker-dealers' experience in providing recommendations or investment advice, as well as broker-dealers' access to investors.[890] There is anecdotal evidence

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887 For example, a recent crowdfunding industry report suggests that funding portal reputation is important in the crowdfunding market, especially for equity-based crowdfunding. *See id.*

888 For information on Commission staff discussions with industry participants, *see Meetings with SEC Officials*, *available at* http://www.sec.gov/comments/jobs-title-iii/jobs-title-iii.shtml#meetings.

889 *Id.*

890 *See* Mohana Ravindranath, *Crowdfunding platform ships product samples to potential investors*, WASH. POST, Nov. 29, 2012.

that these partnerships are already forming under existing regulations, and one report predicted that in the first quarter of 2013, two to three dozen crowdfunding portals would partner with broker-dealers to start conducting private offerings under Regulation D in anticipation of securities-based crowdfunding.[891]

c. Investors

It is unclear what types of investors would participate in offerings made in reliance on Section 4(a)(6), but based on the profile of investors in the current domestic reward-based and donation-based crowdfunding market, we believe that many investors affected by the proposed rules would likely be individual retail investors who currently do not have broad access to investment opportunities in early-stage ventures, either because they do not have the necessary accreditation or sophistication to invest in most private offerings or because they do not have sufficient funds to participate as angel investors. Offerings made in reliance on Section 4(a)(6) might provide retail investors with additional investment opportunities, although the extent to which they invest in such offerings would likely depend on their view of the potential return on investment as well as the risk for fraud.

In contrast, larger, more sophisticated or well-funded investors may be less likely to invest in offerings made in reliance on Section 4(a)(6). The relatively low investment limits set by the statute for crowdfunding investors might make these offerings less attractive for professional investors, including VCs and angel investors.[892] While an offering made in reliance

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891 *See* David Drake, *Rich Man's Crowd Funding*, FORBES, Jan. 15, 2013. *See also* Mohana Ravindranath, *Quickly adapting to crowdfunding laws*, WASH. POST, Sept. 7, 2012; J.J. Colao, *In the Crowdfunding Gold Rush, This Company Has a Rare Edge*, FORBES, June 5, 2013.

892 An observer suggests that, unlike angels, VCs may be less interested in crowdfunding because, if VCs rely on crowdfunding sites for their deal flow, it would be difficult to justify charging a 2% management fee

on Section 4(a)(6) could bring an issuer to the attention of these investors, it is possible that professional investors would prefer, instead, to invest in a Rule 506 offering, which is not subject to the investment limitations applicable to offerings made in reliance on Section 4(a)(6).

d. Other Capital Providers, Broker-Dealers and Finders in Private Offerings

The proposed rules might affect the capital providers that currently finance small private businesses: small business lenders, VCs, family and friends and angel investors. The current scope of fundraising done by these capital providers is discussed above. As discussed below, the magnitude of the impact would depend on whether crowdfunding in reliance on Section 4(a)(6) emerges as a substitute or a complement to these financing sources.

In addition, issuers conducting private offerings might currently use broker-dealers to help them with various aspects of the offering and to help ensure compliance with the ban on general solicitation and advertising that exists for most private offerings. Private offerings also could involve finders who connect issuers with potential investors for a fee.[893] These private offering intermediaries also may be affected by the proposed rules because once these rules come into effect, issuers might no longer need the services of those broker-dealers and finders. Although we are unable to predict the exact size of the market for broker-dealers and finders in private offerings that are comparable to those that the proposed rules would permit,[894] data on the use of broker-dealers and finders in the Regulation D markets suggest that they may not

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and 20% carried interest to their limited partners. *See* Ryan Caldbeck, *Crowdfunding – Why Angels, Venture Capitalists And Private Equity Investors All May Benefit*, FORBES, Aug. 7, 2013.

893 Depending on their activities, these persons may need to be registered as broker-dealers.

894 *See* The Task Force on Private Placement Broker-Dealers, ABA Section of Business Law, *Report and Recommendations of the Task Force on Private Placement Broker-Dealers,* 60 BUS. LAW. 959, 969-70 (2005) ("Task Force on Private Placement Broker-Dealers").

currently play a large role in private offerings. Only 13% of all new Regulation D offerings from 2009 to 2012 used an intermediary such as a broker-dealer or a finder.[895] Approximately 11% of new offerings reported sales commissions greater than zero, while approximately 3% reported finder fees greater than zero. The use of a broker-dealer or a finder increased with offering size; they participated in 13% of offerings for up to $1 million and 18% of offerings for more than $50 million. Moreover, broker-dealer commissions and finder fees tend to decrease with offering size. Unlike the gross spreads in registered offerings, the differences in commissions for Regulation D offerings of different sizes are large: the average commission paid by issuers conducting offerings of up to $1 million (6.5%) is almost three times larger than the average commission paid by issuers conducting offerings of more than $50 million (1.9%). Similarly, the average finder's fee for offerings of up to $1 million is approximately 6.1%, compared to 1.4% for offerings of more than $50 million. We base these estimates, however, only on the Regulation D market. It is possible that issuers engaging in other types of private offerings (*e.g.*, those relying on Section 4(a)(2)), for which we do not have data, might use broker-dealers and finders more frequently and have different fee structures.

B. Analysis of Proposed Rules

As noted above, we are sensitive to the costs and benefits of the proposed rules, as well as the impact that the proposed rules would have on efficiency, competition and capital formation. In enacting Title III, Congress established a framework for a new type of exempt offering and required us to adopt rules to implement that framework. To the extent that crowdfunding rules are successfully utilized, the crowdfunding provisions of the JOBS Act

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[895] *See Ivanov/Bauguess Study*, note 816.

should provide startups and small businesses with the means to raise relatively modest amounts of capital, from a broad cross section of potential investors, through securities offerings that are exempt from registration under the Securities Act. They also should permit small investors to participate in a wider range of securities offerings than may be available currently.[896] Specifically, the statutory provisions and the proposed rules address several challenges specific to financing startups and small businesses, including, for example, accessing a large number of potential investors, the regulatory requirements associated with issuing a security, protecting investors and making such securities offerings cost-effective for the issuer.

In the sections below, we analyze the costs and benefits associated with the proposed crowdfunding regulatory regime, as well as the potential impacts of such a regulatory regime on efficiency, competition and capital formation, in light of the background discussed above.

1. Broad Economic Considerations

In this release, we discuss costs and benefits that are related to the proposed rules. Many of these costs and benefits are difficult to quantify or estimate with any degree of certainty, especially considering that Section 4(a)(6) provides a new method for raising capital in the United States. Some costs are difficult to quantify or estimate because they represent transfers between various market participants. For instance, costs to issuers could be passed on to investors and costs to intermediaries could be passed on to issuers and investors. These difficulties in estimating and quantifying are exacerbated by the limited public data that indicates how issuers, intermediaries and investors would respond to these new investment opportunities.

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[896] *See, e.g.*, 158 CONG. REC. S1781 (daily ed. Mar. 19, 2012) (statement of Sen. Carl Levin) ("Right now, the rules generally prohibit a company from raising very small amounts from ordinary investors without significant costs.").

The discussion below highlights several general areas where uncertainties regarding the new crowdfunding market might affect the potential costs and benefits of the proposed rules. It also highlights the potential effects on efficiency, competition and capital formation, as well as our ability to quantify relevant benefits and costs. In light of these uncertainties, we encourage commenters to provide data and analysis to help further quantify or estimate the potential benefits and costs of these proposed rules.

The extent to which the statute and the proposed rules would affect capital formation and the cost of capital to issuers depends in part on the issuers that choose to participate. In particular, if the offering exemption under Section 4(a)(6) only attracts issuers that are otherwise able to raise capital through alternative venues (*e.g.*, offerings relying on an exception from registration under Securities Act Section 3(a)(11), Securities Act Section 4(a)(2), Regulation A or Regulation D), the statute and the proposed rules could result in a redistribution of capital flow, which would enhance allocative efficiency but have a limited impact on the aggregate level of capital formation.[897] In addition, the degree to which the proposed rules would affect capital formation depends on the implementation of other provisions of the JOBS Act that may alter existing options for small companies to raise capital. For example, Title II allows issuers relying on the exemption in Securities Act Rule 506(c) to use general solicitation and general advertising, while Title IV envisions a modified Regulation A offering exemption with a higher dollar limit.

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[897] For example, a recent GAO report on Regulation A offerings suggests that a significant decline in the use of this funding alternative after 1997 could be partially attributed to a shift in offerings to Rule 506 offerings under Regulation D, as a result of the preemption of state securities laws for Rule 506 offerings that occurred in 1996. *See* GAO Report, note 824.

Notwithstanding these alternatives, we believe that the Section 4(a)(6) offering exemption would likely represent a new source of capital for many issuers that currently have difficulty raising capital and that would continue to have difficulty raising capital when other JOBS Act provisions are implemented. Startups and small businesses usually have smaller and more variable cash flows than larger more established companies, and internal financing from their own business operations tends to be limited and unstable. Moreover, these businesses tend to have smaller asset bases[898] and, thus, less collateral for traditional bank loans. Startups and small businesses, which are widely viewed to have more financial constraints than publicly-traded companies and large private companies, could therefore benefit significantly from a securities-based crowdfunding market. We believe that the statute, as it would be implemented by the proposed rules, could increase both capital formation and the efficiency of capital allocation. The extent to which such issuers would use the Section 4(a)(6) offering exemption , however, is difficult to assess.

If startups and small businesses find alternative capital raising options more attractive than securities-based crowdfunding, the impact of Section 4(a)(6) on capital formation could be limited. Even so, the availability of securities-based crowdfunding as a financing option could increase competition among suppliers of capital, resulting in a potentially lower cost of capital for all issuers, including those that choose not to use securities-based crowdfunding.

For issuers that pursue offerings in reliance on Section 4(a)(6), establishing an initial price might be challenging. Although the statute requires certain issuer disclosures and the

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898 *See, e.g.*, John Asker, Joan Farre-Mensa and Alexander Ljungqvist, *Corporate Investment and Stock Market Listing: A Puzzle?* (European Corporate Governance Institute Finance Working Paper, June 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1603484.

proposed rules are intended to help investors evaluate the viability of the issuer and the initial offering, these disclosures may be insufficient for investors to determine an appropriate price since there would be no underwriter of the offering and the issuer may not otherwise be skilled in valuation. It is not clear, therefore, how an initial offering price would be reached for many of the securities offered, nor how investors would be protected against poor initial valuations.[899] These potential difficulties might limit investor participation in offerings made in reliance on Section 4(a)(6) and mitigate some of the associated benefits of capital formation.

Uncertainty surrounding exit strategies for investors in crowdfunding offerings also might limit the benefits. In particular, it is unlikely that purchasers in crowdfunding transactions would be able to follow the typical path to liquidity that investors in other exempt offerings follow. For instance, investors in a VC-backed startup might eventually sell their securities in an initial public offering on a national securities exchange or to another company in an acquisition.[900] We anticipate that most businesses engaging in offerings in reliance on Section 4(a)(6) are unlikely to progress directly to an initial public offering on a national securities exchange given their small size,[901] and investors might lack adequate strategies or opportunities

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899 There also is a chance that valuations that emerge are inaccurate. For example, there is vast literature documenting that, on average, IPOs are significantly underpriced relative to their initial prices on the secondary market. For a review of the theory and evidence of IPO underpricing, *see* Jay Ritter and Ivo Welch, *A Review of IPO Activity, Pricing, and Allocations*, 57 J. FIN. 1795-1828 (2002). *See also* Ivo Welch, *Sequential Sales, Learning, and Cascades*, 47 J. FIN. 695-732 (1992) (analyzing the risk of herding among investors when shares are sold sequentially).

900 *See* Gompers, note 830.

901 As noted, under the statute and the proposed rules, businesses relying on Section 4(a)(6) would be limited to raising an aggregate of $1 million during a 12-month period. By contrast, as noted in the IPO Task Force report, the size of an initial public offering generally exceeds $50 million. *See* IPO Task Force, note 818.

to eventually divest their holdings.[902] A sale of the business would require the issuer to have a track record in order to attract investors with the capital willing to buy the business. Moreover, the likely broad geographical dispersion of crowdfunding investors might make shareholder coordination difficult, although the electronic means may mitigate any difficulties. Even if an issuer could execute a sale or otherwise offer to buy back or retire the securities, it might be difficult for investors to determine whether the issuer was offering a fair market price. These uncertainties might limit the use of the Section 4(a)(6) exemption.

The potential benefits of the proposed rules also might depend on how investors respond to potential liquidity issues unique to the securities-based crowdfunding market. It is currently unclear how securities offered and sold in reliance on Section 4(a)(6) would be transferred in the secondary market after the one-year restricted period ends, and investors who purchased securities in reliance on Section 4(a)(6) and who seek to divest their securities would be unlikely to find a liquid market.[903] Shares might migrate to the over-the-counter market or to trading platforms that trade shares of private companies.[904] It is possible that secondary trading costs for investors might be substantial, effective and quoted spreads might be wide, and price volatility

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902 In contrast, given the required qualifications and capital amount limits, Regulation D offerings may generally attract issuers that are more knowledgeable and better capitalized. Moreover, such offerings are likely to have a larger proportion of accredited investors because, in contrast to securities-based crowdfunding, there are no limitations on individual investment amounts. As a result, we believe that Regulation D issuers and investors are more likely to have potential exit strategies in place.

903 Academic studies have shown that the over-the-counter market is less liquid than the national exchanges. *See* Christie, *Market Microstructure of the Pink Sheets*, 33 J. BANKING & FIN. 1,326-1,339 (2009); Andrew Ang, Assaf Shtauber and Paul Tetlock, *Asset Pricing in the Dark: The Cross Section of OTC Stocks*, REV. FIN. STUD. (forthcoming).

904 Given the services that funding portals are permitted to provide under the statute and the proposed rules, investors would not be able to use funding portals to trade in securities offered and sold in reliance on Section 4(a)(6) in a secondary market.

might be high compared to those of listed securities.[905] Illiquidity is a concern for other exempt offerings and small registered offerings. However, because investors purchasing securities in reliance on Section 4(a)(6) might be less sophisticated than investors in other private offerings due to the fact that there would be no investor qualification requirements, we expect that they would face additional challenges in addressing the impact of illiquidity, either in finding a suitable trading venue or negotiating with the issuer for an alternative retirement provision. The potentially high degree of illiquidity associated with securities purchased in reliance on Section 4(a)(6) might prevent investors from investing in businesses through such offerings, thus limiting potential capital formation.

Even with the mandated disclosures, unsophisticated investors purchasing securities issued in reliance on Section 4(a)(6) also may face certain expropriation risks, potentially limiting the upside of their investment, even when they select investments in successful ventures. This could occur if issuers issue securities with certain features (*e.g.*, callable securities or securities with differential control rights) or have insider-only financing rounds or financing rounds at reduced prices (the so-called "down rounds") that could have the effect of diluting an investor's interest or otherwise diminishing the value of the securities offered and sold in

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905 Academic studies show that reducing the information transparency about an issuer increases the effective and quoted spreads of its shares, reduces share price and increases price volatility. Specifically, percentage spreads triple and volatility doubles when NYSE issuers are delisted to the Pink Sheets. *See* Jonathan Macey, Maureen O'Hara and David Pompilio, *Down and Out in the Stock Market: The Law and Finance of the Delisting Process*, 51 J.L. & ECON 683-713 (2008). When NASDAQ issuers delist and subsequently trade on the OTC Bulletin Board and/or the Pink Sheets, share volume declines by two-thirds, quoted spreads more than double, effective spreads triple and volatility triples. *See* Jeffrey H. Harris, Venkatesh Panchapagesan and Ingrid M. Werner, *Off But Not Gone: A Study of NASDAQ Delistings*, Fisher College of Business Working Paper No. 2008-03-005 and Dice Center Working Paper No. 2008-6 (Mar. 4, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=628203. One factor that may alleviate transparency concerns is the fact that issuers that sold securities in an offering made in reliance on Section 4(a)(6) would have an ongoing reporting obligation, so disclosure of information about the issuer would continue to be required.

reliance on Section 4(a)(6). Investors purchasing securities issued in reliance on Section 4(a)(6) might not have the experience or the market power to negotiate various anti-dilution provisions, right of first refusal, tag-along rights, superior liquidation preferences and rights upon a change in control that have been developed by institutional and angel investors as protections against fundamental changes in a business.[906] If these or similar types of protections are absent, the expropriation risk could discourage some potential investors from participating in offerings made in reliance on Section 4(a)(6), potentially hindering efficiency, competition and capital formation.

The proposed rules also might have an effect on broker-dealers and finders participating in private offerings. Some issuers that previously relied on broker-dealers and finders to assist with raising capital through private offerings may, instead, begin to rely on the Section 4(a)(6) exemption to find potential investors. The precise impact of the proposed rules on these intermediaries would depend on whether (and, if so, to what extent) issuers switch from using existing exemptions to using the exemption provided by Section 4(a)(6) or whether the proposed rules primarily attract new issuers. If a significant number of issuers switch from raising capital under existing private offering exemptions to relying on the exemption provided by Section 4(a)(6), this likely would negatively affect the revenue of finders in the market for private offerings, while intermediaries under Section 4(a)(6) likely would gain from the potential losses in revenue that finders may face. This may disadvantage finders, but competition may ultimately lead to more efficient allocation of capital.

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[906] *See* Kaplan, note 858.

Using information from the Regulation D market allows us to quantify at least some of these potential losses. For example, from 2009 to 2012, the estimated cumulative dollar amount of finder fees charged for Regulation D offerings of up to $1 million was approximately $18 million, covering 437 offerings.[907] In a similar vein, from 2009 to 2012, the estimated cumulative dollar amount of commissions charged by broker-dealers for Regulation D offerings of up to $1 million was approximately $76.6 million, covering 1,480 offerings.[908] Thus, to the extent that issuers rely on Section 4(a)(6) to offer and sell securities in lieu of relying on Regulation D, the dollar amount of commissions and finder fees generated would be reduced, unless broker-dealers and finders provide new services that such issuers are willing to pay. For example, under the statute, broker-dealers would be able to operate portals. If securities-based crowdfunding primarily attracts new issuers to the market, the impact on broker-dealers and finder revenue could be negligible and the proposed rules may even have a positive effect on their revenues by revealing more potential clients for them. Additionally, greater investor interest in private company investment might increase capital formation, creating new opportunities for broker-dealers and finders that otherwise would have been unavailable.

Rules implementing Section 4(a)(6) also could encourage current participants in the securities-based crowdfunding market to diversify their funding models to attract a broader group of issuers and to provide additional investment opportunities for investors. For example, donation-based crowdfunding platforms that currently offer investment opportunities in micro-

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907 We use data from new Form D filings and include in the analysis only filings with an offer amount greater than zero. We also exclude indefinite offerings because, for those, we cannot determine the offer size.

908 Since we do not have data on broker-dealer and finder participation in other types of private offerings (*e.g.*, Section 4(a)(2) offerings), it is possible that the impact of crowdfunding in those offerings could be different than the impact on broker-dealers and finders in Regulation D offerings.

loans generally do not permit donors to collect interest on their investments because of concerns that this activity would implicate the federal securities laws unless an exemption from registration is available.[909] Under the proposed rules, these platforms might choose to permit businesses to offer securities that would provide investors with the opportunity to obtain a return on investment. This could broaden their user base and attract a group of investors different from those already participating in reward-based or donation-based crowdfunding. It is likely that some registered broker-dealers will find it profitable to enter the securities-based crowdfunding market and operate funding portals as well. Such an entry will increase the competition among intermediaries and likely lead to lower costs for issuers.

However, many projects that are well suited for reward-based or donation-based crowdfunding (*e.g.*, because they have finite lives, their payoffs to investors could come before the project is completed, they could be contingent on the project's success, etc.) may have little in common with startups and small businesses that are well suited for an offering in reliance on Section 4(a)(6). As a result, diversification among existing platforms might not always be optimal or preferred, particularly if complying with the proposed rules proves disproportionately costly compared to the amount of potential capital to be raised.

2. Crowdfunding Exemption

a. Limitation on Capital Raised

The statute imposes certain limitations on the total amount of securities that may be sold by an issuer during the 12-month period preceding the date of the transaction made in reliance on

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[909] *See, e.g.*, *Deutsche Bank Microcredit Development Fund, Inc.*, SEC No-Action Letter (Apr. 8, 2012).

Section 4(a)(6). Specifically, Section 4(a)(6)(A) provides for a maximum aggregate amount of $1 million sold in reliance on the exemption during the 12-month period.[910]

The limitation on the amount that may be raised could benefit investors by reducing the potential for dilution or fraud. However, we recognize that the cap on the maximum amount that may be sold in reliance on Section 4(a)(6) also could prevent certain issuers from raising all the capital they need to make their businesses viable, which in turn could result in lost opportunities. It also is likely to reduce efficiency to the extent that resources cannot be channeled to productive use. Due to the lack of data, however, we are not able to quantify the size of the efficiency loss. We are proposing, however, to allow issuers to conduct other exempt offerings that would not necessarily be integrated with the offering made in reliance on Section 4(a)(6), as long as the issuer satisfies the requirements of the exemption relied upon for the particular offering. We could have selected an alternative that would have aggregated the amounts offered in reliance on Section 4(a)(6) with the amounts offered pursuant to other exempt offerings. Under such an alternative, the amounts raised in other exempt offerings would count toward the maximum offering amount under Section 4(a)(6). Compared to this alternative, the ability of issuers to conduct other exempt offerings that would not count toward the maximum offering amount under Section 4(a)(6) might alleviate some of the concerns that certain issuers would not be able to raise sufficient capital.

b. Investment Limitations

The statute and the proposed rules also impose certain limitations on the aggregate dollar amount of securities that may be sold to any investor in reliance on Section 4(a)(6) during the

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[910] *See also* proposed Rule 100(a)(1) of Regulation Crowdfunding.

preceding 12 months.[911] These provisions would cap the potential investment and, consequently, the potential losses for any single investor. Offerings made in reliance on Section 4(a)(6) would not be subject to review by Commission staff prior to the sale of securities, but the aggregate investment limits would provide some measure of protection for investors.

We recognize that the investment caps would limit the potential upside for investors. This might particularly affect the decisions of those with large portfolios who might be able to absorb losses and understand the risks associated with risky investments. For these investors, the $100,000 aggregate cap might limit their incentive to participate in the securities-based crowdfunding market, compared to other types of investments, potentially depriving the securities-based crowdfunding market of more experienced and knowledgeable investors and possibly impeding capital formation. Limiting the participation of such investors would be likely to negatively affect the informational efficiency of the securities-based crowdfunding market because sophisticated investors are better able to accurately price such offerings. These investors also could add value to the discussions taking place through an intermediary's communication channels about a potential offering by providing their views on financial viability.

The aggregate cap on investments also could limit the ability of investors to diversify within the securities-based crowdfunding market. As securities-based crowdfunding investments might have inherently high failure rates,[912] investors who do not diversify their investments across a number of offerings could face an increased risk of incurring large losses, relative to their investments, even when they investigate offerings thoroughly. By comparison, VC firms typically construct highly diversified portfolios with the understanding that many ventures fail,

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911 *See* Section 4(a)(6)(B). *See also* proposed Rule 100(a)(2) of Regulation Crowdfunding.

912 *See* discussion in Section III.A.3 above.

resulting in a complete loss of some investments, but with the expectation that those losses will be offset by the large upside of the relatively fewer investments that succeed.[913] The securities-based crowdfunding market is expected to involve earlier-stage financing compared to venture capital financing, and therefore, the chances of investment success may be lower.[914] The statutory thresholds for overall securities-based crowdfunding investments under Section 4(a)(6) might limit an investor's ability to choose a sufficiently large number of investments to offset this risk and to recover the due diligence costs of sufficiently investigating individual investments. One potential solution to this diversification problem would be to invest smaller amounts in more ventures. The drawback is that the costs associated with identifying and reviewing investment opportunities are, to a large extent, fixed.

c. Issuer Eligibility

The statute and the proposed rules exclude certain categories of issuers from eligibility to rely on Section 4(a)(6) to engage in crowdfunding transactions.[915] We are proposing to exclude three additional categories of issuers, beyond those identified in the statute, from being eligible to rely on Section 4(a)(6) to engage in crowdfunding transactions. First, we propose to exclude issuers that would be disqualified from relying on Section 4(a)(6) pursuant to the disqualification provisions of Section 302(d) of the JOBS Act.[916] Second, we propose to exclude issuers that sold securities in reliance on Section 4(a)(6) and have not filed with the Commission and provided to investors the ongoing annual reports required by Regulation Crowdfunding during

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913 *See* John Cochrane, *The Risk and Return of Venture Capital*, 75 J. OF FIN. ECON. 3 (2005).

914 *See* Agarwal, note 873.

915 *See* Section 4A(f). *See also* proposed Rule 100(b) of Regulation Crowdfunding.

916 *See* proposed Rule 100(b)(4) of Regulation Crowdfunding.

the two years immediately preceding the filing of the required offering statement.[917] This additional exclusion would not impose any additional burdens and costs on an issuer that the issuer would not have already incurred had it complied with the ongoing reporting requirements as they came due. Further, the requirement that a delinquent issuer prepare two annual reports at one time should provide updated and current information to investors without requiring an issuer to become current in its reporting obligations. As a result, we believe that this exclusion would incentivize issuers to comply with its ongoing reporting requirements, if they intend to rely again on Section 4(a)(6) to raise additional capital, which would allow investors to make more informed investment decisions. We also recognize that conditioning an issuer's Section 4(a)(6) eligibility on the requirement that issuers provide ongoing reports for only the previous two-years may deprive investors of information in some periods that might otherwise have negative effects on the price formation and liquidity of the securities in the secondary market. The potential damage to an issuer's reputation resulting from being delinquent, however, may provide the issuer with sufficient incentive to consistently comply with the ongoing reporting requirements.

Third, we propose to exclude a company that has no specific business plan or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies. This proposed ineligibility requirement will have only a marginal effect on issuer participation and capital formation because the startups and small businesses seeking the exemption would generally have, even in the early stage of their development, a business

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917 *See* discussion in Section II.A.4 above.

plan specific enough to distinctly differentiate them from companies with no specific business plan.

3. Issuer Requirements

We recognize that there are benefits and costs associated with the statutory requirements and the proposed rules, including the disclosure requirements, pertaining to issuers. While the estimated costs to issuers are discussed in further detail elsewhere in this section, the following table summarizes these costs:

	Offerings of $100,000 or less	Offerings of more than $100,000, but not more than $500,000	Offerings of more than $500,000
Compensation to the intermediary[918]	$2,500 - $7,500	$15,000 - $45,000	$37,500 - $112,500
Costs per issuer for obtaining EDGAR access codes on Form ID[919]	$60	$60	$60
Costs per issuer for preparation and filing of Form C for each offering[920]	$6,000	$6,000	$6,000
Costs per issuer for preparation and filing of the progress updates on Form C-U[921]	$400	$400	$400
Costs per issuer for	$4,000	$4,000	$4,000

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[918] *See* discussion in Section III.B.4 below. For purposes of the table, we estimate the range of compensation that an issuer would pay the intermediary assuming the following: (1) the compensation would be calculated as a percentage of the offering amount ranging from 5% to 15% of the total offering amount; and (2) the issuer is offering $50,000, $300,000 and $750,000, which are the mid-points of the offering amounts under each of the respective columns. The compensation paid to the intermediary may, or may not, cover services to an issuer in connection with the preparation and filing of the proposed filings identified in this table.

[919] *See* Section IV.C.1.d below for a discussion of the hourly burdens for obtaining EDGAR access codes on Form ID. We estimate, for purposes of the Paperwork Reduction Act, the cost of outside counsel at a rate of $400 an hour. We recognize that the costs of retaining outside professionals may vary depending on the nature of the professional service and that many small issuers are likely to face substantially lower costs. Small issuers also may choose to prepare the proposed forms without seeking the assistance of outside counsel. The table shows only those costs we attribute to outside professionals, for purposes of this analysis, as we believe internal costs would vary greatly among issuers.

[920] *See* proposed Rule 203(a)(1) of Regulation Crowdfunding. *See also* Section IV.C.1.a below for a discussion of the hourly burdens for preparing and filing Form C for each offering. For purposes of the table, we estimate that 25 percent of the hourly burden would be carried by outside professionals retained by the issuer at an average cost of $400 per hour.

[921] *See* proposed Rule 203(a)(3) of Regulation Crowdfunding. *See also* Section IV.C.1.a below for a discussion of the hourly burdens for preparing and filing the progress updates on Form C-U. For purposes of the table, we estimate that the hourly burden would be carried by outside professionals retained by the issuer at an average cost of $400 per hour.

preparation and filing of annual report on Form C-AR[922]			
Costs for annual review or audit of financial statements per issuer[923]	Not required	$14,350	$28,700
Costs per issuer for preparation and filing of Form C-TR to terminate reporting[924]	$600	$600	$600

a. General Disclosure Requirements

The statute and the proposed rules related to issuer disclosures are intended to reduce the information asymmetries that currently exist between small businesses and potential investors. Small private businesses typically do not disclose information as frequently or as extensively as public companies, if at all. Moreover, unlike public companies, small private businesses are not required to hire an independent third party to validate the information disclosed. When information about a company is difficult to obtain or the quality of the information is uncertain, investors are at risk of making poorly-informed investment decisions regarding that company.

Such information asymmetries might be especially acute in the securities-based crowdfunding market because the market includes startups and small businesses that have significant risk factors and that might have characteristics that have led them to be rejected by

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922 *See* proposed Rule 203(b)(1) of Regulation Crowdfunding. *See also* Section IV.C.1.b below for a discussion of the hourly burdens for preparing and filing each annual report on Form C-AR. For purposes of the table, we estimate that 25 percent of the hourly burden would be carried by outside professionals retained by the issuer at an average cost of $400 per hour.

923 *See* proposed Rule 201(t) of Regulation Crowdfunding. *See also* Section II.B.1.a.ii above.

924 *See* proposed Rule 203(b)(2) of Regulation Crowdfunding. *See also* Section IV.C.1.c below for a discussion of the hourly burdens for preparing and filing Form C-TR. For purposes of the table, we estimate that the hourly burden would be carried by outside professionals retained by the issuer at an average cost of $400 per hour.

other potential funding sources, including banks, VCs and angel investors. In addition, the securities-based crowdfunding market may attract unsophisticated retail investors who may not have the resources necessary to effectively monitor issuers. For instance, some issuers might use capital to fund riskier projects than what was disclosed to investors, or they might not make best efforts to achieve their stated business objectives. If investors in securities-based crowdfunding are unable to monitor such issuers because of limited information or credible third-party validation of this information, they might eventually seek higher yields or choose to withdraw from the securities-based crowdfunding market altogether, thus increasing the cost of capital to issuers and impeding capital formation. In addition, investors in offerings made in reliance on Section 4(a)(6) might make relatively small investments. The potential dispersed investor base may make it difficult for investors to solve collective action problems.

The statute and the proposed rules seek to reduce information asymmetries by requiring issuers to file specified disclosures with the Commission for offerings made in reliance on Section 4(a)(6) on the offer date and on an annual basis thereafter.[925] Issuers also would be required to provide these disclosures to investors, and in the case of offering documents, to potential investors and the relevant broker or funding portal. The proposed disclosure requirements described above[926] are more extensive than those required under existing offering exemptions. For example, although the current requirements under Regulation A require similar initial financial disclosures, they do not require periodic reporting.[927] Issuers using the Rule 504

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925 *See* Section 4A(b). *See also* proposed Rules 201, 202 and 203 of Regulation Crowdfunding.

926 *See* Section II.B.1 above.

927 Securities Act Rule 257 (17 CFR 230.257), however, requires issuers conducting offerings pursuant to Regulation A to file Form 2-A (17 CFR 239.91) with the Commission at certain intervals to report sales

exemption under Regulation D to raise up to $1 million do not need to provide audited financial statements and there are no periodic disclosure requirements. Regulation D offerings under Rules 505 and 506 for up to $2 million require issuers to provide audited current balance sheets to non-accredited investors (and unaudited statements of income, cash flows and changes in stockholders' equity), but there are no periodic reporting requirements. The disclosure requirements in the proposed rules should benefit investors by enabling them to better evaluate the issuer and the offering, monitor how the issuer is doing over time and be aware of when the issuer may terminate its ongoing reporting obligations. This would allow investors with various risk preferences to invest in the offerings best suited for their risk tolerance, thus improving allocative efficiency.

The disclosure requirements also could improve informational efficiency in the market. Specifically, the required disclosure would provide investors with a useful benchmark to evaluate other private issuers both within and outside of the securities-based crowdfunding market.[928] Additionally, disclosure by issuers engaging in crowdfunding transactions in reliance on Section 4(a)(6) could inform financial markets more generally by providing information about new consumer trends and new products, thus creating externalities that benefit other types of investors and issuers.

We recognize, however, that the proposed disclosure requirements also would have associated limitations and costs, including the direct costs of preparation, certification (when

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and the use of proceeds until termination, completion or final sale of securities in the offering or until the proceeds have been applied, whichever is later.

928 *See* Christian Leuz and Peter Wysocki, *Economic Consequences of Financial Reporting and Disclosure Regulation: A Review and Suggestions for Future Research*, (Working Paper, University of Chicago) (2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105398.

necessary) and dissemination of the disclosure documents. We note that, under the statute, the disclosure requirements for offerings made in reliance on Section 4(a)(6) are more extensive, in terms of breadth and frequency, than those for other private offerings. The statute also provides us with the discretion to impose additional requirements on issuers engaging in crowdfunding transactions, and in some cases, the proposed rules would require issuers to disclose information in addition to the information specifically listed in the statute.[929] For example, we are proposing to require disclosure of any indebtedness of the issuer[930] because we believe that servicing debt could place additional pressures on a company in the early stages of development and this information would be important to investors. The proposed rules also would require disclosure of any prior securities-based crowdfunding or other exempt offerings conducted within the past three years.[931] In some cases, an issuer might have previously engaged in crowdfunding in reliance on Section 4(a)(6) and may be returning for additional funding. We believe that it would be important to investors to know whether the prior securities-based crowdfunding or other offerings of securities were successful, and if so, the amount raised in these prior offerings. Compared to the disclosure requirements under existing private offering exemptions, this information would better inform investors about the capital structure of an issuer, might provide insight into how prior offerings were valued and could enable investors to more fully assess the issuer and the potential risks associated with the current offering.

We recognize that the additional information required by the discretionary requirements would increase the disclosure costs to issuers, but we believe that this would improve investor

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929 *See* Section 4A(b)(5). *See also* Section II.B.1.a.i(g) for a description of the additional disclosure requirements.

930 *See* proposed Rule 201(p) of Regulation Crowdfunding.

931 *See* proposed Rule 201(q) of Regulation Crowdfunding.

decision-making and ultimately benefit issuers with viable investment opportunities by improving price efficiency in the securities-based crowdfunding market. Although we recognize that requiring less disclosure would impose lower compliance costs, we believe that the additional disclosure requirements we are proposing strike the appropriate balance between enhancing the ability of issuers relying on Section 4(a)(6) to raise capital and enabling investors to make informed investment decisions. Additionally, disclosure might have indirect costs to the extent that information disclosed by issuers relying on Section 4(a)(6) could be used by their competitors. Requiring significant levels of disclosure at an early stage of an issuer's lifecycle might affect an issuer's competitive position and might limit the use of the exemption in Section 4(a)(6) by issuers who are especially concerned with confidentiality. It also is possible that these disclosure costs would make other types of private offerings more attractive to potential securities-based crowdfunding issuers. For example, the recent changes to Rule 506 of Regulation D,[932] which allow for general solicitation, subject to certain conditions, are likely to increase its attractiveness and, thus, may divert potential issuers from crowdfunding.

In addition, under the statute and the proposed rules, issuers that complete a crowdfunding transaction in reliance on Section 4(a)(6) would be subject to ongoing reporting requirements,[933] which are not required under other private offering exemptions and which might increase compliance costs. The ongoing reporting, however, might provide a liquidity benefit for secondary sales of the issuers' securities.

b. Financial Condition and Financial Statement Disclosure Requirements

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932 *See General Solicitation Adopting Release*, note 12.

933 *See* Section 4A(b)(4). *See also* proposed Rule 202 of Regulation Crowdfunding.

With respect to the statutory requirement to provide disclosure about the issuer's financial condition, the proposed rules would require narrative disclosure addressing the issuer's historical results of operations, in addition to information about its liquidity and capital resources.[934] We expect that this discussion would inform investors about the financial condition of the issuer, without imposing significant costs, because the issuer should already have such information readily available. In addition, the proposed rules would not prescribe the content or format for this information.

With respect to the requirement to provide financial statements, the proposed rules would implement the tiered financial disclosure requirements specified by the statute, which are based on the aggregate amount of securities offered and sold during the preceding 12-month period, inclusive of the offering amount in the offering for which disclosure is being provided.[935] Although the disclosure requirements would provide investors with more information than might otherwise be obtained in private offerings, the disclosures might create additional costs for those issuers who have limited financial and accounting expertise necessary to produce the financial disclosures envisioned by the statute and the proposed rules. In this respect, the statute anticipates a level of development among issuers that might not be present in the relevant securities-based crowdfunding market. For instance, a startup with a promising business idea might have little capital prior to the offering, leaving limited amounts to be audited or certified. The issuer disclosures required for offerings made in reliance on Section 4(a)(6), therefore, might not always help investors with their investment decisions or may weigh against an issuer when a potential investor is deciding whether to make an investment.

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934 *See* proposed Rule 201(s) of Regulation Crowdfunding. *See also* Section II.B.1.a.ii(a) above.

935 *See* proposed Rule 201(t) of Regulation Crowdfunding. *See also* Section II.B.1.a.ii(b) above.

The proposed rules would require all issuers to provide a complete set of their financial statements (a balance sheet, income statement, statement of cash flows and statement of changes in owners' equity) that are prepared in accordance with U.S. GAAP and cover the shorter of the two most recently completed fiscal years or the period since inception.[936] This proposed requirement may impose a cost on potential issuers, especially those smaller issuers that may have historically prepared their financial statements in accordance with other comprehensive bases of accounting, such as a cash basis of accounting or a tax basis of accounting, rather than U.S. GAAP. Investors, however, would benefit from the requirement that financial statements be prepared in accordance with U.S. GAAP, as U.S. GAAP is widely used and would allow for more comparability among issuers.

The proposed rules also specify that an issuer could conduct an offering in reliance on Section 4(a)(6) using financial statements for the fiscal year prior to the most recently completed fiscal year, provided that not more than 120 days have passed since the end of the issuer's most recently completed fiscal year, the issuer was not otherwise required to update the financial statements and updated financial statements are not otherwise available.[937] This might impose a cost on potential investors to the extent that the investors would not have the most recent information about the issuer's financial condition. However, this concern is somewhat mitigated by the proposed requirement that issuers include a discussion of changes in their financial condition since the period covered by the financial statements, including changes in revenue or net income and other relevant financial measures.[938]

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936 *See* proposed Instruction 2 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

937 *See* proposed Instruction 8 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

938 *See* proposed Instruction 9 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

Requiring financial statements covering the two most recently completed fiscal years, as proposed, would benefit investors by providing a basis for comparison against the most recently completed fiscal year and by allowing investors to identify changes in the development of the business. Compared to an alternative that we could have selected, that of requiring financial statements covering only the most recently completed fiscal year as one commenter suggested,[939] requiring a second year of financial statements might increase the cost for the issuer.[940] Also, to the extent that the issuer had no or little operations in the prior year, the benefit of comparability might not apply. In this regard, we recognize that many issuers might not have any financial history, and potential investors might make investment decisions without a track record of issuer performance, relying largely on the belief that an issuer can succeed based on the concept and other factors.

For offerings of $100,000 or less, the statute and the proposed rules would require the issuer to provide its filed income tax returns for the most recently completed year (if any) and financial statements that are certified by the principal executive officer to be true and complete in all material respects.[941] While providing an income tax return is not expected to impose a significant cost on issuers, it is not clear to what extent the information presented in a tax return would be useful for an investor evaluating whether or not to purchase securities from the issuer. Although the information might be limited, it would not be uninformative. Under the proposed rules, issuers would be required to redact personal information from the required tax returns.[942]

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939 *See* CompTIA Letter.

940 *But see* note 174.

941 *See* Section 4A(b)(1)(D)(i). *See also* proposed Rule 201(t)(1) of Regulation Crowdfunding.

942 *See* proposed Instruction 3 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

We believe that this would alleviate privacy concerns, while still satisfying the statutory requirement to provide tax return information.

Moreover, the proposed rules would specify that if an issuer is offering securities in reliance on Section 4(a)(6) before filing a tax return for the most recently completed fiscal year, the issuer could use the tax return filed for the prior year, on the condition that the issuer provides the tax return for the most recent fiscal year when it is filed, if it is filed during the offering period.[943] This accommodation should benefit issuers by enabling them to engage in transactions during the time period between the end of their fiscal year and when they file their tax return for that year. This might impose a cost on potential investors because they might not receive the most up-to-date information about the issuer's financial condition. However, this concern is somewhat mitigated by the proposed requirement that issuers provide disclosure about material changes in their financial condition since the prior year.[944] In addition, we are proposing a form of certification for the principal executive officer to provide in the issuer's offering statement, which we believe would help issuers comply with the certification required by the statute and the proposed rules.[945]

For offerings of more than $100,000, but not more than $500,000, the proposed rules specify that the required financial statements must be reviewed in accordance with SSARS issued by the AICPA.[946] Although one alternative we could have selected is to develop a new review standard for purposes of these rules, we believe that issuers would benefit from a rule that

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943 *Id*.

944 *See* proposed Instruction 9 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

945 *See* proposed Instruction 4 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

946 *See* proposed Rule 201(t)(2) of Regulation Crowdfunding.

requires the use of the AICPA's widely-utilized review standard, particularly in light of the fact that there are no other widely-utilized review standards from which to choose. We believe that many accountants reviewing financial statements of issuers raising capital in reliance on Section 4(a)(6) would be familiar with the AICPA's standards and procedures for review, which should help to lessen review costs.

For offerings of more than $500,000, the statute and the proposed rules would require that financial statements be audited.[947] The statute gives us discretion to change the threshold that would require audited financial statements, but we are not proposing to change it at this time. We believe that audited financial statements would benefit investors in offerings by issuers with substantive prior business activity by providing them with greater confidence in the quality of the financial statements of issuers seeking to raise larger amounts of capital. We also understand that requiring audited financial statements would increase the cost to issuers, and for issuers that are newly formed, with no or very limited operations, the benefit of the audit may not justify the cost of the audit. Compared to an alternative that we could have taken, that of a higher threshold (*e.g.*, offerings of more than $700,000) for providing audited financial statements, our approach in the proposed rules would likely result in more issuers having to provide audited financial statements, as well as higher compliance costs for those issuers. Based on a compilation of data submitted to us by reporting companies, the average cost of an audit for an issuer with less than $1 million in market capitalization and less than $1 million in revenues is approximately $28,700.[948] We expect that the cost of an audit for many issuers engaging in a

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947 *See* Section 4A(b)(1)(D)(iii). *See also* proposed Rule 201(t)(3) of Regulation Crowdfunding.

948 *See* Audit Analytics, *Auditor-Fees*, *available at* http://www.auditanalytics.com/0002/audit-data-company.php. The auditor fee database contains fee data disclosed by Exchange Act reporting companies

crowdfunding transaction in reliance on Section 4(a)(6) might be less, because they likely would be at an earlier stage of development than issuers that file Exchange Act reports with us and, thus, would be less complex to audit.

For offerings of more than $500,000, the proposed rules also would require financial statements to be audited in accordance with the auditing standards issued by either the AICPA or the PCAOB.[949] We believe that letting issuers choose the auditing standards could provide a number of benefits. If an issuer currently has financial statements audited under one of the specified standards, the issuer would not need to obtain a new audit or engage a different auditor to conduct an audit to engage in a crowdfunding transaction in reliance on Section 4(a)(6) and the proposed rules. If an issuer chooses to have an audit conducted in accordance with PCAOB auditing standards, it would not need to obtain a new audit to file a registration statement with the Commission for a registered offering. By not taking an alternative approach, that of requiring the audits to be conducted by PCAOB-registered firms, the proposed rules should allow for the eligibility of a greater number of accountants to audit the issuers' financial statements, and thereby, could reduce costs for crowdfunding issuers.

As described above, the statute and the proposed rules require some financial statements to be reviewed or audited by a public accountant. The proposed rules would specify that a public accountant must be independent of the issuer, in accordance with the independence standards set forth in Rule 2-01 of Regulation S-X.[950] The proposed requirement to comply with our

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in electronic filings since January 1, 2001. For purposes of our calculation, we averaged the auditor fee data for companies with both market capitalization and revenues of less than $1 million (the smallest subgroup of companies for which data is compiled).

949 *See* proposed Rule 201(t)(3) of Regulation Crowdfunding.

950 *See* proposed Instruction 7 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

independence standards may impose costs to the extent that there are higher costs associated with engaging an accountant that satisfies the independence standards. Also, the independence standards set forth in Rule 2-01 of Regulation S-X may impose higher costs than other independence standards, such as the AICPA independence standards.[951]

In addition, the proposed rules would require an issuer to file a review report or audit report, whichever is applicable.[952] This could impose an additional cost on issuers to the extent that the accountant or auditor increases the fee associated with the review or audit to compensate for any additional liability that may result.

c. Issuer Filing Requirements

The statute does not specify a format that issuers must use to present the required disclosures and file the disclosures with the Commission. As noted above, we are proposing to require issuers to file the mandated disclosure on EDGAR using new Form C.[953] Issuers would incur the cost to comply with the disclosure requirements and file the information in the new proposed Form C: Offering Statement and Form C-U: Progress Update before the offering was funded, thus imposing a cost on issuers regardless of whether their offerings were successful. In addition, issuers would incur the cost to comply with the ongoing reporting requirements and file information in the new proposed Form C-AR: Annual Report.[954]

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951 For example, under the independence standards set forth in Rule 2-01 of Regulation S-X, an auditor cannot provide bookkeeping services to an audit client, so an issuer would need to retain a different accountant to provide those services. *See* Rule 2-01(c)(4) of Regulation S-X [17 CFR 210.2-01(c)(4)].

952 *See* proposed Instructions 5 and 6 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

953 *See* proposed Rule 203(a) of Regulation Crowdfunding. *See also* Section II.B.3 above.

954 *See* proposed Rule 203(b) of Regulation Crowdfunding. *See also* Section II.B.3 above.

Form C would require certain disclosures to be submitted using an XML-based filing,[955] while allowing the issuer to customize the presentation of other required disclosures. This proposed approach would provide issuers with the flexibility to present required disclosures in a cost-effective manner, while also requiring the disclosure of certain key offering information that would be collected in a standardized format, which we believe would benefit investors and help facilitate capital formation.

We expect that requiring certain disclosures to be submitted using XML-based filings would produce numerous benefits for issuers, investors and the Commission. For instance, using information filed pursuant to these proposed requirements, users of the information could readily track capital generated through crowdfunding offerings without requiring the manual inspection of each filing. The ability to efficiently collect information on all issuers also could provide an incentive for data aggregators or other market participants to offer services or analysis that investors could use to compare and choose among different offerings. For example, reporting key financial information using XML-based filings would allow investors, analysts and data aggregators to more easily compile, analyze and compare information regarding the capital structure and financial position of various issuers. XML-based filings also would provide the Commission with data about the use of the new exemption that would allow the Commission to evaluate whether the rules implementing the exemption include appropriate investor protections and whether the rules unduly restrict capital formation. In addition, requiring disclosure of the compensation paid to intermediaries would help inform the Commission, issuers and investors about the costs of raising capital in this market.

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[955] *See* proposed Instruction to paragraph (a)(1) of proposed Rule 203 of Regulation Crowdfunding. *See also* Section II.B.3 above.

We expect that the cost of preparing and filing Form C could vary significantly among issuers. For example, issuers with little operating activity might have lower costs because they likely would have less to disclose than a more complex operation. Further, small issuers might choose to prepare and file Form C without seeking the assistance of outside counsel.[956] Thus, the Commission also expects that reporting costs for many small issuers may be insignificant.[957]

The proposed rules also would require that issuers file a Form C-U: Progress Update to describe the progress of the issuer in meeting the target offering amount.[958] The proposed rules would require the issuer to file two progress updates within five business days from the day when the issuer reaches one-half and 100 percent of the target offering amount, as well as a final progress update within five business days after the end of the offering period if the issuer will accept proceeds in excess of the target offering amount. The Commission expects the costs of preparing these updates to vary but to be relatively small, given how little information is required.[959] However, if the size of the security-based crowdfunding market developed to a level commensurate with the current non-security-based crowdfunding market, this could result in tens of thousands of filings with the Commission each year. To the extent that this same progress information also would be available on the registered intermediary's website, as is already occurring with existing non-security-based offering platforms, then there might be little marginal

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956 *See* Section IV.C.1. below.

957 We estimate, for purposes of the Paperwork Reduction Act, that 25 percent of the 60 hours anticipated to prepare and file Form C could be performed by outside counsel at a rate of $400 an hour. *See* Section IV.C.1.a below. We recognize that the costs of retaining outside professionals may vary depending on the nature of the professional service and that many small issuers are likely to face substantially lower costs.

958 *See* proposed Rule 203(a)(3) of Regulation Crowdfunding. *See also* Sections II.B.1.b and II.B.3 above.

959 *See* Section IV.C.1.a below.

benefit to these filings. For these reasons, we are seeking comment on alternative frequencies and manner of progress updates.

As noted above, the statute also requires an issuer to file and provide to investors information about the issuer's financial condition on at least an annual basis, as determined by the Commission.[960] To implement this statutory requirement, the proposed rules would require any issuer that sold securities in a crowdfunding transaction in reliance on Section 4(a)(6) to file annually with the Commission a new Form C-AR: Annual Report, no later than 120 days after the end of each fiscal year covered by the report.[961] We believe that annual reports would inform investors in their portfolio decisions and could enhance price efficiency. Moreover, as discussed above, under the statute and the proposed rules, the securities would be freely tradable after one year,[962] and therefore, this information also would benefit potential future holders of the issuer's securities by enabling them to update their assessments as new information was made available through the annual updates, potentially allowing for more efficient pricing. More generally, these proposed continued disclosures also might help facilitate the transfer of securities in secondary markets after the one-year restricted period ends, which could mitigate some of the potential liquidity issues that are unique to the securities-based crowdfunding market, discussed above.

Annual reporting requirements, however, would impose ongoing costs on issuers. The proposed rules would require that issuers continue to file Form C-AR: Annual Report until the earlier of the following: (1) the issuer becomes a reporting company required to file reports

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960 *See* Section 4A(b)(4).

961 *See* proposed Rule 202 of Regulation Crowdfunding. *See also* Section II.B.2 above for a discussion of the disclosure requirements for Form C-AR.

962 *See* Section 4A(e). *See also* proposed Rule 501 of Regulation Crowdfunding.

under Exchange Act Sections 13(a) or 15(d); (2) the issuer or another party repurchases all of the securities issued pursuant to Securities Act Section 4(a)(6), including any payment in full of debt securities or any complete redemption of redeemable securities; or (3) the issuer liquidates or dissolves its business in accordance with state law.[963] We estimate that the cost to prepare and file Form C-AR would be approximately two-thirds of the cost to prepare and file Form C: Offering Statement. Form C-AR requires similar disclosure as Form C. If an issuer undertakes multiple offerings, which individually require different levels of financial statements, the issuer would be required to provide financial statements that meet the highest standard previously provided. An issuer would not be required to provide the offering-specific information that was filed at the time of the offering, but the disclosure requirements would otherwise be the same as those required in connection with the offer and sale of the securities,[964] which should minimize the disclosure burden for issuers. Any issuer terminating its annual reporting obligations would be required to file a notice under cover of "Form C-TR: Termination of Reporting" to notify investors and the Commission that it would no longer file and provide annual reports pursuant to the requirements of Regulation Crowdfunding.[965] The Commission expects the costs of preparing these updates to vary significantly among issuers.[966]

d. Advertising – Notice of Offering

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963 *See* proposed Rule 202(b) of Regulation Crowdfunding.

964 *See* proposed Rule 202(a) of Regulation Crowdfunding.

965 *See* proposed Rule 203(b)(2) of Regulation Crowdfunding.

966 Issuers would spend, on average, approximately 1.5 hours to complete this task. Again, we do not have the information necessary to provide a reasonable estimate of the costs associated with this time burden because these costs would vary significantly among small issuers and would depend, in part, on the stage of the issuer's development. *See* Section IV.C.1.c below.

The statute and the proposed rules would prohibit an issuer from advertising the terms of the offering, except for notices that direct investors to an intermediary's platform.[967] The terms of the offering would include the amount offered, the nature of the securities, price of the securities and length of the offering period.[968] The proposed rules would allow an issuer to publish a notice about the terms of the offering made in reliance on Section 4(a)(6), subject to certain limitations on the content of the notice.[969] The notices would be similar to the "tombstone ads" permitted under Securities Act Rule 134,[970] except that the proposed rules would require the notices to direct potential investors to the intermediary's platform, through which the offering made in reliance on Section 4(a)(6) would be conducted.

We believe this approach would allow issuers to generate interest in offerings and to leverage the power of social media to attract potential investors. At the same time, we believe it also would protect potential investors by limiting the ability of issuers to provide certain advertising materials without also providing the disclosures, available on the intermediary's platform, that are required for an offering made in reliance on Section 4(a)(6). Moreover, this proposed requirement that limits the issuer's ability to advertise the terms of the offering, while directing investors to the intermediary's platform for more offering-specific information, would not impose costs to market participants.

e. Compensation of Persons Promoting the Offering

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967 *See* Section 4A(b)(2). *See also* proposed Rule 204 of Regulation Crowdfunding.

968 *See* proposed Instruction to proposed Rule 204 of Regulation Crowdfunding.

969 *See* proposed Rule 204(b) of Regulation Crowdfunding. *See also* Section II.B.4 above.

970 17 CFR 230.134.

The statute and the proposed rules would prohibit an issuer from compensating, or committing to compensate, directly or indirectly, any person to promote the issuer's offering through communication channels provided by the intermediary unless the issuer takes reasonable steps to ensure that such person clearly discloses the receipt of such compensation (both past and prospective) each time a promotional communication is made.[971]

We believe that such requirement would benefit the securities-based crowdfunding market because it would allow investors to make better informed investment decisions. A premise of crowdfunding is that investors would rely, at least in part, on the collective wisdom of the crowd to make better informed investment decisions. Accordingly, we propose to require intermediaries to provide communication channels for issuers and investors to exchange information about the issuer and its offering.[972] Although the requirement to take steps to ensure disclosure of compensation paid to persons promoting the offering would impose compliance costs for issuers, we believe that investors would benefit from knowing if the investment they are considering and discussing with other potential investors is being touted by a promoter who is compensated by the issuer.

f. Oversubscription and Offering Price

The proposed rules would permit an issuer to accept investments in excess of the target offering amount, subject to the $1 million limitation and certain conditions.[973] We believe that permitting oversubscriptions would provide flexibility to issuers so that they can raise the amount of capital they deem necessary to finance their businesses. For example, permitting

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971 *See* Section 4A(b)(3). *See also* proposed Rule 205 of Regulation Crowdfunding.

972 *See* proposed Rule 303(c) of Regulation Crowdfunding.

973 *See* proposed Rule 201(h) of Regulation Crowdfunding. *See also* Section II.B.6.i above.

oversubscriptions would allow an issuer to raise more funds, while lowering compliance costs, if the issuer discovers during the offering process that there is greater investor interest in the offering than initially anticipated or if the cost of capital is lower than initially anticipated.

The proposed rules also would not require issuers to set a fixed price or prohibit dynamic pricing. We believe that allowing issuers flexibility in setting the offering price would allow them to extract investors' reservation price for a given offering or to incentivize investors to subscribe to an offering early, thus increasing the likelihood that the offering would be successful. Further, the proposed required disclosure of the pricing method used and the final prices for the securities before an offering closes,[974] coupled with the investor's ability to cancel his or her investment commitment,[975] could mitigate potential concerns that dynamic pricing could be used to provide preferential treatment to certain investors (*e.g.*, when an issuer offers better prices to relatives or insiders). We also believe that the proposed cancellation rights would address the concerns about time pressure on the investment decision because investors would have the opportunity to cancel their investment commitments if they decide to do so.

h. Restrictions on Resales

The statute and the proposed rules also include restrictions on transfers of securities for one year, subject to limited exceptions (*e.g.*, for transfers to the issuer of the securities, in a registered offering, to an accredited investor or to certain family members).[976] The proposed rules also would permit transfers to trusts controlled by, or held for the benefit of, covered family

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974 *See* proposed Rule 201(*l*) of Regulation Crowdfunding.

975 *See* proposed Rule 201(j) of Regulation Crowdfunding.

976 *See* Section 4A(e). *See also* proposed Rule 501 of Regulation Crowdfunding.

members.[977] We believe that including such proposed restrictions is important for investor protection. By restricting the transfer of securities for a one-year period, the proposed rules would give investors in a business a defined period to observe the performance of the business and to potentially obtain more information about the potential success or failure of the business before trading occurs. The restrictions on resales, however, may impede price discovery.

The proposed one-year restriction on transfers of securities purchased in a transaction conducted in reliance on Section 4(a)(6) might reduce trading liquidity, raise capital costs to issuers and limit investor participation, particularly for investors who cannot risk locking up their investments for this period. The illiquidity cost would be mitigated, in part, by provisions that allow investors to transfer the securities within one year of issuance by reselling the securities to accredited investors, back to the issuer or in a registered offering or transferring them to certain family members or trusts of those family members. These provisions likely would improve the liquidity of these securities and, thus, could increase investor participation in securities-based crowdfunding offerings.

4. Intermediary Requirements

The statute and the proposed rules require that transactions be conducted through a registered broker or registered funding portal. The use of a registered intermediary to match issuers and investors would require that they incur certain transactions costs necessary to support the intermediation activity, but also would provide centralized venues for crowdfunding activities that should lower investor and issuer search costs. As discussed earlier, existing rewards-based and donations-based crowdfunding platforms already engage in a large number of

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[977] *See* proposed Rule 501(a)(4) of Regulation Crowdfunding.

transactions, estimated at over 500,000 successful campaigns in the aggregate,[978] demonstrating that the use of platforms for crowdfunding may be familiar to investors and issuers.

We believe that existing crowdfunding platforms would initially be the primary, non-broker-dealer intermediaries in the securities-based crowdfunding market. Registered brokers, or broker-dealers that are currently unregistered, but are planning to register in the future, also might wish to enter the securities-based crowdfunding market, which would increase the competition among crowdfunding intermediaries and potentially lower the cost of intermediation to issuers. Both existing non-securities-based crowdfunding platforms and registered brokers might need to invest resources (including costs to comply with the proposed regime) to create the infrastructure for securities-based crowdfunding, with brokers likely investing to develop an Internet-based platform and non-securities-based crowdfunding platforms investing to register as funding portals and revise their existing sites to comply with the requirements of the statute and the proposed rules. Although the eventual extent of broker involvement in the securities-based crowdfunding market is difficult to anticipate, we believe that some brokers might acquire or form partnerships with funding portals to obtain access to a new and diverse investor base. In addition, some existing non-securities-based crowdfunding platforms might eventually either register as brokers or form partnerships with registered brokers to offer brokerage services as part of their service offerings. As discussed above, we believe that there could be incentives for funding portals to pursue such partnerships, because of brokers' expertise and access to investors, as well as because of the statutory and proposed rule restrictions on funding portal activities.

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978 *See* note 863.

Although it is not possible to predict precisely the future number of persons (or entities) who would register as either brokers or funding portals to act as intermediaries in securities-based crowdfunding transactions,[979] we estimate that intermediaries would number approximately 110, including approximately 10 intermediaries that would register as brokers in order to engage in crowdfunding, approximately 50 intermediaries that would already be registered as brokers and approximately 50 intermediaries that would register as funding portals.[980] It is possible that the actual number of participants could deviate significantly from these estimates, and it is likely that there would be significant competition between existing crowdfunding venues and new entrants that could result in further changes in the number and types of intermediaries as the market develops and matures. It also is likely that there will be significant developments in the types and ranges of crowdfunding products and services offered to potential issuers and investors, particularly as competitors learn from their experiences. Moreover, the business models of the successful crowdfunding intermediaries are likely to

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979 There are significant challenges to establishing a statistically reliable estimate of the number of intermediaries that would participate in the securities-based crowdfunding market. For example, in a similar context, a 2005 report on private placement broker-dealers determined that there is no effective measuring device to estimate the number of intermediaries for small businesses currently in the marketplace. *See* Task Force on Private Placement Broker-Dealers, note 894. We also recognize that there are limitations on predicting the number of intermediaries that would participate in securities-based crowdfunding, based on existing practices in the donation-based and rewards-based crowdfunding markets or foreign securities-based crowdfunding. In particular, platforms currently involved in donation-based and rewards-based crowdfunding may be motivated by philanthropic interests and may not intend to expand their platforms to offer securities-based crowdfunding opportunities. In addition, foreign securities-based crowdfunding takes place in a different regulatory setting, and thus, the market may not develop the same way in the United States.

980 These estimates are based, in part, on current indications of interest, which may change as the market develops. According to FINRA, as of October 3, 2013, approximately 36 entities have submitted the voluntary Interim Form for Funding Portals to FINRA to indicate their intention to act as funding portals under the JOBS Act. *See* Press Release, Financial Industry Regulatory Authority, FINRA Issues Voluntary Interim Form for Crowdfunding Portals (Jan. 10, 2013), *available at* http://www.finra.org/Newsroom/NewsReleases/2013/P197636; Financial Industry Regulatory Authority, *Crowdfunding Portals*, *available at* http://www.finra.org/industry/issues/crowdfunding. Based on the current indication of interest, we expect that the number of funding portals that would ultimately register with the Commission will be approximately 50. This estimate may change as the market develops.

change over time as they grow in size or market share or if they are forced to differentiate from other market participants in order to maintain a place in the market.

As a result of the uncertainty over how the market may develop, any estimates of the potential number of market participants, their services or fees charged are subject to significant estimation error. While we recognize that there are benefits as well as costs associated with the statutory requirements and the proposed rules pertaining to intermediaries, there are significant limitations to our ability to estimate the potential benefits and costs.

The statute requires that the offer or sale of securities in reliance on Securities Act Section 4(a)(6) be conducted through a broker or a funding portal that complies with the requirements of Securities Act Section 4A(a).[981] Among other things, the intermediary must register with the Commission as a broker or a funding portal, and it also must register with a registered national securities association.[982] The proposed rules would implement these statutory requirements, including by requiring an intermediary to be a member of FINRA or any other applicable registered national securities association.

We recognize that there are benefits and costs associated with the statutory requirements and the proposed rules pertaining to intermediaries. While the benefits and costs are described in further detail below, the following tables summarize the estimated direct costs to intermediaries, including brokers and funding portals. Some of the direct costs of the rules would be incurred by all intermediaries, while others are specific to whether the intermediary is a new entrant (either broker or funding portal) or is already registered as a broker.

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981 Section 4(a)(6)(C).

982 Section 4A(a)(2).

Although we have attempted to estimate the direct costs on intermediaries, we recognize that some costs could vary significantly across intermediaries, and within categories of intermediaries. For example, some intermediaries may choose to leverage existing platforms or systems and so may not need to incur significant additional expenses to develop a platform or comply with specific proposed requirements of Regulation Crowdfunding. In light of these uncertainties, we encourage commenters to provide data and analysis to help analyze and quantify further the potential benefits and costs of these rules.

We estimate that the cost for an entity to register as a broker and become a member of a national securities association in order to engage in crowdfunding pursuant to Section 4(a)(6) would be approximately $275,000, with an ongoing annual cost of approximately $50,000 to maintain that registration and membership.[983] In addition, we estimate that the cost to comply with the various requirements that apply to registered brokers engaging in transactions pursuant to Section 4(a)(6) would be approximately $245,000 initially, and $180,000 each year thereafter. In making this estimate, we assume that brokers acting as intermediaries in transactions pursuant to Section 4(a)(6) would provide a full range of brokerage services in connection with these transactions, including certain services such as providing investment advice and

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983 We recognize that the cost of registering and becoming a member of a national securities association varies significantly among brokers, depending on facts and circumstances. Among other things, the cost can vary depending on the number of associated persons of the broker entity and their licensing requirements, the scope of the proposed brokerage activities, and the means by which the broker administers the registration process (*e.g.*, it may choose to hire outside counsel to assist with the process). We also recognize that the time required for a broker to become a member of a national securities association varies and could take six months to one year. We estimate the range of this cost to be between $50,000 and $500,000, and so we have chosen the average amount of $275,000 for purposes of this discussion.

recommendations, soliciting investors, and managing and handling customer funds and securities, that funding portals cannot provide.[984]

If instead an entity were to register as a funding portal and become a funding portal member of a national securities association, we estimate the initial cost would be approximately $100,000, with an ongoing cost of approximately $10,000 in each year thereafter to maintain this registration and membership.[985]

These estimated costs are exclusive of the cost of establishing and maintaining a platform and related functionality. We anticipate that a significant percentage of intermediaries (whether brokers or funding portals) will already have in place platforms and related systems that would only need to be tailored to comply with the requirements of Title III of the JOBS Act and Regulation Crowdfunding. We estimate that a cost of approximately $100,000 in the first year, and approximately $40,000 annually thereafter for an intermediary that already has in place a platform and related systems. However, for an intermediary (whether broker or funding portal) that would need to develop a platform from scratch, we estimate the cost to do so would be approximately $400,000 in the initial year, and approximately $40,000 annually to maintain thereafter.

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984 Among other things, a broker providing recommendations and investment advice would be required to comply with FINRA rules on suitability. *See* FINRA Rule 2111. A broker soliciting through advertisements would be required to comply with FINRA rules relating to communications with the public. *See* FINRA Rule 2210. Brokers handling customer funds and securities also would be required to maintain net capital, segregate customer funds and comply with Exchange Act Rule 15c2-4. *See* Exchange Act Rules 15c3-1, 15c3-3 and 15c2-4 [17 CFR 240.15c3-1, 15c3-3 and 15c2-4].

985 In making these estimates, we assume that the membership process would take approximately one month and that there would be no related licensing requirement for associated persons of the funding portal. We also only include domestic entities in these estimates, which would not need to comply with the proposed requirements in Regulation Crowdfunding that would apply to nonresident funding portals. Nonresident funding portals would be subject to an additional cost of approximately $25,870 to comply with the costs of completing Schedule C to Form Funding Portal, hiring and maintaining an agent for service of process and providing the required opinion of counsel.

Estimated Costs of Intermediaries That Register As Brokers

	Estimated Costs	
	Initial Cost (Year 1)	**Ongoing Cost per Year**
Form BD Registration and National Securities Association Membership	$275,000	$50,000
Complying with Requirements to Act as an Intermediary in, and to Engage in Broker Activities Related to, Transactions pursuant to Section 4(a)(6)[986]	$245,000	$180,000
Platform Development	$250,000[987]	$40,000
Subtotal	*$770,000*	*$270,000*

Estimated Costs of Intermediaries That Register As Funding Portals

	Estimated Costs	
	Initial Cost (Year 1)	**Ongoing Cost per Year**
Form Funding Portal Registration and National Securities Association Membership[988]	$100,000	$10,000
Complying with Requirements to Act as an Intermediary[989]	$67,000	$40,000
Platform Development[990]	$250,000	$40,000
Subtotal	*$417,000*	*$90,000*

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986 As discussed above, these costs include, among others, the costs to the broker of having associated persons, who have licensing requirements, suitability requirements, requirements relating to advertisements, net capital and fidelity bond requirements, and compliance with Exchange Act Rule 15c2-4 (17 CFR 240.15c2-4), as well as the costs of complying with proposed Subpart C of Regulation Crowdfunding. *See* Section IV.C. 2 below for further detail on the costs associated with the requirements under proposed Subpart C.

987 As described above, the cost to develop a platform is expected to vary depending on the extent to which the entity already has a platform and related systems in place. For purposes of this chart, we use the average of the range provided above ($100,000 to $400,000 in the initial year).

988 As described above, this estimate reflects a streamlined process of becoming a member of a national securities association, which we assume would take approximately one month and not involve application or licensing of associated persons.

989 This includes the costs of complying with the requirements of proposed Subparts C and D of Regulation Crowdfunding. *See* Section IV.C.2 below for further detail on these costs.

990 As described above, the cost to develop a platform is expected to vary depending on the extent to which the entity already has a platform and related systems in place. For purposes of this chart, we use the average of the range provided above. *See* Section IV.C.2 below for further detail on costs associated with developing a platform.

Estimated Incremental Costs of Intermediaries Already Registered as Brokers

	Estimated Costs	
	Initial Cost (Year 1)	**Ongoing Cost per Year**
Complying with Requirements to Act as an Intermediary in Transactions pursuant to Section 4(a)(6)[991]	$45,000	$30,000
Platform Development[992]	$250,000	$40,000
Subtotal	*$295,000*	*$70,000*

We believe that, while the registration requirements would necessarily impose costs on intermediaries, they also would provide significant protections for the crowdfunding investor marketplace. Among other things, in addition to the Commission's oversight and rule-writing functions with regard to broker-dealers, FINRA currently is responsible for conducting most broker-dealer examinations, mandating certain disclosures by its members, writing rules governing the conduct of its members and associated persons, and informing and educating the investing public. Similarly, the regulatory framework that a registered national securities association – likely initially FINRA – would be required to create for funding portals would play an important role in the oversight of these entities.

The estimated costs in the table above reflect the direct, quantifiable costs that intermediaries would incur in connection with registering as a broker on Form BD or as a funding portal on Form Funding Portal, submitting amendments to registrations and withdrawing registrations. We estimate that approximately 50 intermediaries that would already be brokers

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991 This includes the incremental costs of complying with the requirements of proposed Subpart C of Regulation Crowdfunding, but it excludes any registration or membership requirements. *See* Section IV.C.2 below for further detail on these costs.

992 As described above, the cost to develop a platform is expected to vary depending on the extent to which the entity already has a platform and related systems in place. For purposes of this chart, we use the average of the range provided above. *See* Section IV.C.2 below for further detail on costs associated with developing a platform.

that have already registered with the Commission[993] and, as such, these brokers would not incur additional SEC registration costs associated with the proposed rules. Additionally, intermediaries that are not otherwise registered with FINRA or any other registered national securities association would need to register, and the estimated cost for such registration is included in the table above. We anticipate that the cost for a funding portal to become a member of a registered national securities association would be proportionately less than the cost for a broker to do so because of the more limited nature of a funding portal's permissible activities, and the streamlined set of rules that the association would impose on funding portals. [994] However, the exact cost of registration for funding portals would not be known until a registered national securities association adopts rules applicable to funding portals, and for purposes of this economic analysis, we have used a conservative estimate for this cost based on the current fee and costs applicable to brokers applying to become members of a national securities association.

The proposed rules would also require that an intermediary execute transactions exclusively through its online platform. This requirement should help to minimize the potential for "boiler room" and other similar abusive sales practices. Based on comments received and our discussions with industry participants,[995] we believe that the use of an online platform would enhance the ability of issuers and investors to transparently communicate as compared to the

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993 *See* Section IV.C.2 below.

994 *See* FINRA, *Jumpstart Our Business Startups Act: FINRA Requests Comment on Proposed Regulation of Crowdfunding Activities*, FINRA Regulatory Notice 12-34 (July 2012), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p131268.pdf ("In writing rules specifically for registered funding portals, FINRA would seek to ensure that the capital-raising objectives of the JOBS Act are advanced in a manner consistent with investor protection. Commenters are urged to identify the types of requirements that should apply to registered funding portals, taking into account the relatively limited scope of activities by a registered funding portal permitted under the JOBS Act.")

995 *See* note 888.

alternative of allowing transactions to occur offline. This requirement should help issuers gain exposure to a wide range of potential investors, who also may benefit from having numerous investment opportunities aggregated in one place, resulting in lower search costs or burdens related to identifying suitable investment opportunities.

We preliminarily estimate that the requirement to use an intermediary could result in transaction costs for issuers of 5% to 15% of the amount of the offering made in reliance on Section 4(a)(6),[996] depending on the intermediary used and the fees charged for services, including payment processing. Although crowdfunding intermediaries are not expected to provide issuers with underwriting services commensurate with registered offerings (and, in fact, funding portals would be prohibited from doing so), the fees charged in a crowdfunding offering could be significantly larger on a percentage basis relative to the underwriting fees for registered offerings, which range from as high as 7% for initial public offerings to less than 1% for certain bond issuances.[997] In general, to the extent that a significant component of the fees is fixed, the transaction costs for issuers would make smaller issues more expensive. Although crowdfunding offerings would likely vary in size, based on an offering size of $100,000, an issuer would incur an average of $5,000 to $15,000 in fees. As previously discussed, we believe that competition among potential crowdfunding venues and the potential development of new products and services could have a significant impact on these estimates over time.

a. Disclosure and Dissemination Requirements

The statute and proposed rules include disclosure and dissemination provisions designed to provide information to security-based crowdfunding investors. These provisions, together

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996 *See* note 918.

997 *See* note 817 and accompanying text.

with the issuer disclosure provisions discussed above, are expected to limit information asymmetries and promote the efficient allocation of capital amongst crowdfunding issues. Additionally, these disclosure and dissemination provisions would provide information intended to ensure that investors are aware of the risks associated with their investment, which would help protect investors in this new market. As discussed above, many of these costs and benefits are difficult to quantify or estimate with any degree of certainty, especially considering securities-based crowdfunding provides a new method for raising capital in the United States. To the extent possible, however, we have quantified the direct costs to intermediaries associated with these provisions in the table above. The proposed rules would prohibit any intermediary or its associated persons from accepting an investment commitment until the investor has opened an account with the intermediary and the intermediary has obtained the investor's consent to electronic delivery of materials. This requirement would help ensure that certain basic information about the investor is on file with the intermediary and that all investors are on notice of the primary method of delivery for communications from the intermediary. We estimate the direct cost of this requirement in the table above.

The statute requires intermediaries to provide disclosures related to risks and other investor education materials. The proposed rules would implement this statutory mandate by requiring intermediaries to deliver educational materials that explain how the offering process works and the risks associated with investing in crowdfunding securities.[998]

The proposed educational requirements would help make investors aware of the limits and risks associated with purchasing crowdfunding securities. Such knowledge would help

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[998] *See* proposed Rule 302(b) of Regulation Crowdfunding.

investors understand the payoff structures that are specified by the offering contractual features and the circumstances under which they could expect to be compensated. It also would help ensure that offerings proceed more efficiently as investors would be more informed by the time they decide to make their investment commitments and receive required notices. We recognize that the effectiveness of the educational materials to enhance investor protection would vary depending upon the education and experience of retail investors.[999] In addition, a presentation that highlights the risks of securities-based crowdfunding could discourage investor participation.

Under the proposed rules, the educational materials could be in any electronic format, including video format, and the intermediary would have the flexibility to determine how best to communicate the contents of the educational material, thus the cost for intermediaries to develop educational materials is expected to vary widely. The table above includes our current estimates of the direct, quantifiable costs that would be incurred to comply with the proposed requirement, as well as additional costs to update or revise the materials from time to time.

The proposed rules also require that intermediaries obtain representations from investors regarding their review of the investor education materials and their understanding of the risks.[1000] The Commission believes these proposed rules would improve investors' understanding of crowdfunding generally, as well as aspects of certain types of securities and the implications for their investments in issuers that are raising capital through securities-based crowdfunding in reliance on Section 4(a)(6). We estimate that the direct costs of this requirement to an

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[999] *See* Jennifer E. Bethel and Allen Ferrell, *Policy Issues Raised by Structured Products*, HARV. L. & ECON. Discussion Paper No. 560, 2007, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=941720.

[1000] *See* proposed Rule 303(b)(2) of Regulation Crowdfunding.

intermediary would be incorporated into the costs of developing a platform and that the ongoing burden to comply would be minimal. This proposed requirement also might impose a further cost to the extent that the requirement deters investors from making investment commitments or otherwise participating in offerings made in reliance on Section 4(a)(6).

The proposed rules would also require an intermediary to clearly disclose the manner in which the intermediary is compensated in connection with offers and sales of securities in reliance on Section 4(a)(6).[1001] As explained above, we believe that investors would benefit by having information about how intermediaries are compensated, such as through compensation arrangements with affiliates. We believe that the costs of complying with this requirement also generally would be included in the overall cost for intermediaries to develop their platforms, as it would entail adding an item of disclosure that would be built into the functionality of their platforms. The costs are reflected in the table above, and we believe that this requirement would impose only nominal incremental costs on intermediaries on an ongoing basis. We also do not expect significant competitive costs from the disclosure of such compensation arrangements.

The statute and the proposed rules further would require that intermediaries make available certain issuer-provided information. As described above, intermediaries would have to implement and maintain systems to comply with the information disclosure requirements so that the information was publicly available and easily accessible on the intermediary's platform by interested persons.

The issuer disclosure requirements should benefit investors by enabling them to better evaluate the issuer and the offering. Requiring intermediaries to make the issuer information

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[1001] *See* proposed Rule 302(d) of Regulation Crowdfunding.

publicly available and easily accessible on their platforms would reduce information asymmetries between issuers and investors and would enhance both transparency and efficiency of the market. We expect that intermediaries would incur costs to develop the functionality that would allow the uploading and downloading of issuer information. We believe that the direct costs of complying with this requirement would be included in the overall cost to intermediaries to develop their platforms and that this requirement would impose only nominal incremental costs on intermediaries on an ongoing basis, primarily because the functionality necessary to upload the required issuer disclosure information is a standard feature offered on many websites and would not require frequent updates.

The proposed rules would also require an intermediary to provide communication channels on its platform, meeting certain conditions, which would allow investors who have opened accounts with intermediaries and representatives of the issuer to interact and exchange comments about the issuer's offering on that intermediary's platform, and which would be publicly available for viewing (*i.e.,* by those who may not have opened accounts with the intermediary).[1002] While Congress contemplated the use of such communication channels, the statute does not explicitly require intermediaries to provide them.[1003] Compared with the alternative of not requiring intermediaries to provide communication channels, we believe that requiring the communications channel to be on the intermediary's platform would allow investors, particularly those who might be less familiar with online social media, to participate in online discussions regarding ongoing offerings without having to actively search for such discussions on external websites. We do recognize, however, that this requirement would not

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[1002] *See* proposed Rule 303(c) of Regulation Crowdfunding.

[1003] *See* Section 4A(b)(3).

preclude investors from initiating additional discussions on external websites. Furthermore, the requirements that the communication channels be viewable by the public and that promoters be clearly identified on these channels would enhance transparency about the issuer and its offering with appropriate disclosures, ultimately allowing investors to make more informed investment decisions. We estimate that the costs of this proposed requirement are incorporated into the costs of developing a platform and that once the platform has been set up the ongoing burden to comply would be minimal.

We are also proposing to require intermediaries to, upon receipt of an investment commitment from an investor, promptly provide or send to the investor a notification of that investment commitment.[1004] While this notice is not statutorily required, we believe that this requirement is appropriate as it would provide investors with key information about their investment commitments, including notice of the opportunity, as relevant, to cancel their investment commitments. Investors would benefit from these requirements because they would be provided with the necessary information to evaluate their investment commitments, their securities transactions and the intermediaries that are effecting those transactions. We estimate that the costs of these requirements are incorporated into the costs of developing a platform and that the ongoing burden to comply would be minimal.

We also propose to implement the statutory requirement for intermediaries to allow investors to cancel their commitments to invest, by requiring investors to have until 48 hours prior to the deadline identified in the issuer's offering materials to cancel their investment

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[1004] *See* proposed Rule 303(d) of Regulation Crowdfunding.

commitments.[1005] If an issuer reaches its target offering amount prior to the target offering deadline, the proposed rules would permit early closing of the offering, provided that the intermediary sends notices to investors informing them of the closing and the deadline for the opportunity to cancel.[1006] The proposed rules also would set forth notice requirements and requirements related to the intermediary directing payments in the event of cancellations and material changes to offerings.[1007] The proposed rules would impose specific obligations on intermediaries related to informing investors about their right to cancel, depending on particular circumstances relating to timing of the offering, such as in the event of early closings, cancellations and material changes that trigger reconfirmations of investment commitments.

We believe that investors would benefit from receiving these notices because the notifications and accompanying information would keep investors informed about the status of the offering and help them make informed investment decisions. We further believe that investors would reasonably expect to be informed of changes impacting the timing of offerings and other material changes. This approach also would benefit investors by providing investors with sufficient time to review and assess information and communications about the issuer.

We recognize that allowing investors to cancel their investment commitments up to 48 hours prior to the deadline identified in the issuer's offering materials may impose a cost on issuers who, because of investors cancelling commitments late in the offering period, may fall below the target offering amount and so decide to cancel the offering or to extend the offering period. Accordingly, we recognize that this requirement may have an effect on capital

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1005 *See* proposed Rule 304(a) of Regulation Crowdfunding.

1006 *See* proposed Rule 304(b) of Regulation Crowdfunding.

1007 *See* proposed Rules 304(c) and (d) of Regulation Crowdfunding.

formation. Intermediaries also may incur direct costs in developing and maintaining such systems, for instance to send the relevant notices to investors, as part of the cost of developing a platform reflected in the table above.

b. Measures to Reduce the Risk of Fraud and Limitations

The statute and proposed rules require intermediaries to take certain steps to reduce the risk of fraud, including steps related to checking whether issuers are eligible to rely on Section 4(a)(6) and whether investors comply with investment limits in order to participate in an offering pursuant to Section 4(a)(6). We believe that intermediaries will be in the best position to take these steps and that these requirements will increase investor protections. Additionally, the statute and proposed rules place certain limitations on intermediaries. These limitations are further meant to increase investor protection in the securities-based crowdfunding market. As noted above, the costs and benefits of these provisions are difficult to quantify or estimate with any degree of certainty. To the extent possible, however, we have quantified estimates of the direct costs associated with these provisions and the proposed rules in the table above.

The proposed rules would require that an intermediary have a reasonable basis for believing that an issuer seeking to offer and sell securities in reliance on Section 4(a)(6) through the intermediary's platform complies with the requirements in Section 4A(b) of the Securities Act and the related requirements in Regulation Crowdfunding. In satisfying this requirement, an intermediary may rely on the representations of the issuer concerning compliance with these requirements unless the intermediary has reason to question the reliability of those representations. The proposed rules would also require that an intermediary have a reasonable basis for believing that an issuer seeking to offer and sell securities on the intermediary's platform complies with all issuer requirements and has established means to keep accurate

records of holders of the securities. The proposed rules would permit an intermediary to rely on an issuer's representations concerning compliance with these requirements unless the intermediary has reason to question the reliability of the representations. The proposed rules also would require an intermediary to deny access to an issuer if it has a reasonable basis for believing that the issuer or any of its officers, directors (or any person occupying a similar status or performing a similar function) or 20 Percent Beneficial Owners was subject to a disqualification under the proposed rules. As required by the statute, the proposed rules would require the intermediary to conduct a background and securities enforcement check on each of these persons. Furthermore, the proposed rules would require an intermediary to deny access to its platform if the intermediary believes that the issuer or the offering presents the potential for fraud or otherwise raises concerns regarding investor protection.[1008] Each of these proposed requirements is intended to help reduce the risk of fraud in securities-based crowdfunding.

We believe that if intermediaries take the measures we propose to require, investors would be more willing to participate in securities-based crowdfunding offerings. Investors would rely on the efforts of the intermediary that conducted a background and securities enforcement regulatory history check, solving a collective action problem that would be prohibitively costly if left to individual investors. To the extent these checks lessened the likelihood of inappropriate or nefarious activity, they could increase investor willingness to purchase crowdfunding securities, thereby potentially resulting in issuers having greater access to capital. We anticipate that most intermediaries would employ third parties to perform background checks.

[1008] *See* proposed Rule 301 of Regulation Crowdfunding.

We also recognize that permitting an intermediary to rely on an issuer's representations unless the intermediary has reason to question the reliability of the representations could potentially lessen the incentive for an intermediary to thoroughly investigate the issuers and securities to be offered on its platform. Such an outcome could result in a higher levels of fraud compared to a requirement that intermediaries perform a thorough investigation to ensure that the issuer complied with all the requirements. A higher level of fraud would negatively affect both investors in crowdfunding offerings and non-fraudulent issuers. Based on comments and conversations with industry participants,[1009] however, we believe it is likely that investors and interested participants would provide relevant adverse information about an issuer or an offering through postings on chat sites, message boards, and other communication channels, including, but not limited to, the communication channels to be provided by the intermediary. These media would provide a potential source of information for intermediaries who may be subject to liability as "issuers."

The proposed rules also would require an intermediary to have a reasonable basis for believing that an investor has not exceeded the investment limits discussed above before accepting an investment commitment from that investor.[1010] Under the proposed rules, an intermediary may rely on an investor's representations concerning compliance with the investment limits unless the intermediary has reason to question the reliability of the representations. We believe that this requirement would help to ensure that the investor protection benefits associated with the investment limits are realized. This ability to rely on investor representations should help mitigate the potential cost that intermediaries could incur in

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[1009] *See* note 888.

[1010] *See* proposed Rule 303(b)(1) of Regulation Crowdfunding.

relation to this requirement. At the same time, we realize that investors might make inaccurate representations, whether intentionally or not. Although some of these concerns could be addressed by the use of a central data repository, for example, the statute does not mandate the use of such a central data repository and we are not proposing to require one because, as we consider this alternative to the proposed standard, we believe that the benefits of establishing such a repository would not at this time justify the potentially significant costs. Accordingly, we believe that the standard proposed represents a reasonable approach to implement the statutory requirement, achieving an appropriate balance between competing concerns.

We expect that because system functionality to obtain user acknowledgments is standard on many online trading and electronic commerce websites, the market to build such system functionality is highly commoditized and the average cost to both develop and maintain systems that allow an investor to represent that he or she has not exceeded allowable investment limits would not be unduly high. As noted in the table above, we estimate that the cost to comply with this requirement would be incorporated into the costs to develop a platform and that the ongoing burden to comply would be minimal.

As noted above, the statute and the proposed rules would also prohibit an issuer from compensating, or committing to compensate, directly or indirectly, any person to promote the issuer's offering through communication channels provided by the intermediary unless the issuer takes reasonable steps to ensure that such person clearly discloses the receipt (both past and prospective) of such compensation each time a promotional communication is made. We also are proposing to require that an intermediary take certain steps to ensure that investors are made aware of such compensation, and that such compensation is disclosed in the communication

channels, so that investors can gauge the promoter's communications appropriately.[1011] We believe that intermediaries would be in an appropriate position to take such steps. As part of the account opening, the intermediary would be required disclose to persons opening accounts that any person who receives compensation to promote an issuer's offering, or who is a founder or an employee of an issuer that engages in promotional activities on behalf of the issuer on the intermediary's platform, must clearly disclose on the platform the receipt of the compensation and that he or she is engaging in promotional activities on behalf of the issuer. In addition, under the proposed rules, the intermediary must require that any person posting a comment in the communication channels clearly disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or is otherwise compensated, whether in the past or prospectively, to promote the issuer's offering.

Under the proposed rules, intermediaries might incur direct costs in complying with the requirements to disclose compensation to promoters, and certain additional costs from time to time to ensure continued compliance, as outlined in the table above. In addition, if this proposed requirement discourages the use of promoters by issuers, it could limit the investor pool for a securities-based offering made in reliance on Section 4(a)(6), thus limiting the ability of an issuer to raise capital.

Additionally, the statute prohibits the directors, officers or partners of an intermediary, or any person occupying a similar status or performing a similar function, from having any financial interest in an issuer that uses the services of the intermediary. The proposed rules would implement this statutory requirement but extend the prohibition to the intermediary as

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[1011] *See* proposed Rules 302(c) and 303(c)(4) of Regulation Crowdfunding.

well.[1012] Such a prohibition would be beneficial to investors and issuers because if an intermediary were to have a financial interest in one or more issuers that plan to use its services, the intermediary could have an incentive not based solely on merit to promote that issuer's offering, potentially to the detriment of investors and other issuers. The prohibition would, however, impose a cost on an issuer who might otherwise seek to compensate an intermediary with an interest in the issuer, rather than cash, for its services. It is thus possible that the prohibition could make securities-based crowdfunding unavailable to an issuer that does not have the ability to otherwise compensate an intermediary.

The statute requires that intermediaries ensure that all offering proceeds are provided to the issuer only when the aggregate capital raised from all investors is equal to or greater than a target offering amount. The proposed rules would implement this requirement by requiring intermediaries that are registered as brokers to comply with the existing requirements of Exchange Act Rule 15c2-4.[1013] Intermediaries registered as funding portals would be required to direct investors to transmit the funds or other consideration directly to a qualified third party, which is a bank, that has agreed in writing to hold the funds or maintain a bank account (or accounts) for the exclusive benefit of, and to promptly transmit the funds to, the issuer or the investors, depending on circumstances such as whether the offering was completed or was cancelled, and whether the investment commitment was cancelled. The proposed rules also would require a funding portal to direct the qualified third party to transmit funds to the issuer once the target offering amount is reached and the cancellation period has elapsed; to return

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[1012] *See* proposed Rule 300(b) of Regulation Crowdfunding.

[1013] *See* proposed Rule 303(e) of Regulation Crowdfunding.

funds to an investor when an investment commitment has been cancelled; and to return funds to investors when the offering has not been completed.

These requirements would benefit investors and issuers by helping to ensure that funds are appropriately refunded or transmitted in accordance with the terms of the offering. In particular, the requirement that the account in which funds are deposited be exclusively for the benefit of investors and the issuer would help prevent the intermediary or other parties from claiming or otherwise unlawfully taking funds from that account.

Under the statute, intermediaries also may not compensate promoters, finders or lead generators for providing brokers or funding portals with the personally identifiable information of any potential investor. We propose to implement this statutory requirement by prohibiting an intermediary from compensating any person for providing the personally identifiable information of any crowdfunding investor or potential investor to intermediaries.[1014] We anticipate that intermediaries would have some need for referrals to the intermediary's platform and, therefore, we are proposing to permit an intermediary to compensate a person for directing issuers or potential investors to the intermediary's platform in certain situations.[1015] These requirements would benefit intermediaries by providing them with a means to attract more investors to their crowdfunding portals, without allowing the sharing of personally identifiable information. Investors would meanwhile benefit from the additional privacy protection. Intermediaries might incur a cost because the proposed requirement would not allow them to use personally identifiable information to target and seek out specific investors, thus reducing the potential investor pool for certain offerings.

[1014] *See* proposed Rule 305(a) of Regulation Crowdfunding.

[1015] *See* proposed Rule 305(b) of Regulation Crowdfunding.

5. Additional Funding Portal Requirements

Under the proposed rules, a funding portal would register with the Commission by filing a complete Form Funding Portal with information concerning the funding portal's operation.[1016] In the table above, we estimate the costs that intermediaries would incur related to registering as a funding portal on Form Funding Portal.

The proposed rules would include the statutory requirement that a funding portal be a member of a registered national securities association. As explained above, we believe that the statute effectively mandates that an intermediary be a FINRA member or any other registered national securities association (as applicable). The proposed requirement that funding portals register with the Commission and a registered national securities association benefits investors by providing oversight to reduce the risk for fraud. Although we estimate that there are costs associated with this requirement, we believe that the reduction in fraud risk deriving from this requirement might benefit portals by helping to create a marketplace in which investors are more willing to participate and issuers are more comfortable using this method of capital formation.

The proposed rules also would require that funding portals use proposed Form Funding Portal to provide updates whenever information on file becomes inaccurate for any reason, to register successor funding portals and to withdraw from funding portal registration. Although funding portals would incur time and compliance costs to update Form Funding Portal, we expect funding portals would have navigated the filing process for Form Funding Portal when they register and would be familiar with the process by the time they update the form.

[1016] *See* proposed Rule 400(a) of Regulation Crowdfunding.

We propose to allow nonresident funding portals to register with us, provided that certain conditions are met. One condition is that an information sharing agreement is in place between the Commission and a competent regulatory authority in the relevant jurisdiction. The proposed rules would also require a nonresident funding portal to appoint an agent for service of process in the United States, and to certify and provide opinion of counsel that as a matter of law, the funding portal can provide the Commission and any national securities association of which it is a member with prompt access to its books and records and can, as a matter of law, submit to onsite inspection and examination by the Commission and the national securities association.

Compared to an alternative that we could have selected, *i.e.*, that of not allowing nonresident entities to operate as funding portals in the U.S. crowdfunding market, the proposed rules would increase competition among crowdfunding intermediaries, which in turn is likely to reduce the fees that intermediaries charge issuers. The lack of data does not allow us to estimate the magnitude of this potential fee reduction. Lower costs of raising capital could also attract more potential issuers to use the crowdfunding exemption, thus enhancing capital formation. Conditioning the nonresident funding portal registration on the presence of an information sharing agreement as mentioned above would provide regulators and market participants with more information about the nonresident funding portals, thus reducing the likelihood of fraud.

Although the requirements we propose with respect to appointment of an agent for service of process, and a certification and legal opinion would impose costs on nonresident funding portals, these requirements are consistent with regulations we have proposed to impose on other nonresident entities subject to our regulation. The proposed regulations would enhance investor protection by requiring steps to ensure that funding portals that were not based in the United States, or that were subject to laws other than those of the United States, would nevertheless be accessible to the Commission and other relevant regulators for purposes of conducting examinations of, and enforcing

U.S. laws and regulations against these entities. While the JOBS Act does not distinguish between resident and nonresident funding portals, it clearly contemplates Commission oversight of registered funding portals and the tailoring of such requirements to varied circumstances.

The statute also provides an exemption from broker-dealer registration for funding portals. The proposed rules would implement the statutory requirement by stating that a registered funding portal is exempt from the broker registration requirements of Exchange Act Section 15(a)(1) in connection with its activities as a funding portal.[1017] This proposed rule would benefit funding portals because it would specify the scope of the limited exemption in the statute, thus providing clarity to the funding portals regarding their activities. We believe this approach of exempting funding portals from broker registration and its accompanying regulations would benefit the market and its participants. The activities of funding portals would be more limited than those of brokers. Thus, the proposed rules would require funding portals to comply with a registration requirement and set of regulations more appropriate for their activities, rather than the more extensive and higher cost requirements that accompany broker-dealer registration. Lower registration costs of funding portals could translate into lower fees they charge issuers that use these portals, thus benefiting issuers of crowdfunding securities and potentially increasing capital formation. We are unable to quantify these potential benefits. We do not expect any significant benefits to registered broker-dealers from this limited exemption for funding portals. Registered broker-dealers could be put at a competitive disadvantage because of the higher registration cost. They, however, will be allowed a wider variety of

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[1017] *See* proposed Rule 401(a) of Regulation Crowdfunding. *See also* Section IV.C.2.j below.

activities compared to funding portals, the benefits of which could more than compensate for the higher registration costs.

The proposed rules would also require a funding portal to obtain a fidelity bond, and maintain fidelity bond coverage for the duration of its registration as a funding portal.[1018] This requirement would benefit investors by protecting them to some extent from potential losses caused by fraud. Investors and issuers that used funding portals for their offerings would likewise benefit from the added stability that the fidelity bond protection would provide.

We estimated the costs of maintaining fidelity bond coverage based on conversations with insurance service companies for FINRA-registered firms and note that the actual cost of coverage for funding portals would vary depending on particular circumstances, such as the size of the firm. For instance, according to these sources, funding portals with fewer employees (*e.g.*, up to 30 employees) might incur lower fidelity bond costs than funding portals with more employees.

a. Safe Harbor for Certain Activities

Exchange Act Section 3(a)(80) prohibits funding portals from (1) offering investment advice or recommendations, (2) soliciting purchases, sales or offers to buy securities offered or displayed on the funding portal's platform, (3) compensating employees, agents or other such persons for solicitation or based on the sale of securities displayed or referenced on the funding portal's platform, or (4) holding, managing, possessing or otherwise handling investor funds or securities. The proposed rules would give funding portals, their associated persons, affiliates and business associates, a measure of clarity regarding activities that would be permissible without

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[1018] *See* proposed Rule 400(f) of Regulation Crowdfunding.

violating these statutory prohibitions, while also helping to protect investors from activities that would create potential conflicts of interest.[1019] Thus, compared with the alternative that we could have chosen, that of not providing the safe harbor, the proposed rules will likely reduce funding portals' regulatory burden (*e.g.*, it will be easier for funding portals to advertise their activities and attract issuers and investors, thus potentially increasing their revenue). The legal certainty provided by the safe harbors, for example proposed Rule 402(b)(4) which permits a funding portal to provide on its platform communication channels, would help ensure that the benefits of the substantive rule provisions are realized. Such measures have the potential to attract greater numbers of investors to crowdfunding through funding portals than would otherwise participate, thereby encouraging capital formation.

The proposed rules would permit a funding portal to apply objective criteria to limit the crowdfunding securities offered on its platform.[1020] Investors would benefit by being able to search, sort or categorize offerings on a funding portal's platform in an organized manner, which would allow them to find investment opportunities meeting specific criteria. This functionality would more efficiently match investors with investment opportunities. These proposed rules would benefit funding portals by providing them with the flexibility to limit the use of their platform to certain types of issuers and to highlight certain offerings on their platforms which investors may find of interest.

Under the proposed rules, funding portals would be permitted to provide advice to an issuer on the structure and content of its offerings, including assistance to the issuer in preparing

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[1019] *See* proposed Rule 402 of Regulation Crowdfunding.

[1020] *See* proposed Rule 402(b)(1) of Regulation Crowdfunding.

documentation.[1021] This proposed rule would allow issuers to obtain guidance that may not typically be available to them and lower funding costs. Many potential issuers seeking to offer and sell crowdfunding securities are unlikely to be familiar with how to best structure offerings so as to raise capital in the most cost effective manner, and they might not have the capital, knowledge or resources to hire outside advisors. Given that an issuer would be required to effect offerings through an intermediary, we believe that permitting funding portals to provide these services to issuers would lower overall transaction costs for issuers, as they would not need to engage another party to provide these services. This effect would in turn help to enhance market efficiency.

The proposed rules would also permit a funding portal to compensate a third party for referring a person to the funding portal in certain circumstances.[1022] As discussed above, this proposed safe harbor would benefit funding portals by providing them with a means to attract more investors to their crowdfunding platforms, while protecting investors' personally identifiable information. Investors also would benefit from the prohibition on transaction-based compensation (other than to registered broker-dealers), which would help to reduce the incentive for abusive practices.

The proposed rules would permit a funding portal to pay or offer to pay compensation to a registered broker or dealer for services provided in connection with the offer or sale of securities in reliance on Section 4(a)(6), subject to certain conditions set forth in the rule.[1023] Similarly, a funding portal could, subject to certain conditions, receive compensation from a

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1021 *See* proposed Rule 402(b)(5) of Regulation Crowdfunding.

1022 *See* proposed Rule 402(b)(6) of Regulation Crowdfunding.

1023 *See* proposed Rule 402(b)(7) of Regulation Crowdfunding.

registered broker or dealer for services provided by the funding portal.[1024] Under these proposed rules, funding portals would benefit from being able to enter into these types of arrangements with registered broker-dealers who could provide services that the funding portals otherwise would be prohibited from providing. Brokers also would benefit from the additional business that funding portals might be able to attract through their platforms and online presence generally, as well as from services, such as those related to technology, which funding portals could provide. Issuers and investors might benefit from such arrangements by having more readily-available services provided to them by entities subject to the applicable regulatory oversight.

The proposed rules would permit a funding portal to advertise its existence, subject to certain conditions.[1025] These requirements would benefit funding portals by allowing them to advertise publicly to attract more investors to their crowdfunding platforms; however, they might bear costs associated with ensuring compliance with the rule's conditions. The proposed rule also would enhance market efficiency as investors become more aware of available offerings through advertisements by funding portals and are thus able to better match their investments with projects that are most suitable for their risk preferences.

The statute requires intermediaries to take measures to reduce the risk of fraud, and we propose to implement this requirement by requiring a funding portal to deny access to its platform to an issuer that the funding portal believes presents the potential for fraud or otherwise raises concerns regarding investor protection.[1026] The requirement would further enhance

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[1024] *See* proposed Rule 402(b)(8) of Regulation Crowdfunding.

[1025] *See* proposed Rule 402(b)(9) of Regulation Crowdfunding.

[1026] *See* proposed Rules 301(c) and 402(b)(10) of Regulation Crowdfunding.

investor protection by giving funding portals the flexibility to deny access to potential bad actors. Funding portals also would benefit from the ability to deny access to certain issuers to protect the integrity of the offering process and the market reputation of the crowdfunding platforms without fear of violating the prohibition on providing investment advice.

The proposed rules would clarify that a funding portal would not be in violation of the statutory prohibitions on holding, managing, possessing or otherwise handling investor funds or securities by accepting investment commitments from potential investors.[1027] Under the proposed rules funding portals could direct investors where to transmit funds or remit payment in connection with the purchase of securities offered and sold in reliance on Section 4(a)(6).[1028] Similarly, a funding portal could direct a qualified third party to release proceeds of a successful offering to the issuer upon completion of the offering or to return investor proceeds when an investment commitment or offering is cancelled.[1029] These proposed rules would give both funding portals and entities with which they do business a measure of legal certainty that funding portals providing direction for funds to and from qualified third parties in compliance with the proposed rules would not constitute activity in violation of the statutory prohibitions on holding, managing, possessing or otherwise handling investor funds or securities.

b. Compliance Requirements

We are proposing to require that a funding portal implement written policies and procedures, reasonably designed to achieve compliance with proposed Regulation Crowdfunding

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1027 *See* proposed Rule 402(b)(11) of Regulation Crowdfunding.

1028 *See* proposed Rule 402(b)(12) of Regulation Crowdfunding.

1029 *See* proposed Rule 402(b)(13) of Regulation Crowdfunding.

and the rules and regulations thereunder, relating to its business as a funding portal.[1030] This requirement would provide a benefit to investors and funding portals alike, as written policies and procedures would aid, enhance and help to ensure consistent compliance with the proposed rules. Funding portals would incur costs associated with the requirement to develop their own procedures and implement written policies and procedures, as well as to update and enforce them, as set forth in the table above.

We are also proposing to require registered funding portals to comply with the requirements of the Bank Secrecy Act (BSA), including the reporting, recordkeeping and record retention requirements that apply to brokers.[1031] We recognize that the proposed rules would impose costs on funding portals to implement anti-money laundering (AML) procedures, as set forth in the table above; however, we believe that the proposed requirements provide important benefits. As discussed above,[1032] low-priced and privately-placed securities pose a money laundering risk because they are susceptible to market manipulation and fraud.[1033] Requiring funding portals to follow these AML procedures, in particular the requirement to file SARs, would help identify to law enforcement and regulators potentially fraudulent activity. These AML requirements would help therefore to protect market participants from illegal activity that could potentially infiltrate new online investment opportunities. Requiring the implementation of AML procedures would, in turn, provide potential investors with some degree of confidence

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1030 *See* proposed Rule 403(a) of Regulation Crowdfunding.

1031 *See* proposed Rules 401(b), 403(b) and 404(f) of Regulation Crowdfunding. *See also* Section II.D.4 above.

1032 *See* Section II.D.4.b above.

1033 *See* FATF Typology, note 641.

that adequate protections against illegal activity exist for this new fundraising approach and would encourage more investors to participate, thus facilitating capital formation.

Additionally, the statute requires that intermediaries take such steps to protect the privacy of information collected from investors as we determine appropriate. We are proposing to implement this statutory provision by requiring a funding portal to comply with Regulation S-P, S-ID and Regulation S-AM, which are applicable to brokers.[1034] We believe that requiring a funding portal to comply with privacy obligations would help protect the personally identifiable information of investors and potential investors, consistent with how it is protected by other financial intermediaries. Compared with an alternative that we could have selected, that of developing a new privacy regime applicable only to funding portals, the proposed rules would introduce consistency between funding portals and broker-dealers with respect to privacy obligations. That will benefit investors by lowering their information search costs and reducing investor confusion. We recognize that the requirement would impose costs on funding portals to comply with the privacy requirements, as set forth in the table above; however, these additional privacy protections could give potential investors the confidence to participate in offerings made in reliance on Section 4(a)(6), which would facilitate capital formation and benefit the markets generally.

As a condition to exempting funding portals from the requirement to register as broker-dealers under Exchange Act Section 15(a)(1), Exchange Act Section 3(h)(1)(A) requires that registered funding portals remain subject to, among other things, the Commission's examination authority. Under the proposed rules, a funding portal would be required to permit the

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[1034] *See* proposed Rule 403(c) of Regulation Crowdfunding.

examination and inspection of all its business and business operations relating to its activities as a funding portal, including its premises, systems, platforms and records by Commission representatives and by representatives of the registered national securities association of which it is a member.[1035] Although funding portals would face time and compliance costs in submitting to Commission and registered national securities association examinations, inspections or investigations, and potentially responding to any issues identified, funding portals, investors and issuers would benefit from the enhanced compliance with regulations due to the oversight, as well as the sanctions or other disciplinary actions that may follow upon findings of violations through such inspections, examinations or investigations.

We are proposing to require a registered funding portal to maintain and preserve certain records relating to its business.[1036] The proposed rules would require, among other things, that the funding portal maintain and preserve certain books and records for a period of not less than five years and in an easily-accessible place for the first two years. Recordkeeping requirements help registrants with their compliance. They are a familiar and important element of the approach to broker-dealer regulation, as well as the regulation of investment advisers and others, and are designed to maintain the effectiveness of our inspection program for regulated entities, facilitating our review of their compliance with statutory mandates and with our rules. The proposed rule would assist us in evaluating a funding portal's compliance with the Securities Act Sections 4(a)(6) and 4A and the rules issued thereunder. Regulators would benefit from

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[1035] *See* proposed Rule 403(d) of Regulation Crowdfunding.

[1036] *See* proposed Rule 404 of Regulation Crowdfunding. We note that registered brokers already are expected to comply with the books and records requirements in Exchange Act Rules 17a-3, 17a-4 and 17a-5 (17 CFR 240.17a-3, 17a-4 and 17a-5). Thus, all intermediaries, whether registered as brokers or as funding portals, would be required to make and preserve books and records.

standardized recordkeeping practices for intermediaries because they would be able to perform more efficient, targeted inspections and examinations, and have an increased likelihood of identifying improper conduct at earlier stages of the inspection or examination.

Funding portals may incur one-time costs in establishing the systems necessary to comply with the proposed books and records requirements. We note, however, that the records required to be made and preserved under the proposed rules are those that would ordinarily be made and preserved in the ordinary course of business by a regulated broker engaging in these activities. We recognize that there may be a slight competitive advantage for funding portals over brokers to the extent that the proposed recordkeeping rule for funding portals is less burdensome for than the requirements applicable to brokers. At the same time, we believe that the proposed recordkeeping rule for funding portals is consistent with the narrow range of their activities. Our estimates of the costs associated with this requirement are set forth in the table above.

6. Insignificant Deviations

We are proposing to provide a safe harbor for issuers for certain insignificant deviations from a term, condition or requirement of Regulation Crowdfunding.[1037] The proposed safe harbor would provide that insignificant deviations from a term, condition or requirement of Regulation Crowdfunding would not result in a loss of the exemption, so long as the issuer relying on the exemption can show that: (1) the failure to comply was insignificant with respect to the offering as a whole; (2) the issuer made a good faith and reasonable attempt to comply with all applicable terms, conditions and requirements of Regulation Crowdfunding; and (3) the issuer did not know of the failure to comply, where the failure to comply with a term, condition

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[1037] *See* proposed Rule 502(a) of Regulation Crowdfunding.

or requirement was the result of the failure of the intermediary to comply with the requirements of Section 4A(a) and the related rules, or such failure by the intermediary occurred solely in offerings other than the issuer's offering.

Providing a safe harbor could impose costs on investors, issuers, funding portals and regulators, compared with the alternative of not providing a safe harbor, to the extent that issuers lessen the vigor with which they develop and implement systems and controls to achieve compliance with the requirements of Regulation Crowdfunding. We believe that limiting the proposed safe harbor to insignificant instances of non-compliance and requiring a good faith and reasonable attempt to comply with the requirements would mitigate these potential costs and would benefit issuers and funding portals by providing greater certainty regarding their reliance on the exemption. In the absence of a safe harbor, issuers may extend significantly more effort and more resources to satisfy the requirements of Regulation Crowdfunding or they may face greater uncertainty regarding their reliance on the exemption, which could discourage participation in this market, impacting efficiency and capital formation.

7. Relationship with State Law

Section 305 of the JOBS Act amended Securities Act Section 18(b)(4)[1038] to preempt the ability of states to regulate certain aspects of crowdfunding conducted pursuant to Section 4(a)(6). This statutory amendment would benefit issuers by making transactions made in reliance on Section 4(a)(6) less costly, because an issuer would not be required to register transactions with each state where it offers and sells securities in reliance on Section 4(a)(6). It also could benefit investors because these cost savings ultimately may be passed on to investors.

[1038] 15 U.S.C. 77r(b)(4).

Absent preemption of the states' registration requirements, an offering made through the Internet in reliance on Section 4(a)(6) and the proposed rules could result in an issuer potentially violating state securities laws. Recent evidence in donation-based and reward-based crowdfunding campaigns suggests that contributions are not exclusively local.[1039] The statutory preemption of state registration laws would reduce issuer uncertainty regarding the necessity of state registration, and it would eliminate the costs that would be associated with state registration. On the other hand, state registration laws may provide an additional layer of investor protection, and their preemption will remove a potential layer of review and may lead to increased levels of fraud. This potential negative effect of state law preemption, however, could be offset by some of the statutory requirements and the proposed rules that are designed to deter fraud, such as public disclosure, investment limits and the use of a registered intermediary.

8. Exemption from Section 12(g)

Proposed Rule 12g-6 provides that securities issued pursuant to an offering made under Section 4(a)(6) would be permanently exempted from the record holder count under Section 12(g). This proposal delays the more extensive Exchange Act reporting requirements until the issuer either sells securities in a registered transaction or registers a class of securities under the Exchange Act to reach a trading market. This allows an issuer to time the decision to become a reporting company without forcing it to become a reporting company through actions outside of its control (*e.g.*, secondary market trading). By conditioning the more burdensome reporting requirements on the decision to raise new capital or to actively seek a liquid trading market, the

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[1039] For example, in crowdfunding campaigns for early stage musical projects, the average distance between artist-entrepreneurs and contributors was 3,000 miles. *See* Ajay Agrawal, Christian Catalini and Avi Goldfarb, *The Geography of Crowdfunding*, NET Institute Working Paper No. 10-08 (Oct. 29, 2010), *available at* http://ssrn.com/abstract=1692661.

benefits of increased disclosure would scale with the scope of investment in the issuer, thus improving efficiency.

This proposal could, however, result in an unintended and potentially costly outcome. It is possible that an issuer that sells securities in reliance on Section 4(a)(6) could become an Exchange Act reporting company, but then deregister and go dark with potentially thousands of investors. For example, in an attempt to provide additional liquidity to its shareholders, an issuer could voluntarily register a class of securities under Exchange Act Section 12(g) so that the securities could be quoted in the over-the-counter market. The issuer would become subject to Exchange Act reporting requirements and would no longer be subject to the ongoing reporting requirements of Regulation Crowdfunding. If the issuer does not sell securities in a registered offering or trigger the asset and holder of record thresholds for mandatory Exchange Act registration in Section 12(g), the issuer could deregister its securities and stop all ongoing reporting obligations even if all the securities sold in reliance on Section 4(a)(6) remain outstanding.[1040] Given that securities-based crowdfunding could attract thousands of potential issuers, this is a possible outcome for some of these issuers. Under such an outcome, a significant number of investors in an issuer might be unable to obtain important information about that issuer, which could affect the liquidity and pricing of the securities these investors hold.

[1040] Although less likely, the same could happen if an issuer sells securities in reliance on Section 4(a)(6) and subsequently registers a class of securities under Exchange Act Section 12(b) in order to list its securities on a national securities exchange.

9. Disqualification

The statute and the proposed rules impose disqualification provisions under which an issuer would not be eligible to offer securities pursuant to Section 4(a)(6) and an intermediary would not be eligible to effect or participate in transactions pursuant to Section 4(a)(6).[1041] The proposed disqualification provisions for issuers are substantially similar to those imposed under Rules 262 of Regulation A and 506 of Regulation D,[1042] while the proposed disqualification provisions for intermediaries under Section 3(a)(39) are substantially similar to, while somewhat broader than, the provisions of Rule 262.

a. Issuers

The proposed rules should induce issuers to implement measures to restrict bad actor participation in offerings made in reliance on Section 4(a)(6). This should help reduce the potential for fraud in the market for such offerings, which should help reduce the cost of raising capital to issuers that rely on Section 4(a)(6), to the extent that disqualification standards lower the risk premium associated with the presence of bad actors in securities offerings. In addition, the requirement that issuers determine whether any covered persons are subject to disqualification might obviate the need for investors to do their own investigations and eliminate redundancies that might exist in otherwise separate investigations. This should help reduce information-gathering costs to investors, to the extent that issuers are at an advantage in accessing much of the relevant information and to the extent that issuers could do so at a lower cost than investors.

[1041] *See* Section 302(d) of the JOBS Act; proposed Rule 503 of Regulation Crowdfunding. *See also* discussion in Section II.E.6 above.

[1042] *See Disqualification Adopting Release*, note 101.

The proposed rules still would, however, impose costs on issuers, other covered persons and investors. If issuers are disqualified from relying on Section 4(a)(6) to make their offerings, they might experience increased costs in raising capital through alternative methods that do not require bad actor disqualification, if available, or alternative methods might be altogether unavailable. This could hinder potential investment opportunities for such issuers, with possible negative effects on capital formation. In addition, issuers and other covered persons may incur costs in connection with internal personnel changes that issuers may make to avoid the participation of those covered persons who are subject to disqualifying events. Issuers also might incur costs associated with restructuring share ownership positions to avoid having 20 Percent Beneficial Owners who are subject to disqualifying events. Finally, issuers might incur costs in connection with seeking waivers of disqualification from the Commission or determinations by other authorities that existing orders should not give rise to disqualification.

We anticipate that the reasonable care exception[1043] also would impose costs and benefits. In this regard, a reasonable care exception might encourage capital formation by eliminating any hesitation issuers might otherwise experience under a strict liability standard. However, such an exception also might encourage issuers to take fewer steps to inquire about offering participants than they would if a strict liability standard applied, increasing the potential for fraud in the market for offerings made in reliance on Section 4(a)(6). Nevertheless, some issuers, with regard to the exercise of reasonable care, might incur costs associated with conducting and documenting their factual inquiry into possible disqualifications. The lack of specificity in the rule, while providing flexibility to the issuer to tailor its factual inquiry as

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[1043] *See* proposed Rule 503(b)(4) of Regulation Crowdfunding. *See also* Section II.E.6.a.iii above.

appropriate to a particular offering, might increase these costs because uncertainty could drive issuers to do more than necessary under the rule. Alternatively, it might reduce these costs because uncertainty might drive issuers to exert minimum effort in conducting and documenting a factual inquiry.

The requirement that issuers disclose matters that would have triggered disqualification, had they occurred after the effective date of proposed Regulation Crowdfunding,[1044] also would impose costs and benefits. The disclosure requirement would reduce costs associated with covered persons who would be disqualified under the proposed rules but for the fact that the disqualifying event occurred prior to the effective date of the rules. However, this approach would allow the participation of past bad actors, whose disqualifying events occurred prior to the effective date of the proposed rules, which could expose investors to the risks that arise when bad actors are associated with an offering. Nevertheless, investors would benefit by having access to such information that could inform their investment decisions. Issuers also may incur costs associated with the factual inquiry, preparing the required disclosure and making any internal or share ownership changes they may decide to make to avoid the participation of covered persons that trigger the disclosure requirement. Disclosure of triggering events also may make it more difficult for issuers to attract investors, and issuers may experience some or all of the impact of disqualification as a result.

We believe the inclusion of Commission cease-and-desist orders in the list of disqualifying events would not impose a significant, incremental cost on issuers and other covered persons because many of these groups might already be subject to disqualifying orders

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[1044] *See* proposed Rule 201(u) of Regulation Crowdfunding. *See also* Section II.E.6.a.v above.

issued by the states, federal banking regulators and the National Credit Union Administration.[1045] The inclusion of such orders in the list of disqualifying events might change how settlement negotiations are conducted between respondents and the Commission, and the Commission could grant an appropriate waiver from disqualification.

Under the proposed rules, orders issued by the CFTC would trigger disqualification to the same extent as orders of the regulators enumerated in Section 302(d)(2)(B)(i) of the JOBS Act (*e.g.*, state securities, insurance and banking regulators, federal banking agencies and the National Credit Union Administration). We believe that including orders of the CFTC would result in the similar treatment, for disqualification purposes, of comparable sanctions. In this regard, we note that the conduct that would typically give rise to CFTC sanctions is similar to the type of conduct that would result in disqualification if it were the subject of sanctions by another financial services industry regulator. This should enable the disqualification rules to more effectively screen out bad actors.

As discussed above, the baseline for our economic analysis of proposed Regulation Crowdfunding, including the baseline for our consideration of the effects of the proposed rules on efficiency, competition and capital formation, is the situation in existence today, in which startups and small businesses seeking to raise capital through securities offerings must register the offer and sale of securities under the Securities Act unless they can comply with an existing exemption from registration under the federal securities laws. Relative to the current baseline, we believe that the disqualification provisions may not impose significant incremental costs on

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[1045] *See Disqualification Adopting Release*, note 101.

issuers and other covered persons because the proposed rules are substantially similar to the disqualification provisions under existing exemptions.

b. Intermediaries

In implementing the statute, we are proposing to apply to intermediaries the disqualification provisions under Section 3(a)(39), rather than Rule 262 or the disqualification rules we are proposing for issuers. We believe that the standard of Section 3(a)(39) is already an established one among broker-dealers and their regulators and that, despite the differences, Section 3(a)(39) and Rule 262 are substantially similar in particular with regard to the persons and events they cover, their scope and their purpose.[1046] We believe that imposing any new or different standard, including Rule 262, only for those intermediaries that engage in crowdfunding transactions would likely create confusion and unnecessary burdens, as currently-registered broker-dealers and their associated persons would become subject to two distinct standards for disqualification. Consistent standards for all brokers and funding portals also would assist a registered national securities association in monitoring compliance and enforcing its rules.

The proposed rules would implement the statutory requirement for intermediaries by providing that a person subject to a statutory disqualification, as defined in Exchange Act Section 3(a)(39), may not act as, or be an associated person of, an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) unless so permitted by Commission rule or order. While this requirement would potentially reduce the number of intermediaries, we expect that it would strengthen investor protection by preventing bad actors

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[1046] *See* discussion in Section II.E.6.b above.

from entering the securities-based crowdfunding market and by reducing the potential for fraud and other abuse.

As discussed above, the baseline for our economic analysis of proposed Regulation Crowdfunding, including the baseline for our consideration of the effects of the proposed rules on efficiency, competition and capital formation, is the situation in existence today, in which intermediaries intending to facilitate securities transactions are required to register with the Commission as broker-dealers under Exchange Act Section 15(a). Relative to the current baseline, we believe that the disqualification provisions might not impose significant incremental costs to brokers because the proposed rules are the same as the disqualification provisions that are already imposed on broker-dealers.

C. Request for Comment

Throughout this release, we have discussed the anticipated costs and benefits of the proposed rules and their potential impact on efficiency, competition and capital formation. We request and encourage any interested person to submit comments regarding the proposed rules, our analysis of the potential effects of the rules and other matters that may have an effect on the proposed rules. We request comment from the point of view of issuers, investors and other market participants. With regard to any comments, we note that such comments are of particular assistance to us if accompanied by supporting data and analysis of the issues addressed in those comments. We also are interested in comments on the qualitative benefits and costs we have identified and any benefits and costs we may have overlooked. We urge commenters to be as specific as possible.

Comments on the following questions are of particular interest.

285. How similar or different is a securities-based crowdfunding offering from a non-securities-based crowdfunding offering? To what extent should we base the anticipated effects of the proposed rules on the experience of current crowdfunding platforms and their participants, including those based on rewards and donations? Should we expect the same incidence of success, failure, fraud and other outcomes when crowdfunding involves participants providing financing with an expectation of a monetary return on their investments? Would securities-based crowdfunding attract similar projects, ventures and capital seekers as other forms of crowdfunding? If not, why not, and what differences in the types of ventures, participants and outcomes might be expected?

286. How would securities issued in reliance on Section 4(a)(6) be valued? Would issuers and/or investors have sufficient financial sophistication or methods available to accurately assess the intrinsic risks associated with the issuance? If so, what mechanisms would help assure accurate pricing? If not, what specific challenges or issues would prevent issuers and/or investors from arriving at a price that reflects the intrinsic value of the offering?

287. How would investors who purchase securities in an offering in reliance on Section 4(a)(6) exit their investment? Once the securities are issued, investors would have to wait, except in certain circumstances, for one year before selling a security sold in a Section 4(a)(6) offering. At that time, how would existing security holders liquidate their positions? What is the likelihood that there would be a ready market for mature securities issued in reliance on Section 4(a)(6)? What entities or investors are likely to supply the liquidity, and what

discounts, if any, are investors likely to face when exiting their investments? To what extent would, or should, liquidity provisions be built into the design of the security issues (*e.g.*, call provisions or self-liquidation features)?

288. How, and to what extent, would the collective knowledge of crowdfunding investors (*i.e.*, the "wisdom of the crowd") provide investor protections and mitigate potential fraud or unspecified offering risks at the time of issuance? Would "the wisdom of the crowd" provide ongoing investor protections to the community of securities-based crowdfunding investors? If so, how and to what extent?

289. Do the proposed rules require sufficient disclosure and educational requirements to help ensure that investors have a reasonable understanding of the risks and costs of investing in crowdfunding securities? Are the proposed disclosure and educational requirements sufficient for investors to understand: (1) the methods used for valuing securities issued in reliance on Section 4(a)(6), (2) potential complexity in the security design, or (3) risks of subsequent dilution of their investment? If not, what additional requirements would further mitigate the associated risks?

290. Should intermediaries be required to systematically collect and report information – to the Commission and/or publicly – about the progress, success and failures of issuers that relied on Section 4(a)(6) to offer and sell securities subsequent to initial financing? Would collecting and reporting such statistics help investors better understand the risks associated with securities-based crowdfunding investments with the passage of time? If so, what information

should be reported, and to whom and in what manner should it be reported? Would a requirement to collect and maintain information about issuers that relied on Section 4(a)(6) after the completion of the offering be too burdensome for intermediaries?

291. Other than averting potential losses, what are the potential economic effects of limiting the investment size for any single investor to a maximum aggregate amount of $100,000? Would this reduce the incentive for some investors to participate in offerings in reliance on Section 4(a)(6), and if so, would this impede potential capital formation or the efficiency with which offerings can be made? Would this limit the ability of investors to appropriately diversify their securities-based crowdfunding investments? Please explain.

292. Would the permanent exemption of securities-based crowdfunding securities from the record holder count under Section 12(g) of the Exchange Act pose any significant risks to investors of successful ventures? For example, is it likely or possible that an issuers that offers and sells securities in reliance on Section 4(a)(6) could became subject to Exchange Act reporting, but then subsequently delist and go dark without regard to the number of record holders?

293. We estimated the costs for a broker to act as an intermediary in transactions conducted pursuant to Section 4(a)(6), and to engage in related broker activities, to be approximately $770,000 in the first year and approximately $270,000 each year thereafter. In making these estimates, we assumed that brokers would engage in particular activities in connection with these transactions, namely providing investment advice and recommendations, soliciting investors, and

managing and handling customer funds and securities. Are our assumptions correct? If not, please explain. Are our estimates of the cost of doing business as a broker, in general, accurate? If not, please explain and provide relevant data.

294. We estimated the costs for a funding portal to act as an intermediary in transactions pursuant to Section 4(a)(6) to be approximately $417,000 in the first year, and approximately $90,000 each year thereafter. Are our estimates of the costs of doing business as a funding portal, and the assumptions behind these estimates, in general, accurate? If not, please explain and provide relevant data.

295. The Commission is interested in receiving comments, views, estimates and data concerning the following:

- Expected size of the securities-based crowdfunding market (*e.g.*, number of offerings, number of issuers, number for funding portals, size of offerings, number of investors, etc., as well as information comparing these estimates to the current baseline);
- Overall economic impact of the proposed rules;
- Competitive effects on brokers of the development of funding portals; and
- Any other aspect of the economic analysis.

IV. Paperwork Reduction Act

A. Background

Certain provisions of the proposed rules contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[1047] We are submitting the proposal to the Office of Management and Budget ("OMB") for review in accordance with the PRA.[1048] The titles for the collections of information are:

(1) "Form ID" (OMB Control Number 3235-0328);

(2) "Form C" (a proposed new collection of information);

(3) "Form BD" (OMB Control Number 3235-0012); and

(4) "Regulation Crowdfunding – Intermediaries and Funding Portals" (a proposed new collection of information).

In addition, the collections of information included under OMB Control Numbers 1506-0034 and 1506-0019, regarding the CIP and SAR requirements of the Department of Treasury, would be amended to reflect related burdens under proposed Rule 403(b) of Regulation Crowdfunding. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. We are applying for OMB control numbers for the proposed new collections of information in accordance with 44 U.S.C. 3507(j) and 5 CFR 1320.13, and OMB has not yet assigned a control number to each new collection. Responses to these new collections of information would be mandatory.

[1047] 44 U.S.C. 3501 *et seq.*

[1048] 44 U.S.C. 3507(d); 5 CFR 1320.11.

B. Estimate of Issuers and Intermediaries

1. Issuers

The number, type and size of the issuers that would participate in securities-based crowdfunding transactions are uncertain, but data regarding current market practices may help identify the number and characteristics of potential issuers that may offer and sell securities in reliance on Section 4(a)(6).[1049] While it is not possible to predict the number of future offerings made in reliance on Section 4(a)(6), particularly because rules governing the process are not yet in place, for purposes of this analysis, we estimate that the number would be 2,300 offerings per year. We base this estimate on the number of issuers that conducted a Regulation D offering that had no revenues or less than $1 million in revenues.[1050] We believe those issuers would be similar in size to the potential issuers that may participate in securities-based crowdfunding, and we assume that each issuer would conduct one offering per year, raising an average of $100,000 per offering.

2. Intermediaries that are Registered Brokers

We estimate that the proposed collections of information would apply to approximately 10 intermediaries per year that are not currently registered with the Commission and would choose to register as brokers to act as intermediaries for transactions made in reliance on Section 4(a)(6). However, we believe that, given the high cost that an unregistered entity would incur to register as a broker with us, compared with the lower cost of becoming a funding portal, unregistered entities generally would have less incentive to register as brokers than as funding portals.

1049 *See* Section III.A.4.a above for a discussion of the data regarding current market practices.

1050 *See id.*

We further estimate that approximately 50 intermediaries per year that are already registered as brokers with the Commission would choose to add to their current service offerings by also becoming crowdfunding intermediaries. These entities would not have to register anew with us, and if doing business with the public, would already be members of FINRA (the applicable national securities association registered under Exchange Act Section 15A). Because we do not have any data indicating the number of currently-registered brokers that would be interested in becoming crowdfunding intermediaries, we cannot estimate how many would choose to enter the crowdfunding market.[1051]

3. Funding Portals

We estimate that approximately 50 intermediaries per year would choose to register as funding portals during the first three years following effectiveness of the proposed rules. This estimate assumes that, upon effectiveness of the proposed rules, about 15% of the approximately 200 U.S.-based crowdfunding portals[1052] currently in existence would participate in securities-based crowdfunding and that the number of crowdfunding portals would grow at 60% per year over the next three years.[1053] Therefore, we estimate that an average of approximately 50

1051 Similarly, we cannot estimate with any degree of certainty how many unregistered "finders" would potentially choose to enter the securities-based crowdfunding market. *See, e.g.*, Task Force on Private Placement Broker-Dealers, note 894 (stating that quantifying the number of "finders" that help small businesses to obtain sources of capital "is an impossibility, since there is no effective measuring device.").

1052 This estimate is based in part on an industry estimate that, as of April 2012, there were approximately 200 non-securities-based crowdfunding portals operating in the United States. *See* Massolution, note 861 at 16.

1053 A worldwide survey of crowdfunding portals indicated that, in 2011, approximately 14.8% of the surveyed crowdfunding portals (mostly based in Europe) participated in "equity-based" crowdfunding. *Id.* Also, the total number of crowdfunding portals worldwide grew by an estimated 60% from 2011 to 2012. *Id*. at 13.

respondents would register as funding portals annually.[1054] Of those 50 funding portals, we estimate that two would be nonresident funding portals. These estimates are based in part on current indications of interest expressed in responses to FINRA's voluntary interim form for funding portals.[1055]

C. Estimate of Burdens

1. Issuers

a. Form C: Offering Statement and Progress Update

Under the proposed rules, an issuer conducting a transaction in reliance on Section 4(a)(6) would file with us specified disclosures on a Form C: Offering Statement.[1056] An issuer also would file with us amendments to Form C to disclose any material change in the offer terms or disclosure previously provided to investors.[1057] Form C is similar to the Form 1-A offering statement under Regulation A, but it would require fewer disclosure items (*e.g.*, it would not require disclosure about the plan of distribution, the compensation of officers and directors, litigation or a discussion of federal tax aspects). We note that offerings made in reliance on Regulation A allow issuers to offer up to $5 million, involve review by the staff and require filings at the state level. In light of these factors, we expect that issuers seeking to raise capital pursuant to a Regulation A offering generally would be at a more advanced stage of development

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1054 200 U.S.-based crowdfunding portals x 15% (estimated percentage of crowdfunding portals that would participate in securities-based crowdfunding) = 30 funding portals that would participate in securities-based crowdfunding. Assuming 60% growth over three years, the number of registered funding portals would be 30 during the first year, 48 during the second year and 77 during the third year. The average number of registered funding portals over three years is (30 + 48 + 77) / 3 = 52 funding portals (or approximately 50 funding portals per year).

1055 *See* note 980.

1056 *See* proposed Rule 203(a)(1) of Regulation Crowdfunding.

1057 *See* proposed Rule 203(a)(2) of Regulation Crowdfunding.

than issuers likely to raise capital pursuant to Section 4(a)(6), so the complexity of the required disclosure and, in turn, the burden of compliance with the requirements of proposed Form C would be significantly less than for Form 1-A.[1058] We estimate that the total burden to prepare and file the Form C, including any amendment to disclose any material change, would be approximately 60.00 hours, which is approximately 10 percent of the burden to prepare a Form 1-A for a Regulation A offering. We estimate that 75 percent of the burden of preparation would be carried by the issuer internally and that 25 percent would be carried by outside professionals[1059] retained by the issuer at an average cost of $400 per hour.[1060]

Under the proposed rules, the issuer also would be required to file with us regular updates regarding the progress of the issuer in meeting the target offering amount.[1061] The issuer would make the filing under cover of a Form C-U: Progress Update. The issuer would be required to disclose its progress in meeting the target offering amount. Form C-U is similar to a Form D Notice of Exempt Offering of Securities under Regulation D[1062] and a Form 2-A Report of Sales and Uses of Proceeds Pursuant to Rule 257 of Regulation A.[1063] Form C-U would require significantly less disclosure than the Form D and the Form 2-A, however, as it would only require disclosure of the issuer's progress in meeting the target offering amount, rather than

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1058 We estimate the burden per response for preparing a Form 1-A to be 608.00 hours. *See* Form 1-A at 1.

1059 For example, an issuer could retain an outside professional to assist in the preparation of the financial statements, but could decide to address the remaining disclosure requirements internally.

1060 We recognize that the costs of retaining outside professionals may vary depending on the nature of the professional services, but for purposes of this PRA analysis, we estimate that such costs would be an average of $400 per hour. This is the rate we typically estimate for outside legal services used in connection with public company reporting.

1061 *See* proposed Rule 203(a)(3) of Regulation Crowdfunding.

1062 We estimate the burden per response for preparing a Form D to be 4.00 hours. *See* Form D at 1.

1063 We estimate the burden per response for preparing a Form 2-A to be 12.00 hours. *See* Form 2-A at 1.

compensation and use of proceeds disclosures or other information about the issuer and the offering. Thus, the complexity of the required disclosure and the burden to prepare and file Form C-U would be significantly less than for either Form D or Form 2-A. We estimate that the burden to prepare and file each progress update, which only has one disclosure requirement, would be 0.50 hours. We further estimate that an issuer would be required to file an average of two progress updates during each offering.[1064] Therefore, we estimate that an issuer's compliance with proposed Form C-U would result in an aggregate burden of 1.00 hours per issuer.[1065]

We estimate that compliance with the requirements of a Form C submitted in connection with transactions made in reliance on Section 4(a)(6) would require 138,000 burden hours (2,300 offering statements x 60.00 hours/offering statement) in aggregate each year, which corresponds to 103,500 hours carried by the issuer internally (2,300 offering statements x 60.00 hours/offering statement x 0.75) and costs of $13,800,000 (2,300 offering statements x 60.00 hours/offering statement x 0.25 x $400) for the services of outside professionals. We also estimate that compliance with the requirements of Form C-U submitted during an offering would require 2,300 burden hours (2,300 offering statements x 2 progress updates per offering x 0.50 hours per progress update) in aggregate each year. These estimates include the time and cost of collecting the information, preparing and reviewing disclosure, filing documents and retaining records. We derived the above estimates by estimating the average number of hours it would take an issuer to prepare and review the proposed disclosure requirements. In deriving our

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[1064] *See* proposed Rule 203(a)(3) of Regulation Crowdfunding. The proposed rules would require an issuer to file a progress update after reaching one-half and 100 percent of the target offering amount.

[1065] We estimate that the burden of preparing Form C-U would be approximately 1/8 of the burden for Form D. Therefore, the aggregate burden per issuer would be 100 hour (2 progress updates x 0.50 hours/update).

estimates, we recognize that the burdens likely would vary among individual issuers based on a number of factors, including the stage of development of the business and the number of years since inception of the business. We believe that some issuers would experience costs in excess of this average and some issuers may experience less than these average costs.

b. Form C-AR: Annual Report

Under the proposed rules, any issuer that sells securities in a transaction made pursuant to Section 4(a)(6) would be required to file annually with us an annual report on Form C-AR: Annual Report.[1066] Form C-AR would require disclosure substantially similar to the disclosure provided in the Form C: Offering Statement, except that offering-specific disclosure would not be required. Therefore, we estimate that the burden to prepare and file Form C-AR would be less than that required to prepare and file Form C. We estimate that compliance with proposed Form C-AR would result in a burden of 40.00 hours per response.[1067] We further estimate that 75 percent of the burden of preparation would be carried by the issuer internally and that 25 percent would be carried by outside professionals[1068] retained by the issuer at an average cost of $400 per hour.[1069]

We estimate that compliance with the requirements of Form C-AR after issuers sell securities pursuant to Section 4(a)(6) would require 92,000 burden hours (2,300 issuers x 40.00 hours/issuer) in the aggregate each year, which corresponds to 69,000 hours carried by the issuer

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1066 *See* proposed Rule 202 of Regulation Crowdfunding.

1067 We estimate that the burden of preparing the information required by Form C-AR would be approximately 2/3 of the burden for the Form C: Offering Statement in light of the fact that offering-specific disclosure would not be required and that the issuer may be able to update disclosure previously provided in the Form C: Offering Statement.

1068 *See* note 1059.

1069 *See* note 1060.

internally (2,300 issuers x 40.00 hours/issuer x 0.75) and costs of $9,200,000 (2,300 issuers x 40.00 hours/issuer x 0.25 x $400) for the services of outside professionals.

c. Form C-TR: Termination of Reporting

Under the proposed rules, any issuer terminating its annual reporting obligations would be required to file a notice under cover of Form C-TR: Termination of Reporting to notify investors and the Commission that it no longer will file and provide annual reports pursuant to the requirements of Regulation Crowdfunding.[1070] We estimate that eight percent of the issuers that sell securities pursuant to Section 4(a)(6) would file a notice under cover of Form C-TR during the first year.[1071] The Form C-TR would be similar to the Form 15 that issuers file to provide notice of termination of the registration of a class of securities under Exchange Act Section 12(g) or to provide notice of the suspension of the duty to file reports required by Exchange Act Sections 13(a) or 15(d).[1072] Therefore, we estimate that compliance with the proposed Form C-TR would result in a similar burden as compliance with Form 15, a burden of 1.50 hours per response. We estimate that compliance with proposed Form C-TR would result in a burden of 276 hours (2,300 issuers x 0.08 issuers filing Form C-TR x 1.50 hours/issuer) in the aggregate during the first year for issuers terminating their reporting obligations.

d. Form ID Filings

1070 *See* proposed Rule 203(b)(2) of Regulation Crowdfunding.

1071 For purposes of the PRA, we estimate that eight percent of issuers will not survive past their first year, based on a recent study that found that of a random sample of 4,022 new high-technology businesses started in 2004, 92.3% survived past their first year. *See* Kauffman Firm Survey, note 869 at 13.

1072 We currently estimate the burden per response for preparing a Form 15 to be 1.50 hours. *See* Form 15 at 1.

Under the proposed rules, an issuer would be required to file specified disclosures with us on EDGAR.[1073] We anticipate that the majority of first-time issuers seeking to offer and sell securities in reliance on Section 4(a)(6) would not previously have filed an electronic submission with us and so would need to file a Form ID. Form ID is the application form for access codes to permit filing on EDGAR. The proposed rules would not change the form itself, but we anticipate that the number of Form ID filings would increase due to new issuers seeking to offer and sell securities in reliance on Section 4(a)(6). For purposes of this PRA discussion, we estimate that all of the issuers who would seek to offer and sell securities in reliance on Section 4(a)(6) would not have filed an electronic submission with us previously and would, therefore, be required to file a Form ID. As noted above, we estimate that approximately 2,300 issuers per year would seek to offer and sell securities in reliance on Section 4(a)(6), which would correspond to 2,300 additional Form ID filings. As a result, we estimate the additional annual burden would be approximately 345 hours (2,300 filings x 0.15 hours/filing).[1074]

2. Brokers and Funding Portals

a. Registration Requirements

i. Time Burden

The proposed rules would require intermediaries to register with us as either a broker or funding portal. We believe that some entities that may engage in crowdfunding pursuant to Section 4(a)(6) and the proposed regulation would already be registered as brokers. Therefore, this registration requirement would impose no new requirement on these entities and no additional burden for purposes of this PRA discussion. Entities that are not already registered as

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1073 *See* proposed Rules 201-203 of Regulation Crowdfunding.

1074 We currently estimate the burden associated with Form ID is 0.15 hours per response. *See* Form ID at 1.

brokers may decide to register as brokers or as funding portals and to become members of a registered national securities association, pursuant to the proposed rules. We estimate that each year, approximately 10 entities may decide to register as brokers, and on average, approximately 50 entities may decide to register as funding portals by filing Form Funding Portal. In addition, we estimate that of those 50 entities that register as funding portals, two would be nonresident funding portals and subject to the additional requirements of completing Schedule C, hiring an agent for service of process in the United States and providing an opinion of counsel.

We estimate the burden for registering as a broker with us based upon the existing burdens for completing and filing Form BD.[1075] Consequently, we estimate that total annual burden hours required for all intermediaries, including brokers and funding portals, to register with us under the proposed rules would be approximately 165 hours (2.75 hours/respondent x (10 brokers + 50 funding portals)). In addition, those entities that register as nonresident funding portals would face an additional burden of half an hour to complete Schedule C, half an hour to hire an agent for the service of process, and one hour to provide an opinion of counsel. Consequently, we estimate that of the 50 registered funding portals, two would face the burden of an additional two hours to register.

We take into consideration that brokers that register to engage in crowdfunding transactions conducted in reliance on Section 4(a)(6) may eventually decide to withdraw their

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[1075] While it is likely that the time necessary to complete Form BD varies depending on the nature and complexity of the entity's business, we previously estimated that the average time necessary for a broker-dealer to complete and file an application for broker-dealer registration on Form BD would be approximately 2.75 hours. We also estimate that the time burden to register as a funding portal on Form Funding Portal would be, for purposes of this PRA discussion, the same, based upon the time required to complete and file Form BD because the information required for that form is similar.

registration. Withdrawal requires the entity to complete and file with us a Form BDW.[1076] We further estimate that approximately 500 broker-dealers withdraw from Commission registration annually[1077] and, therefore, file a Form BDW. Of them, we estimate that approximately one broker who had registered in order to facilitate crowdfunding transactions made in reliance on Section 4(a)(6) may decide to withdraw in each year following adoption of the rules.[1078] Therefore, the one broker-dealer that withdraws from registration by filing Form BDW would incur an aggregate annual reporting burden of approximately one hour (one hour/respondent x one broker). Similarly, we estimate that approximately six funding portals may choose to withdraw from registration each year[1079] and that each withdrawal, as with Form BDW, would take one hour. This would result in an aggregate annual reporting burden of approximately six hours (one hour/respondent x 6 funding portals).

1076 The time necessary to complete Form BDW varies depending on the nature and complexity of the applicant's securities business. We previously estimated that it would take a broker-dealer approximately one hour to complete and file a Form BDW to withdraw from Commission registration, as required by Exchange Act Rule 15b6-1 (17 CFR 240.15b6-1).

1077 This estimate is based on Form BDW data collected over the past five years and may be skewed as a result of the impact of the financial crisis on broker-dealers. For the past five fiscal years (from 10/1 through 9/30), the number of broker-dealers that withdrew from registration were as follows: 503 in 2008, 533 in 2009, 510 in 2010, 524 in 2011 and 428 in 2012. (503 + 533 + 510 + 524 + 428) / 5 = 500.

1078 As of September 30, 2012, there were 4,653 broker-dealers registered with the Commission. An average of 500 broker-dealers per year withdraw from registration, or 11% of the number of registered broker-dealers (500 withdrawing broker-dealers / 4,653 registered broker-dealers). We are assuming that the same percentage of broker-dealers that withdraw from registration would apply to the population of registered broker-dealers participating in offerings in reliance on Section 4(a)(6). Of our estimate of 10 registered broker-dealers per year registering to participate in crowdfunding transactions in reliance on Section 4(a)(6), we estimate that approximately one broker-dealer per year (10 registered broker-dealers x 11%) would withdraw from registration.

1079 We estimate that the percentage of registered funding portals participating in crowdfunding transactions in reliance on Section 4(a)(6) that would withdraw from registration annually would be the same as the percentage of broker dealers that withdraw from registration annually because of the similarity of the businesses. Of our estimate of 50 registered funding portals participating in crowdfunding transactions in reliance on Section 4(a)(6), we estimate that approximately six funding portals per year (50 registered funding portals x 11%) would withdraw from registration. For funding portals, a decision to withdraw registration would be required to be reported to us in the same way an amendment would; however, for brokers, withdrawal requires the fling of Form BDW.

Newly-registered intermediaries would be required to also become members of FINRA or any other registered national securities association. Based on discussions with industry participants, we estimate that the burden associated with this requirement would be approximately 220 hours per intermediary that registers as a broker-dealer. We also assume that approximately one-half of that amount or 110 hours would be required of an intermediary registering as a funding portal. Consequently, we estimate that total annual burden hours required for all intermediaries, including brokers and funding portals, to register with FINRA or any other registered national securities association would be approximately 6,600 hours (220 hours/broker-dealer respondent x 10 brokers + 110 hours/funding portal respondent x 50 funding portals). For intermediaries who choose to hire a third party to assist in the membership process, we assume that the hours would be further reduced by at least one-half for a total of 3,300 hours.

Once registered, a broker must promptly file an amended Form BD when information it originally reported on Form BD changes or becomes inaccurate. Similarly, a registered funding portal must report to us amendments relating to its Form Funding Portal filing.[1080] Based on the number of amended Forms BD that we received from October 1, 2007 through September 30, 2012, we estimate that the total number of amendments that we would receive on Form BD from the 10 brokers that register under this proposed system would be approximately 34.[1081]

[1080] We previously estimated that the average time necessary to complete an amended Form BD would be approximately 20 minutes. We estimate that an amendment to Form Funding Portal would take the same amount of time as an amendment to Form BD because the forms are similar.

[1081] We received 16,365, 17,247, 15,638, 15,491 and 13,271 amended Forms BD during the fiscal years ending 2008, 2009, 2010, 2011 and 2012, respectively, reflecting an average of 15,602 amendment filings per year (16,365 + 17,247 + 15,638 + 15,491 + 13,271) / 5 years). As of September 30, 2012, there were 4,653 broker-dealers registered with the Commission. Therefore, we estimate that there are approximately 3.4 amendments (15,602 amended Forms BD / 4,653 broker-dealers) per registered broker-dealer per year. We estimate that the 10 broker-dealers who register under this proposed regulation would submit, on aggregate, approximately 34 amendments per year.

Therefore, we estimate that the total additional annual burden hours necessary for broker-dealers to complete and file amended Forms BD would be approximately 11.2 hours (34 amended Forms BD per year x 0.33 hours, *i.e.*, 20 minutes, per amendment). Similarly, we estimate that the total annual burden hours for funding portals to complete and file amended Forms Funding Portal would be approximately 56.1 hours (50 funding portals x 3.4 amendments per year x 0.33 hours per amendment).

ii. Cost

We estimate that the initial registration cost for an intermediary to register with a national securities association would be approximately $10,000. This estimate is based on FINRA's current member application fee structure, which assesses fees depending on the size of the new member applicant. The current member application fee for broker-dealers with 1 to 10 associated registered persons is $7,500, and the fee for broker-dealers with 11 to 100 associated registered persons is $12,500.[1082] We expect that the size of funding portals that would register with FINRA would be similar, and therefore, our preliminary estimate of FINRA's application fee for funding portals is based on the above fees. The average of the two fees is ($7,500 + $12,500)/2 = $10,000. The total cost across all intermediaries would be approximately ($10,000/intermediary x (10 brokers + 50 funding portals) = $600,000. In addition, two intermediaries would face an additional cost of $25,130 to complete Schedule C, retain an agent for the service of process and provide an opinion of counsel to register as a nonresident funding portal.

[1082] *See* FINRA, *Revised Fees: Changes to Advertising, Corporate Financing, New Membership and Continuing Membership Application, Central Registration Depository and Branch Office Annual Registration Fees*, FINRA Regulatory Notice 12-32 (June 2012), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p127238.pdf.

In addition to the initial registration cost, we estimate that costs associated with completing a membership process with FINRA or any other registered national securities association would be approximately $3,450,000 across all intermediaries. Discussions with industry participants have indicated that most broker-dealers currently hire a third party consultant or attorney to assist in the membership process. Assuming that 90% of intermediaries (9 brokers and 45 funding portals) would employ an outside party, we estimate total costs charged by the outside party to be $1,575,000 ($50,000/third party assisting broker-dealers x 9 brokers + $25,0000/third party assisting funding portals x 45 funding portals).[1083] As indicated above, we assume that the intermediary's Chief Compliance Officer or person in a similar position would spend approximately 110 hours assisting in broker-dealer registration and 55 hours assisting in funding portal registration for a total approximate cost of $1,530,000 (110 hours/broker-dealer respondent x 9 brokers + 55 hours/funding portal respondent x 45 funding portals) x $441/hour.[1084] For the remaining 10% of intermediaries (1 broker and 5 funding portals) that would not employ an outside party to assist in the process, we estimate the total cost to be $340,000 ((220 hours/broker-dealer respondent x 1 broker + 110 hours/funding portal respondent x 45 funding portals) x $441/hour).

Intermediaries would face an ongoing cost to remain registered with a national securities association. We expect these costs would vary based on the size and profitability of the intermediary. The current FINRA annual assessment fee for members that are brokers having

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[1083] Discussions with industry participants indicated that third parties charge between $25,000 and $75,000, for an average of $50,000, to assist applicants seeking to register as broker-dealers. We assume that charges for intermediaries registering as funding portals would be approximately one-half of these costs, for an average of $25,000.

[1084] The hourly rate estimate for a Chief Compliance Officer is taken from SIFMA Management Data.

annual revenue of up to $1,000,000 is $1,200. In addition, FINRA members currently pay $150.00 for each principal and each representative of the member entity, up to five principals and representatives, and also pay $175 for the first 250 branch offices registered by the member. For purposes of the PRA, we assume that brokers acting as intermediaries as well as funding portals would have on average a total of five principals or representatives (or their equivalent), would maintain fewer than 250 branch offices, and would have annual revenues less than $1,000,000. Also for purpose of these estimates, we assume that the fees the national securities association would set for funding portals would be the same as those FINRA currently has set for members that are brokers. We do recognize, however, that the national securities association fees for funding portals may be lower than those currently in place for brokers, proportionate to funding portals' more limited scope of activity compared to brokers.[1085] Thus, we estimate that on average intermediaries would pay ongoing annual fees to a national securities association of $2,130, after the year they become members ((5x$150.00) + $175 + $1,200 = $2,125). Nonresident funding portals, would also be subject to an annual cost of $130 to maintain an agent for service of process in the United States

b. Development of Intermediary Platform

i. Time Burden

The proposed rules are based on an intermediary developing an electronic platform to offer securities in reliance on Section 4(a)(6) to the public. A broker or funding portal that creates its initial platform in-house would incur an initial time burden associated with setting up systems functionality to comply with our proposed rules, and developing other platform

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[1085] *See* note 994.

capabilities and operations. Based on our discussions with potential intermediaries, we initially estimate that intermediaries would typically hire a team of approximately 4 to 6 developers that would work on all aspects of platform development, including, but not limited to, front-end programming, data management, systems analysis, communication channels, document delivery, and Internet security. To develop a platform, we estimate, based on our discussions with potential intermediaries, that intermediaries would spend an average of 1,500 hours for planning, programming and implementation.

As discussed above, we anticipate that 10 intermediaries would newly register as brokers, 50 intermediaries would be brokers that are already registered and 50 intermediaries would register as funding portals. It is difficult to estimate the number of intermediaries that would develop their platforms in-house, but if we assume that half of the 110 newly-registered intermediaries were to do so, then the total initial time burden would be 82,500 hours (55 intermediaries x 1,500 hours = 82,500 hours).

We estimate that annually updating the features and functionality of an intermediary's platform would require approximately 20% of the hours required to initially develop the platform, for an average burden of 300 hours per year. If we assume that half of the 110 newly-registered intermediaries updated their systems accordingly, the total ongoing time burden would be 16,500 hours per year (55 intermediaries x 300 hours = 16,500 hours).

ii. Cost

There would be a cost to developing a platform. Based on our discussions with potential intermediaries, we initially estimate that it would cost an intermediary approximately $250,000 to $600,000 to build an Internet-based crowdfunding portal and all of its basic functionality. Assuming that half of the 110 newly-registered intermediaries were to hire outside developers to

build their platforms, the total initial cost would be $13,750,000 to $33,000,000 (55 intermediaries x $250,000 = $13,750,000; 55 intermediaries x $600,000 = $33,000,000). For purposes of the PRA, we are estimating the cost at $23,375,000.

We estimate that it would typically cost an intermediary approximately one-fifth of the initial development cost per year to use a third-party developer to update an Internet-based crowdfunding portal and all of its basic functionality, or $85,000 per year on average.[1086] If we assume that half of the 110 newly-registered intermediaries updated their systems accordingly, the total ongoing cost would be $4,675,000 per year (55 intermediaries x $85,000 = $4,675,000).

c. Measures to Reduce the Risk of Fraud

i. Time Burden

The proposed rules would require intermediaries to have a reasonable basis for believing that an issuer seeking to offer and sell securities in reliance on Section 4(a)(6) through the intermediary's platform complies with the requirements in Section 4A(b) and the related requirements in Regulation Crowdfunding.[1087] The proposed rules would require intermediaries to have a reasonable basis for believing that an issuer has established means to keep accurate records of the holders of the securities it would offer and sell through the intermediary's platform. For both requirements, an intermediary may reasonably rely on the representations of the issuer. For the purposes of the PRA, we expect that 100% of intermediaries would rely on the representations of issuers. This would impose an estimated time burden in the first year of five hours per intermediary to establish standard representations it would request from issuers,

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[1086] Our estimate of the average initial external cost per intermediary to develop a crowdfunding platform is the average of the cited range of $250,000 to $600,000, or (($250,000 + $600,000)/)/) / 2) = $425,000. One-fifth of the cost of $425,000 is ($425,000/ / 5) = $85,000.

[1087] *See* proposed Rule 301(a) of Regulation Crowdfunding.

and 6 minutes per intermediary per issuer to obtain the issuer representation, which is consistent with estimates we have used for other regulated entities to obtain similar documentation, such as consents, from customers. Based on our estimate that there would be approximately 2,300 offerings per year, that each issuer would conduct one offering per year, and that there would be 110 intermediaries, we calculate that each intermediary would facilitate approximately 20 offerings per year (2,300 offerings /(10 newly registered broker-dealers + 50 previously registered broker-dealers + 50 funding portals) = 20.9). Therefore, we estimate that the total initial burden hours would be approximately 770 hours ((5 hours/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals) + (6 minutes/issuer x 20 issuers/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)).

We believe that the ongoing time burdens for this requirement would be approximately one hour per intermediary per year to review and check that the standard representations it requests from issuers remain appropriate, and 6 minutes per intermediary per issuer to obtain the representation. Therefore, we estimate that the ongoing total burden hours necessary for intermediaries to rely on the representations of the issuers would be approximately 330 hours per year ((1 hour/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)) + (6 minutes/issuer x 20 issuers/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals))).

ii. Cost

The proposed rules would require intermediaries to conduct a background and securities enforcement regulatory history check on each issuer and each officer, director or 20 Percent Beneficial Owner to determine whether the issuer or such person is subject to a disqualification.

We anticipate that most intermediaries would employ third-parties that perform background checks, and for the purposes of this PRA discussion, we assume that 100% of intermediaries would use these third-party services rather than develop the capability to conduct background and securities enforcement regulatory history checks in-house. The cost to perform a background check is estimated to be between $200 and $500, depending on the nature and extent of the information provided.[1088] We recognize that some issuers would require more than one background check (*e.g.*, for officers or directors of the issuer), and we estimate that intermediaries would perform four background checks per issuer, on average. We base this number on that assumption that most crowdfunding issuers will be startups and small businesses with small management teams and few owners. Assuming that there is an average of approximately 2,300 offerings made in reliance on Section 4(a)(6) per year,[1089] the total estimated initial cost for all intermediaries to fulfill the required background and securities enforcement regulatory history checks would range from approximately $1,840,000 to $4,600,000 per year,[1090]or approximately $16,700 to $41,800 per intermediary per year.[1091] For purposes of the PRA, we will average the cost to $29,250 per intermediary per year.

1088 *See, e.g.*, A Matter of Fact, *Background Check FAQ: Frequently Asked Questions*, *available at* http://www.amof.info/faq.htm (Matter of Fact is a background check provider accredited by the National Association of Professional Background Screeners and the Background Screening Credentialing Council and states that the cost for a comprehensive background check is $200 to $500).

1089 Because crowdfunding transactions in reliance on Section 4(a)(6) are a new approach to capital formation, it is difficult for us to accurately estimate an average number of offerings per year. As stated above, we assume that there would be approximately 2,300 offerings made in reliance on Section 4(a)(6) per year.

1090 2,300 securities-based offerings made in reliance on Section 4(a)(6) per year x ($200 to $500 per background and securities enforcement regulatory history check) x 4 checks per offering = $1,840,000 to $4,600,000 per year.

1091 $1,840,000/110 intermediaries = approx. $16,700 per intermediary; $4,600,000/110 intermediaries = approx. $41,800 per intermediary.

We believe that, on an ongoing basis, intermediaries would continue to use third-party services to conduct background and securities enforcement regulatory history checks. We also believe that the total estimated ongoing cost for all intermediaries to fulfill the required background and securities enforcement regulatory history checks would be the same as the estimated initial cost, ranging from approximately $1,840,000 to $4,600,000 per year, or approximately $16,700 to $41,800 per intermediary per year. For purposes of the PRA, we will average the cost to $29,250 per intermediary per year.

d. Account Opening: Accounts and Electronic Delivery

i. Time Burden

The proposed rules would provide that no intermediary or associated person of an intermediary could accept an investment commitment in a transaction involving the offer or sale of securities made in reliance on Section 4(a)(6) until the investor has opened an account with the intermediary and consented to electronic delivery of materials.[1092] For the purposes of the PRA, we expect that the functionality required to require an investor to open an account with an intermediary and obtain consents would result in an initial time burden of approximately 10 hours per intermediary in the first year. Therefore, we estimate that the total initial burden hours necessary for this functionality would be approximately 1,100 hours (10 hours/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)).

We believe that the ongoing time burdens for this requirement would be significantly less than the initial time burden, and thus we are estimating approximately two hours per

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[1092] *See* proposed Rule 302(a) of Regulation Crowdfunding.

intermediary per year, to review and check the related processes. Therefore, we estimate that the ongoing total burden hours necessary for this functionality would be approximately 220 hours per year (2 hours/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)).

ii. Cost

To the extent an intermediary uses a third party to establish account opening functionality, the initial costs relevant to this requirement would be incorporated into the cost of hiring a third party to develop the platform, discussed below in Section IV.C.2.f.

We do not believe that there are any ongoing costs relevant to this requirement.

e. Account Opening: Educational Materials

i. Time Burden

The proposed rules would require intermediaries to provide educational materials to investors,[1093] to help ensure that investors have a baseline understanding of the risks and costs of investing in securities offered and sold in reliance on Section 4(a)(6). Given that the intermediary would determine what electronic format is effective in communicating the requisite contents of the educational material, the expected cost for intermediaries to develop the educational material is expected to vary widely and are difficult to estimate. For the purposes of the PRA, we are assuming that half of the intermediaries would develop their educational materials in-house, which would include online presentations and written documents, and that the other half would employ third-parties to produce professional-quality online video presentations. We estimate that, to develop their non-video educational materials in-house, each

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[1093] *See* proposed Rule 302(b) of Regulation Crowdfunding.

intermediary would incur an initial time burden of approximately 20 hours. Therefore, the total initial burden would be approximately 2,200 hours (110 intermediaries x 20 hours/intermediary).

Assuming that half of the intermediaries would develop their educational materials in-house, we expect that these intermediaries also would update their educational materials in-house, as needed. We estimate that to update their educational materials in-house, each intermediary would incur an ongoing time burden of approximately 10 hours per year. Therefore, the total ongoing burden would be approximately 1,100 hours per year (110 intermediaries x 10 hours/intermediary).

ii. Cost

As stated above, for the purposes of this PRA discussion, we assume that half of the intermediaries would employ third-party companies to produce professional-quality video materials instead of developing materials in-house. Public sources indicate that the typical cost to produce a professional corporate training video ranges from approximately $1,000 to $3,000 per production minute.[1094] Based on discussions with industry participants, we assume that, on average, each intermediary would produce a series of short educational videos that would cover all of the requirements of the proposed rules, and the video material would be 10 minutes long in total. Based on this assumption, we estimate that the average initial cost for an intermediary to develop and produce educational materials would range from approximately $10,000 to $30,000. The total initial cost across all 110 intermediaries per year would be $1,100,000 to $3,300,000. For purposes of the PRA, we will average the cost to $20,000 per intermediary per year. We

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[1094] *See, e.g.*, Lee W. Frederiksen, *What Is the Cost of Video Production for the Web?*, Hinge Marketing, *available at* http://www.hingemarketing.com/library/article/what-is-the-cost-of-video-production-for-the-web.

note that the estimated initial cost may be significantly lower, because not all intermediaries that outsource the development of educational materials may choose to produce educational videos, while others may produce videos of shorter length.

We estimate that, on an ongoing basis, when using a third-party company to update their video educational materials, each intermediary would spend approximately half of the initial average cost. We estimate, therefore, that the average ongoing annual cost for an issuer to update its video educational materials would range from approximately $5,000 to $15,000 and that the total ongoing annual cost across all intermediaries would range from approximately $550,000 to $1,650,000 per year. For purposes of the PRA, we will average the cost to $10,000 per intermediary per year.

f. Account Opening: Promoters

i. Time Burden

The proposed rules would require an intermediary, at the account opening stage, to disclose to investors that any person who receives compensation to promote an issuer's offering, or who is a founder or employee of an issuer engaging in promotional activities on behalf of the issuer, must clearly disclose the receipt of compensation and his or her engagement in promotional activities on the platform.[1095] For purposes of the PRA, we expect that this requirement would result in an estimated time burden of five hours per intermediary in the first year, to prepare this particular disclosure and incorporate it into the account opening process. Therefore, we estimate that the total initial burden hours necessary for intermediaries to comply

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[1095] *See* proposed Rule 302(c) of Regulation Crowdfunding.

with this requirement would be approximately 550 hours (5 hours/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)).

We believe that the ongoing time burdens for this requirement would be approximately one hour per intermediary per year to review and check that the disclosures remain appropriate. Therefore, we estimate that the ongoing total burden hours necessary for intermediaries to comply with this requirement would be approximately 110 hours per year (1 hour/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)).

ii. Cost

To the extent an intermediary uses a third party to develop the functionality for this requirement, the initial costs relevant to this requirement would be incorporated into the cost of hiring a third party to develop the platform, discussed below in subsection IV.C.2.f.

We do not believe that there are any ongoing costs relevant to this requirement.

g. Issuer Disclosures to be Made Available

i. Time Burden

The proposed rules would require an intermediary to make publicly available on its platform the information that an issuer of crowdfunding securities is required to provide to potential investors, in a manner that reasonably permits a person accessing the platform to save, download or otherwise store the information, until the offer and sale of securities is completed or cancelled.[1096]

[1096] *See* proposed Rule 303(a) of Regulation Crowdfunding.

For purposes of the PRA, our estimate of the hourly burdens related to the public availability of the issuer information is included as part of our estimate of the hourly burdens associated with overall platform development, as discussed above in Section IV.C.2.b. The platform functionality would include not only the ability to display, upload and download issuer information as required under the proposed rules, but also the ability to provide users with required online disclosures, as discussed below.

We recognize that, over time, intermediaries may need to update their systems that allow issuer information to be uploaded to their platforms. We do not expect a significant ongoing burden for providing issuer disclosures, primarily because the functionality required for required issuer disclosure information to be uploaded is a standard feature offered on many websites and would not require frequent or significant updates.

ii. Cost

We do not expect a significant ongoing cost for providing issuer disclosures, primarily because the functionality required to upload required issuer disclosure information is a standard feature offered on many websites and would not require frequent updates. Because we are including the burdens that are associated with providing issuer disclosures as part of our estimates for overall platform development, we discuss our cost estimates for ongoing platform development and updates there.

h. Other Disclosures to Investors and Potential Investors

i. Time Burden

Intermediaries would be required to implement and maintain systems to comply with the information disclosure, communication channels, and investor notification requirements, including providing disclosure about compensation at account opening, obtaining investor

acknowledgements to confirm investor qualifications and review of educational materials, providing investor questionnaires, providing communication channels with third parties and among investors, notifying investors of investment commitments, confirming completed transactions and confirming or reconfirming offering cancellations. Based on our discussions with industry participants, these functionalities would generally be part of the overall platform development process and costs. We discuss platform development costs above, which would include developing the functionality that would allow intermediaries to comply with disclosure and notification requirements.[1097]

We do not expect a significant ongoing burden for providing disclosures, as required by the proposed rules, because the functionality required to provide information and communication channels would likely not require frequent updates. We incorporate the total burden to update the required functionality for processing issuer disclosure and investor acknowledgment information in the total burden estimates discussed above relating to platform development.[1098]

ii. Cost

We recognize that some intermediaries may add the required functionality for processing issuer disclosure and investor acknowledgments by using a third-party developer. We also do not expect there to be a significant ongoing cost for developing the functionality to process these disclosures and acknowledgments, primarily because this functionality would likely not require frequent updates by third-party developers. The total cost to add the required functionality for processing issuer disclosure and investor acknowledgments, as well as to update the required

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[1097] *See* Section IV.C.2.b.i above.

[1098] *See* Section IV.C.2.b.i above.

functionality for processing issuer disclosure and investor acknowledgments, is incorporated into the total cost estimates discussed above relating to platform development.[1099]

i. Maintenance and Transmission of Funds

i. Time Burden

Intermediaries would be required to comply with the requirements related to the maintenance and transmission of funds. A registered broker would be required to comply with the requirements of Rule 15c2-4 of the Exchange Act (Transmission or Maintenance of Payments Received in Connection with Underwritings).[1100] A registered funding portal would be required to enter into a written agreement with a qualified third party to hold its client funds, or to open a bank account for the exclusive benefit of the investors and issuer, and it also would be required to send directions to the qualified third party depending on whether an investing target is met or an investment commitment or offering is cancelled. For purposes of the PRA, we are providing an estimate for the time that a funding portal would need to enter into on an initial basis, and review and update on an ongoing basis, a written agreement with the qualified third party. We expect that the burden associated with the website functionality required to send directions to third parties would be included as part of the platform development discussed above. Based on discussion with industry participants, we estimate that funding portals would incur an initial burden of approximately 20 hours each to comply with these requirements, or 1,000 hours total (20 hours per funding portal x 50 funding portals = 1,000 hours).

[1099] *See* Section IV.C.2.b above.

[1100] 17 CFR 240.15c2-4. For purposes of this PRA discussion, the burdens associated with this rule, as well as for any other rule to which brokers are subject regardless of whether they engage in transactions pursuant to Section 4(a)(6), are not addressed here; rather, they are included in any OMB approvals for the relevant rule. Rule 15c2-4, however, does not include any information collection requests for purposes of the PRA, and so there is no relevant approval or control number from OMB for this rule.

We expect that, on an ongoing basis, a registered funding portal would have to periodically review and update its written agreement with a bank or other third party to hold its client funds. A registered funding portal also would be required to send directions on an ongoing basis to a third party depending on whether an investing target is met or an investment commitment or offering is cancelled. Based on discussion with industry participants, we estimate that funding portals would incur an ongoing annual burden of approximately 5 hours each to comply with these requirements, or 250 hours total (5 hours per funding portal x 50 funding portals = 2,500 hours).

ii. Cost

For purposes of the PRA, we are not providing any cost estimate for this requirement, because we expect that the cost associated with developing the functionality required to send instructions to third parties would be included as part of the platform development discussed above.[1101]

j. Fidelity Bond

i. Time Burden

Funding portals would be required to comply with the requirements in proposed Rule 400(f) related to obtaining and maintaining fidelity bond coverage. A registered funding portal would be required to enter into a written agreement with a fidelity bond provider to obtain the required coverage. Based on discussion with industry participants, we estimate that funding portals would incur an initial burden of approximately 15 hours each to comply with these requirements, or 750 hours total (15 hours per funding portal x 50 funding portals = 750 hours).

[1101] *See* Section IV.C.2.f above.

We expect that, on an ongoing basis, a registered funding portal would have to periodically review and update its fidelity bond coverage. We estimate that funding portals would incur an ongoing burden of approximately 5 hours each to comply with these requirements, or 250 hours total (5 hours per funding portal x 50 funding portals = 2,500 hours).

ii. Cost

We estimate the initial costs for the fidelity bond to be $825. We estimate that on an ongoing basis, the costs would be $825.

k. Compliance: Policies and Procedures

i. Time Burden

Based on discussion with industry participants, we estimate that a funding portal would spend approximately 40 hours to establish written policies and procedures to achieve compliance with the JOBS Act and the rules and regulations thereunder, as required under the proposed rules. This would result in an aggregate initial recordkeeping burden of 2,000 hours (40 hours x 50 funding portals).

We estimate that, on an ongoing basis, funding portals would spend approximately 5 hours per year updating, as necessary, the policies and procedures required by the proposed rules. This would result in an aggregate ongoing recordkeeping burden of 250 hours (5 hours x 50 funding portals).

ii. Cost

As we anticipate that funding portals would comply with this requirement by using internal personnel and internal information technology resources integrated into their platforms, we estimate that there would be no costs related to this requirement. To the extent a funding

portal employs a consultant or attorney to establish written policies and procedures, these costs would be incorporated into the cost of hiring a third party to assist in the membership process.

l. Compliance: Anti-Money Laundering

While the proposed CIP and the SAR Requirements, and other BSA requirements, impose burdens on relevant entities, the proposed rules do not impose any burden on funding portals in addition to that already imposed on broker-dealers by those requirements. The burden on funding portals, would be the same as broker-dealers, and would be included within those estimates provided by Treasury,[1102] so we do not discuss those burdens here, and we would not be requesting any separate approval from OMB to impose the burdens associated with the information collection requirements to comply with the CIP and SAR Requirements.

m. Compliance: Privacy

i. Time Burden

We estimate that the initial time burden of the requirement related to the proposed Privacy Rules, including Regulation S-P, S-AM and S-ID, would be negligible in light of the limited activities of funding portals, so we discuss it below only in relation to ongoing time burdens.

Regulation S-P would require a funding portal to provide notice to investors about its privacy policies and practices; describes the conditions under which a broker may disclose nonpublic personal information about investors to nonaffiliated third parties; and provides a method for investors to prevent a funding portal from disclosing that information to most nonaffiliated third parties by "opting out" of that disclosure, subject to certain exceptions. For

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[1102] *See* OMB File No. 1506-0034 for the CIP requirement and OMB File No. 1506-0019 for the SAR requirement.

funding portals, we expect that the privacy and opt-out notices would be delivered electronically, which reduces the delivery burden compared to paper delivery.

Based on the proposed requirements, we estimate that all 50 funding portals would be subject to the requirements of Regulation S-P under the proposed regulation. In developing an estimate we have considered: (1) the minimal recordkeeping burden imposed by Regulation S-P (Regulation S-P has no recordkeeping requirement, and records relating to customer communications already must be made and retained pursuant to other Commission rules); (2) the summary fashion in which information must be provided to investors in the privacy and opt-out notices required by Regulation S-P (the model privacy form adopted by the Commission and the other agencies in 2009, designed to serve as both a privacy notice and an opt-out notice, is only two pages); and (3) the availability of the model privacy form and online model privacy form builder. Given these consideration and with the aid of our institutional knowledge, we estimate that each funding portal would spend, on an ongoing basis, an average of approximately 12 hours per year complying with the information collection requirement of Regulation S-P, for a total of approximately 600 annual burden-hours (12 hours/respondent x 50 funding portals).

Regulation S-AM would require funding portals to provide a notice to each affected individual informing the individual of his or her right to prohibit such marketing before a receiving affiliate may make marketing solicitations based on the communication of certain consumer financial information from the broker. Based on the discussion with industry participants, we estimate that approximately 20 funding portals would have affiliations that would subject them to the requirements of Regulation S-AM under the proposed regulation, and that they would require an average one-time burden of 1 hour to review affiliate marketing practices, for a total of 20 hours (1 hour/respondent x 20 funding portals). We also estimate that these 20 funding

portals would be required to provide notice and opt-out opportunities to consumers pursuant to the requirements of Regulation S-AM and that they would incur an average first-year burden of 18 hours in doing so, for a total estimated first-year burden of 360 hours (18 hours/respondent x 20 funding portals). We estimate that funding portals would incur a continuing ongoing burden related to the requirements of Regulation S-AM to provide notice and opt-out opportunities of approximately 4 hours per respondent per year to create and deliver notices to new investors and record any opt-outs that are received on an ongoing basis, for a total of approximately 80 annual burden-hours (4 hours/respondent x 20 funding portals).[1103]

Under our proposed rules, Regulation S-ID generally would require funding portals to develop and implement a written identity theft prevention program that is designed to detect, prevent and mitigate identity theft in connection with certain existing accounts or the opening of new accounts. Based on our institutional knowledge, we estimate that the initial burden for funding portals to comply with the applicable portions of proposed Regulation S-ID would be (1) 25 hours to develop and obtain board approval of a program; (2) 4 hours to train staff; and (3) 2 hours to conduct an initial assessment of relevant accounts, for a total of 31 hours. We estimate that all 50 funding portals would incur these initial time burdens, resulting in an aggregate time burden of 1,550 hours ((25 + 4 + 2 hours / respondent) x 50 funding portals).

With respect to the requirements of Regulation S-ID, we estimate that the ongoing burden per year would include: (1) 2 hours to periodically review and update the program, review and preserve contracts with service providers and review and preserve any documentation received from service providers; (2) 4 hours to prepare and present an annual report to a compliance

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[1103] The average (blended) annual time burden per respondent for Regulation S-AM requirements would be 10 hours ((18 hours in the first year / 3 years) + 4 hours/year continuing burden = 10 hours per year).

director; and (3) 2 hours to conduct periodic assessments to determine if the entity offers or maintains covered accounts, for a total of 8 hours, of which we estimate 7 hours would be spent by internal counsel and 1 hour would be spent by a compliance director. We estimate that 50 funding portals would incur these ongoing time burdens, making the total ongoing burden 400 hours (8 hours/respondent x 50 funding portals).

ii. Cost

We estimate that, for PRA purposes, there is no cost associated with the requirements of Regulation S-P, Regulation S-AM or Regulation S-ID.

n. Records to be Made and Kept by Funding Portals

i. Time Burden

All funding portals would be required to make and keep records related to their activities to facilitate transactions in reliance on Section 4(a)(6) and the related rules. These proposed books and records requirements are based generally on Exchange Act Rules 17a-3 and 17a-4, which apply to broker-dealers. To estimate the initial burden for funding portals, we examined the current annual burdens of Rules 17a-3 and 17a-4.[1104]

The most recently approved annual recordkeeping burden for broker-dealer compliance with Rule 17a-3 is currently estimated at 394.16 hours per respondent, and the most recently approved annual recordkeeping burden for broker-dealer compliance with Rule 17a-4 is currently estimated at 254 hours per respondent.

[1104] *See* Collections of Information for Exchange Act Rules 17a-3 and 17a-4 (OMB Control Nos. 3235-0033 and 3235-0279), Office of Information and Regulatory Affairs, Office of Management and Budget, *available at* http://www.reginfo.gov/public/do/PRAMain.

Given the more limited scope of a funding portal's business as compared to that of a broker, the more limited scope of the proposed books and records rules, and the fact that funding portals would make, deliver and store records electronically (as required), we expect the burden of the proposed rules may be less than that of Rules 17a-3 and 17a-4. For the purposes of the PRA, we assume that the recordkeeping burden, on average, for a funding portal to comply with the proposed rules would be 50% of the burdens of a broker-dealer to comply with Rules 17a-3 and 17a-4 (although 50% may turn out to be a high estimate). We expect the ongoing recordkeeping burden for funding portals would be the same as the initial burden because maintaining such records would be consistent each year. Therefore, we estimate the initial burden to be approximately 325 hours per respondent,[1105] or 16,250 hours total (325 hours/respondent x 50 respondents = 16,250 hours). We estimate that the ongoing recordkeeping burden for funding portals would be approximately 325 hours per respondent, or 16,250 hours total (325 hours/ respondent x 50 funding portals).

ii. Cost

For purposes of the PRA, we assume that a funding portal's initial recordkeeping cost associated with making and keeping records by a funding portal would not be significantly different from the ongoing recordkeeping cost because maintaining such records would be consistent each year. The most recently approved annual recordkeeping cost for broker-dealer compliance with Rule 17a-3 is currently estimated at $5,706.67 per respondent. These ongoing recordkeeping costs reflect the costs of systems and equipment development. The most recently

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[1105] 394.16 hours (recordkeeping burden for Rule 17a-3) + 254 hours (recordkeeping burden for Rule 17a-4) = 648.16 hours. 648.16 hours/2 = 324.08 hours.

approved annual recordkeeping cost for broker-dealer compliance with Rule 17a-4 is currently estimated at $5,000 per respondent.

Given the more limited scope of a funding portal's business as compared to that of a broker, the more limited scope of the proposed books and records rules, and the fact that funding portals would make, deliver (as required) and store records electronically, we expect the annual recordkeeping cost of the proposed rule requirements may be less than that of Rules 17a-3 and 17a-4. For purposes of the PRA, we assume that the annual recordkeeping cost on average for a funding portal to comply with the proposed requirements that records be made and kept would be about 50% less than burdens of a broker-dealer to comply with Rules 17a-3 and 17a-4. We expect the initial recordkeeping cost for funding portals, therefore, to be approximately $5,350 per respondent,[1106] or $267,500 total ($5,350 per respondent x 50 respondents = $267,500).

We also estimate that the ongoing recordkeeping cost for funding portals would be approximately $5,350 per respondent, or $267,500 total ($5,350 per respondent x 50 respondents = $267,500).

D. Collections of Information are Mandatory

The collections of information required under proposed Rules 201 through 203 would be mandatory for all issuers. The collections of information required under proposed Rules 300 through 304 would be mandatory for all intermediaries. The collections of information required under proposed Rules 400 through 404 would be mandatory for all funding portals.

[1106] $5,706.673 (recordkeeping cost for Rule 17a-3) + $5,000 (recordkeeping cost for Rule 17a-4) = $10,706.673 multiplied by 50%.

E. Confidentiality

Responses on Form C, Form C-A, Form C-U, Form C-AR and Form C-TR would not be confidential. Responses on Form ID would be kept confidential by the Commission, subject to a request under the Freedom of Information Act.[1107] Responses on Form Funding Portal would not be confidential.

F. Retention Period of Recordkeeping Requirements

Issuers are not subject to recordkeeping requirements under proposed Regulation Crowdfunding. Intermediaries that are brokers would be required to retain records and information relating to proposed Regulation Crowdfunding for the required retention periods specified in Exchange Act Rule 17a-4.[1108] Intermediaries that are funding portals would be required to retain records and information under proposed Regulation Crowdfunding for the required retention periods specified in proposed Rule 404.[1109]

G. Request for Comment

The Commission invites comment on all of the above estimates. In particular, the Commission requests comment on the assumptions and estimates described above with respect to how issuers and intermediaries, especially funding portals, would comply with the proposed information collection requests. Pursuant to 44 U.S.C. 3506(c)(2)(A), the Commission requests comment in order to: (1) evaluate whether the proposed collections of information are necessary for the proper performance of our functions, including whether the information would have practical utility; (2) evaluate the accuracy of our estimate of the burden of the proposed

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[1107] 5 U.S.C. 552. The Commission's regulations that implement the Freedom of Information Act are at 17 CFR 200.80 *et seq*.

[1108] 17 CFR 240.17a-4.

[1109] *See* proposed Rule 404 of Regulation Crowdfunding.

collections of information; (3) determine whether there are ways to enhance the quality, utility and clarity of the information to be collected; and (4) evaluate whether there are ways to minimize the burden of the proposed collections of information on those who respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the proposed collection of information requirements should direct their comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-09-13. Requests for materials submitted to OMB by the Commission, with regard to these collections of information, should be in writing, with reference to File No. S7-09-13, and they should be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street, NE, Washington, DC 20549-2736. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

V. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),[1110] the Commission must advise the OMB as to whether the proposed rules constitute a "major" rule. Under SBREFA, a rule is considered "major" when, if adopted, it

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[1110] Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various Sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

results or is likely to result in: (1) an annual effect on the economy of $100 million or more (either in the form of an increase or a decrease); (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effect on competition, investment or innovation. If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review.

The Commission requests comment on the potential impact of the proposed rules on the economy on an annual basis, any potential increase in costs or prices for consumers or individual industries and any potential effect on competition, investment or innovation. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

VI. Initial Regulatory Flexibility Act Analysis

The Commission has prepared the following Initial Regulatory Flexibility Analysis ("IRFA"), in accordance with the provisions of the Regulatory Flexibility Act,[1111] regarding proposed Regulation Crowdfunding.

A. Reasons for the Proposed Actions

The proposed regulation is designed to implement the requirements of Title III. Title III added Securities Act Section 4(a)(6), which provides a new exemption from the registration requirements of Securities Act Section 5 for crowdfunding transactions, provided the transactions are conducted in the manner set forth in new Securities Act Section 4A. Section 4A includes requirements for issuers that offer or sell securities in reliance on the crowdfunding exemption, as well as for persons acting as intermediaries in those transactions. The proposed rules prescribe requirements governing the offer and sale of securities in reliance on Section

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[1111] 5 U.S.C. 603.

4(a)(6), and provide a framework for the regulation of registered funding portals and brokers that act as intermediaries in the offer and sale of securities in reliance on Section 4(a)(6).

B. Objectives

As discussed above, the crowdfunding provisions of the JOBS Act, which we would implement through this proposed regulation, were designed to help alleviate the funding gap and accompanying regulatory concerns faced by small businesses by making relatively low dollar offerings of securities less costly and by providing crowdfunding platforms a means by which to facilitate the offer and sale of securities without registering as brokers, with a framework for regulatory oversight to protect investors.

C. Small Entities Subject to the Proposed Rules

For purposes of the Regulatory Flexibility Act, under our rules, an issuer (other than an investment company) is a "small business" or "small organization" if it has total assets of $5 million or less as of the end of its most recent fiscal year and is engaged or proposing to engage in an offering of securities which does not exceed $5 million.[1112] We believe that many issuers seeking to offer and sell securities in reliance on Section 4(a)(6) would be at a very early stage of their business development and would likely have total assets of $5 million or less. Also, to qualify for the exemption under Section 4(a)(6), the amount raised by an issuer must not exceed $1 million in a 12-month period. Therefore, we estimate that all issuers who offer or sell securities in reliance on the exemption would be classified as a "small business" or "small organization."

[1112] 17 CFR 230.157.

Paragraph (a) of Rule 0-10 under the Exchange Act provides that, for purposes of the Regulatory Flexibility Act, "[w]hen used with reference to a broker or dealer, the Commission has defined the term "small entity" to mean a broker or dealer ("small broker-dealer" that: (1) had total capital (net worth plus subordinated liabilities of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) or, if not required to file such statements, a broker or dealer that had total capital (net worth plus subordinated debt) of less than $500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business if shorter); and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined in this release."[1113] Currently, based on FOCUS Report[1114] data, there are 871 broker-dealers that are classified as "small" entities for purposes of the Regulatory Flexibility Act.[1115] We apply comparable criteria to funding portals that would register under the proposed regulation. Based on discussions with industry participants, we estimate that, of the anticipated 50 funding portals we expect to register under the proposed regulation, 30 would be classified as "small" entities for purposes of the Regulatory Flexibility Act.

D. Projected Reporting, Recordkeeping and other Compliance Requirements

As discussed above, the proposed regulation includes reporting, recordkeeping and other compliance requirements. In particular, the proposed regulation would impose certain disclosure requirements on issuers offering and selling securities in a transaction relying on the exemption

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1113 17 CFR 240.0-10(c).

1114 FOCUS Reports, or "Financial and Operational Combined Uniform Single" Reports, are monthly, quarterly, and annual reports that broker-dealers generally are required to file with the Commission and/or self-regulatory organizations pursuant to Exchange Act Rule 17a-5 (17 CFR 240.17a-5).

1115 *See* 17 CFR 240.0-10(a).

provided by Section 4(a)(6). The proposed rules would require that issuers relying on the exemption provided by Section 4(a)(6) file with the Commission certain specified information about the issuer and the offering, including information about the issuer's contact information; directors, officers and certain beneficial owners; business and business plan; current number of employees; financial condition; target offering amount and the deadline to reach the target offering amount; use of proceeds from the offering and price or method for calculating the price of the securities being offered; ownership and capital structure; material factors that make an investment in the issuer speculative or risky; indebtedness; description of other offerings of securities; and transactions with related parties. Issuers also would be required to file updates with the Commission to describe the progress of the issuer in meeting the target offering amount. Any issuer that sold securities in reliance on Section 4(a)(6) also would be required to file annually with the Commission an annual report to update the previously provided disclosure about the issuer's contact information; directors, officers and certain beneficial owners; business and business plan; current number of employees; financial condition; ownership and capital structure; material factors that make an investment in the issuer speculative or risky; indebtedness; description of other offerings of securities; and transactions with related parties.

Intermediaries would be required to register with the Commission as either brokers or as funding portals pursuant to the proposed rules. Intermediaries also would be required to provide quarterly reports to the Commission. Funding portals would be required to make and keep certain records in accordance with the proposed rules. In addition, the proposed rules would impose specific compliance requirements on intermediaries.

In proposing this regulation, the Commission took into account that the regulation, as mandated in the JOBS Act, aimed to address difficulties encountered by issuers that are small

entities. Accordingly, the Commission designed the proposed rules for intermediaries, to the extent possible, for small entities. We believe that the potential impact of the proposed regulation on larger brokers and funding portals would be less than on small brokers and small intermediaries. We believe that the reporting, recordkeeping and other compliance requirements of the proposed regulation applicable to intermediaries would impact, in particular, small entities that decide to register as funding portals. We believe that most of these requirements would be performed by internal compliance personnel of the broker or funding portal, but we estimate that at least one-third of funding portals may decide to hire outside counsel and third-party service providers to assist in meeting the compliance requirements. For example, a funding portal may decide to hire a third party to maintain records required by the proposed rules.

E. Duplicative, Overlapping or Conflicting Federal Rules

The Commission believes that there are no federal rules that duplicate, overlap or conflict with the proposed regulation or the proposed amendment to Rule 30-1 of our Rules of Organization and Program Management.

F. Significant Alternatives

Pursuant to Section 3(a) of the Regulatory Flexibility Act,[1116] the Commission must consider certain types of alternatives, including: (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation or simplification of compliance and reporting requirements under the rule for small entities; (3) the use of performance rather than design

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[1116] 5 U.S.C. 603(c).

standards; and (4) an exemption from coverage of the rule, or any part of the rule, for small entities.

1. Issuers

The Commission considered whether it is necessary or appropriate to establish different compliance or reporting requirements or timetables or to clarify, consolidate or simplify compliance and reporting requirements under the proposed rules for small issuers. With respect to using performance rather than design standards, the Commission used performance standards to the extent appropriate under the statute. For example, issuers have the flexibility to customize the presentation of certain disclosures in their offering statements.[1117] The Commission also considered whether there should be an exemption from coverage of the rule, or any part of the rule, for small issuers. However, because the proposed rules have been designed in the context of crowdfunding, which focuses on the needs of issuers that are small entities, the Commission believes that small issuers should be covered by the proposed rules. The Commission does not believe it would be necessary to establish different compliance requirements for small issuers. Having inconsistent requirements could undermine the objectives of the proposed rules.

2. Intermediaries

The Commission also considered whether, for small brokers or small funding portals, it is appropriate to establish different compliance, reporting or timing requirements, or whether to clarify, consolidate or simplify those requirements in our proposed rules. While the proposed rules are based in large part on existing compliance requirements applicable to registered brokers, the Commission believes that it would not be necessary to establish different

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[1117] *See* Section II.B.3 above.

requirements for small entities (whether brokers or funding portals) that engage in crowdfunding. The proposed rules have been tailored to the limited role intermediaries would play in offerings made pursuant to Section 4(a)(6) (as compared to the wide range of services that a traditional broker-dealer may provide). Therefore, we believe that the proposed rules are appropriate, and properly cover all brokers and funding portals. The Commission believes that having separate requirements for small entities (whether brokers or funding portals) could undermine the objectives of the proposed requirements, and could lead to less regulatory clarity.

G. Request for Comment

The Commission encourages written comments on matters discussed in this IRFA. In particular, the Commission seeks comment on the number of small entities that would be affected by the proposed rules and whether the effect on small entities would be economically significant. Commenters are asked to describe the nature of any effect and to provide empirical data to support their views.

VII. STATUTORY AUTHORITY AND TEXT OF PROPOSED REGULATION

We are proposing the rules and forms contained in this document under the authority set forth in the Securities Act, particularly, Sections 4(a)(6), 4A and 19 thereof, 15 U.S.C. 77a *et seq.*, the Exchange Act, particularly, Sections 3(b), 3(h), 10(b), 15, 17, 23(a) and 36 thereof, 15 U.S.C. 78a *et seq.*, and Pub. L. No. 112-106, §301-305, 126 Stat. 306 (2012).

List of Subjects

17 CFR Part 200

Administrative practice and procedure, Authority delegations (Government agencies), Organization and functions (Government agencies).

Reporting and recordkeeping requirements.

17 CFR Part 227

Crowdfunding, Funding Portals, Intermediaries, Reporting and recordkeeping requirements, Securities.

17 CFR Parts 232 and 239

Reporting and recordkeeping requirements, Securities.

17 CFR Part 240

Brokers, Confidential business information, Fraud, Reporting and recordkeeping requirements, Securities.

17 CFR Part 249

Brokers, Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, we propose to amend Title 17, Chapter II of the Code of Federal Regulations as follows:

PART 200 – ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

Subpart A – Organization and Program Management

1. The authority citation for Part 200, Subpart A, continues to read, in part as follows: Authority: 15 U.S.C. 77o, 77s, 77sss, 78d, 78d-1, 78d-2, 78w, 78ll(d), 78mm, 80a-37, 80b-11, 7202, and 7211 et seq., unless otherwise noted.

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2. Amend § 200.30-1 by:

a. Redesignating paragraphs (d), (e), (f), (g), (h), (i), (j) and (k) as paragraphs (e), (f), (g), (h), (i), (j), (k) and (*l*), respectively; and

b. Adding new paragraph (d).

The addition reads as follows:

§ 200.30-1 Delegation of authority to Director of Division of Corporation Finance.

* * * * *

(d) With respect to the Securities Act of 1933 (15 U.S.C. 77a *et seq*.) and Regulation Crowdfunding thereunder (§§ 227.100 through 227.503 of this chapter), to authorize the granting of applications under § 227.503(b)(2) of this chapter upon the showing of good cause that it is not necessary under the circumstances that the exemption under Regulation Crowdfunding be denied.

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3. Part 227 is added to read as follows:

PART 227—REGULATION CROWDFUNDING, GENERAL RULES AND REGULATIONS

Sec.

Subpart A General

227.100 Crowdfunding exemption and requirements.

Subpart B Requirements for Issuers

227.201 Disclosure requirements.

227.202 Ongoing reporting requirements.

227.203 Filing requirements and form.

227.204 Advertising.

227.205 Promoter compensation.

Subpart C Requirements for Intermediaries

227.300 Intermediaries.

227.301 Measures to reduce risk of fraud.

227.302 Account opening.

227.303 Requirements with respect to transactions.

227.304 Completion of offerings, cancellations and reconfirmations.

227.305 Payments to third parties.

Subpart D Funding Portal Regulation

227.400 Registration of funding portals.

227.401 Exemption.

227.402 Conditional safe harbor.

227.403 Compliance.

227.404 Records to be made and kept by funding portals.

Subpart E Miscellaneous Provisions

227.501 Restrictions on resales.

227.502 Insignificant deviations from a term, condition or requirement of Regulation Crowdfunding.

227.503 Disqualification.

Authority: 15 U.S.C. 77d, 77d-1, 77s, 78c, 78o, 78q, 78w, 78mm, and Pub. L. No. 112-106, §301-305, 126 Stat. 306 (2012), unless otherwise noted.

SUBPART A – General

§ 227.100 Crowdfunding exemption and requirements.

(a) *Exemption*. An issuer may offer and sell securities in reliance on Section 4(a)(6) of the Securities Act of 1933 (the "Securities Act") (15 U.S.C. 77d(a)(6)), provided that:

(1) The aggregate amount of securities sold to all investors by the issuer in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) during the 12-month period preceding

the date of such offer or sale, including the securities offered in such transaction, shall not exceed $1,000,000;

(2) The aggregate amount of securities sold to any investor by any issuer in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) during the 12-month period preceding the date of such transaction, including the securities sold to such investor in such transaction, shall not exceed the greater of:

(i) $2,000 or 5 percent of annual income or net worth of the investor, whichever is greater, if both the annual income and net worth are less than $100,000; and

(ii) 10 percent of annual income or net worth of the investor, whichever is greater, not to exceed an amount sold of $100,000, if either the annual income or net worth of the investor is equal to or more than $100,000;

Instruction 1 to paragraph (a)(2). To determine the investment limit for a natural person, the person's annual income and net worth shall be calculated as those values are calculated for purposes of determining accredited investor status in accordance with 17 CFR 230.501.

Instruction 2 to paragraph (a)(2). The person's annual income and net worth may be calculated jointly with the annual income and net worth of the person's spouse.

Instruction 3 to paragraph (a)(2). An issuer offering and selling securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) may rely on the efforts an intermediary is required to undertake pursuant to § 227.303(b) to ensure that the aggregate amount of securities purchased by an investor in offerings pursuant to Section 4(a)(6) of the Securities Act will not cause the investor to exceed the limit set forth in Section 4(a)(6) of the Securities Act and § 227.100(a)(2), provided that the issuer does not know that the investor had exceeded the investor limits or would exceed the investor limits as a result of purchasing

securities in the issuer's offering.

(3) The transaction is conducted through an intermediary that complies with the requirements in Section 4A(a) of the Securities Act (15 U.S.C. 77d-1(a)) and the related requirements in Regulation Crowdfunding (§§ 227.100 *et seq*.), and the transaction is conducted exclusively through the intermediary's platform; and

Instruction 1 to paragraph (a)(3). An issuer shall not conduct an offering or concurrent offerings in reliance on Section 4(a)(6) of the Securities Act of 1933 (15 U.S.C. 77d(a)(6)) using more than one intermediary.

Instruction 2 to paragraph (a)(3). An intermediary through which a crowdfunding transaction is conducted may engage in back office or other administrative functions other than on the intermediary's platform.

(4) The issuer complies with the requirements in Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)) and the related requirements in this part.

(b) *Applicability*. The crowdfunding exemption shall not apply to transactions involving the offer or sale of securities by any issuer that:

(1) Is not organized under, and subject to, the laws of a State or territory of the United States or the District of Columbia;

(2) Is subject to the requirement to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act") (15 U.S.C. 78m or 78o(d));

(3) Is an investment company, as defined in Section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), or is excluded from the definition of investment company by Section 3(b) or Section 3(c) of that Act (15 U.S.C. 80a-3(b) or 80a-3(c));

(4) Is not eligible to offer or sell securities in reliance on Section 4(a)(6) of the Securities

Act (15 U.S.C. 77d(a)(6)) as a result of a disqualification as specified in § 227.503(a);

(5) Has sold securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) and has not filed with the Commission and provided to investors, to the extent required, the ongoing annual reports required by this part during the two years immediately preceding the filing of the required offering statement; or

(6) Has no specific business plan or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies.

(c) *Issuer*. For purposes of this part, *issuer* includes all entities controlled by or under common control with the issuer. It also includes any predecessor of the issuer.

Instruction to paragraph (c). An entity is controlled by or under common control with the issuer if the issuer possesses, directly or indirectly, the power to direct or cause the direction of the management and policies of the entity, whether through the ownership of voting securities, by contract or otherwise.

(d) *Platform*. For purposes of this part, *platform* means an Internet website or other similar electronic medium through which a registered broker or a registered funding portal acts as an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

SUBPART B – Requirements for Issuers

§ 227.201 Disclosure requirements.

An issuer offering or selling securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) and in accordance with Section 4A of the Securities Act (15 U.S.C. 77d-1) and this part must file with the Commission on the Electronic Data Gathering, Analysis, and

Retrieval system (EDGAR), provide to investors and the relevant intermediary, and make available to potential investors the following information:

(a) The name, legal status (including its form of organization, jurisdiction in which it is organized and date of organization), physical address and website of the issuer;

(b) The names of the directors and officers (and any persons occupying a similar status or performing a similar function) of the issuer, all positions and offices with the issuer held by such persons, the period of time in which such persons served in the position or office and their business experience during the past three years, including:

(1) Each person's principal occupation and employment, including whether any officer is employed by another employer; and

(2) The name and principal business of any corporation or other organization in which such occupation and employment took place.

Instruction to paragraph (b). For purposes of this paragraph (b), the term *officer* means a president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization, whether incorporated or unincorporated.

(c) The name of each person, as of the most recent practicable date, who is a beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power;

(d) A description of the business of the issuer and the anticipated business plan of the issuer;

(e) The current number of employees of the issuer;

(f) A discussion of the material factors that make an investment in the issuer speculative or risky;

(g) The target offering amount and the deadline to reach the target offering amount, including a statement that if the sum of the investment commitments does not equal or exceed the target offering amount at the offering deadline, no securities will be sold in the offering, investment commitments will be cancelled and committed funds will be returned;

(h) Whether the issuer will accept investments in excess of the target offering amount and, if so, the maximum amount that the issuer will accept and whether oversubscriptions will be allocated on a pro-rata, first come-first served, or other basis;

(i) A description of the purpose and intended use of the offering proceeds;

Instruction to paragraph (i). An issuer must identify any intended use of proceeds and provide a reasonably detailed description of such intended use, such that investors are provided with an adequate amount of information to understand how the offering proceeds will be used. If an issuer has identified a range of possible uses, the issuer should identify and describe each probable use and the factors impacting the selection of each particular use. If the issuer will accept proceeds in excess of the target offering amount, the issuer must describe the stated purpose and intended use of the excess proceeds with similar specificity.

(j) A description of the process to complete the transaction or cancel an investment commitment, including a statement that:

(1) Investors may cancel an investment commitment until 48 hours prior to the deadline identified in the issuer's offering materials;

(2) The intermediary will notify investors when the target offering amount has been met;

(3) If an issuer reaches the target offering amount prior to the deadline identified in its offering materials, it may close the offering early if it provides notice about the new offering deadline at least five business days prior to such new offering deadline (absent a material change that would require an extension of the offering and reconfirmation of the investment commitment); and

(4) If an investor does not cancel an investment commitment before the 48-hour period prior to the offering deadline, the funds will be released to the issuer upon closing of the offering and the investor will receive securities in exchange for his or her investment;

(k) A statement that if an investor does not reconfirm his or her investment commitment after a material change is made to the offering, the investor's investment commitment will be cancelled and the committed funds will be returned;

(l) The price to the public of the securities or the method for determining the price, provided that, prior to any sale of securities, each investor shall be provided in writing the final price and all required disclosures;

(m) A description of the ownership and capital structure of the issuer, including:

(1) The terms of the securities being offered and each other class of security of the issuer, including the number of securities being offered and/or outstanding, whether or not such securities have voting rights, any limitations on such voting rights, how the terms of the securities being offered may be modified and a summary of the differences between such securities and each other class of security of the issuer, and how the rights of the securities being offered may be materially limited, diluted or qualified by the rights of any other class of security of the issuer;

(2) A description of how the exercise of the rights held by the principal shareholders of the issuer could affect the purchasers of the securities being offered;

(3) The name and ownership level of each person, as of the most recent practicable date, who is the beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power;

(4) How the securities being offered are being valued, and examples of methods for how such securities may be valued by the issuer in the future, including during subsequent corporate actions;

(5) The risks to purchasers of the securities relating to minority ownership in the issuer and the risks associated with corporate actions including additional issuances of securities, issuer repurchases of securities, a sale of the issuer or of assets of the issuer or transactions with related parties; and

(6) A description of the restrictions on transfer of the securities, as set forth in § 227.501;

(n) The name, Commission file number and Central Registration Depository (CRD) number (as applicable) of the intermediary through which the offering is being conducted;

(o) The amount of compensation paid to the intermediary for conducting the offering, including the amount of referral and any other fees associated with the offering;

(p) A description of the material terms of any indebtedness of the issuer, including the amount, interest rate, maturity date and any other material terms;

(q) A description of exempt offerings conducted within the past three years;

Instruction to paragraph (q). In providing a description of any prior exempt offerings, disclose:

(1) The date of the offering;

(2) The offering exemption relied upon;

(3) The type of securities offered; and

(4) The amount of securities sold and the use of proceeds.

(r) A description of any transaction since the beginning of the issuer's last full fiscal year, or any currently proposed transaction, to which the issuer or any entities controlled by or under common control with the issuer was or is to be a party and the amount involved exceeds five percent of the aggregate amount of capital raised by the issuer in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) during the preceding 12-month period, inclusive of the amount the issuer seeks to raise in the current offering under Section 4(a)(6) of the Securities Act, in which any of the following persons had or is to have a direct or indirect material interest:

(1) Any director or officer of the issuer;

(2) Any person who is, as of the most recent practicable date, the beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power;

(3) If the issuer was incorporated or organized within the past three years, any promoter of the issuer;

(4) Any immediate family member of any of the foregoing persons, which means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of the person, and any persons (other than a tenant or employee) sharing the household of the person;

Instruction to paragraph (r). For each transaction identified, disclose the name of the specified person and state his or her relationship to the issuer, the nature of his or her interest in the transaction and, where practicable, the approximate amount of the interest of such specified

person. The amount of such interest shall be computed without regard to the amount of the profit or loss involved in the transaction. Where it is not practicable to state the approximate amount of the interest, the approximate amount involved in the transaction shall be disclosed.

(s) A description of the financial condition of the issuer;

Instruction to paragraph (s). In providing a description of the issuer's financial condition, provide a discussion, to the extent material, of the issuer's historical results of operations, liquidity and capital resources. For issuers with no prior operating history, the description should include a discussion of financial milestones and operational, liquidity and other challenges. For issuers with an operating history, the discussion should address whether historical earnings and cash flows are representative of what investors should expect in the future. Issuers should take into account the proceeds of the offering and any other known or pending sources of capital. Issuers should also discuss how the proceeds from the offering will impact the issuer's liquidity and the necessity of receiving these funds and any other additional funds to the viability of the business. In addition, issuers should describe the other available sources of capital to the business, such as lines of credit or required contributions by shareholders.

(t) For offerings that, together with all other offerings of the issuer under Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) within the preceding 12-month period, have, in the aggregate, target offering amounts of:

(1) $100,000 or less, the income tax returns filed by the issuer for the most recently completed year (if any) and financial statements of the issuer, which shall be certified by the principal executive officer of the issuer to be true and complete in all material respects;

(2) More than $100,000, but not more than $500,000, financial statements reviewed by a public accountant who is independent of the issuer, using the Statements on Standards for Accounting and Review Services issued by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants; and

(3) More than $500,000, financial statements audited by a public accountant who is independent of the issuer, using auditing standards issued by either the American Institute of Certified Public Accountants or the Public Company Accounting Oversight Board;

Instruction 1 to paragraph (t). To determine the financial statements that would be required under paragraph (t), an issuer would aggregate amounts offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) within the preceding 12-month period and the offering amount in the offering for which disclosure is being provided. If the issuer will accept proceeds in excess of the target offering amount, the issuer must include in the calculation to determine the financial statements that would be required under paragraph (t) the maximum offering amount that the issuer will accept.

Instruction 2 to paragraph (t). The financial statements required by paragraphs (t)(1), (t)(2) and (t)(3) of this section would include a balance sheet, income statement, statement of cash flows and statement of changes in owners' equity and notes to the financial statements prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP). The required financial statements must cover the shorter of the two most recently completed fiscal years or the period since inception.

Instruction 3 to paragraph (t). An issuer shall redact personally identifiable information from any tax returns required to be provided under paragraph (t)(1) of this section. Issuers offering securities in a transaction in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C.

77d(a)(6)) before filing a tax return with the U.S. Internal Revenue Service for the most recently completed fiscal year may use the tax return filed with the U.S. Internal Revenue Service for the prior year (if any), provided that the issuer uses the tax return for the most recent fiscal year when it is filed, if filed during the offering period.

Instruction 4 to paragraph (t). With respect to the financial statements required by paragraph (t)(1) of this section, an issuer's principal executive officer must provide the following certification in the Form C – Offering Statement (§ 239.900 of this chapter):

> I, [identify the certifying individual], certify that the financial statements of [identify the issuer] included in this Form are true and complete in all material respects. [Signature and title].

Instruction 5 to paragraph (t). A copy of the public accountant's review report must accompany the financial statements required by paragraph (t)(2) of this section.

Instruction 6 to paragraph (t). A copy of the audit report must accompany financial statements required by paragraph (t)(3) of this section. An issuer will be in compliance with the requirement to provide audited financial statements if the issuer received an unqualified or a qualified opinion, but it will not be in compliance with the requirement if it received an adverse opinion or a disclaimer of opinion.

Instruction 7 to paragraph (t). To qualify as an independent public accountant for purposes of paragraphs (t)(2) and (t)(3) of this section, the accountant must satisfy the independence requirements in Rule 2-01 of Regulation S-X (17 CFR 210.2-01).

Instruction 8 to paragraph (t). An issuer may conduct an offering in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) using financial statements for the fiscal year prior to the issuer's most recently completed fiscal year, provided that the issuer was not

otherwise already required to update the financial statements pursuant to § 227.202 and updated financial statements are not otherwise available. If more than 120 days have passed since the end of the issuer's most recently completed fiscal year, the issuer must use financial statements for its most recently completed fiscal year.

Instruction 9 to paragraph (t). An issuer must include a discussion of any material changes in the financial condition of the issuer during any time period subsequent to the period for which financial statements are provided, including changes in reported revenue or net income.

Instruction 10 to paragraph (t). An issuer may voluntarily provide financial statements that meet the requirements for a higher aggregate target offering amount, even if the aggregate amounts sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) within the preceding 12-month period do not require it.

(u) Any matters that would have triggered disqualification under § 227.503(a) had they occurred on or after [effective date of final rule]. The failure to furnish such disclosure timely shall not prevent an issuer from continuing to rely on the exemption provided by Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) if the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known of the existence of the undisclosed matter or matters; and

Instruction to paragraph (u). An issuer will not be able to establish that it has exercised reasonable care unless it has made factual inquiry into whether any disqualifications exist. The nature and scope of the factual inquiry will vary based on the facts and circumstances concerning, among other things, the issuer and the other offering participants.

(v) Updates regarding the progress of the issuer in meeting the target offering amount, to be provided in accordance with § 227.203.

§ 227.202 Ongoing reporting requirements.

(a) An issuer that has offered and sold securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) and in accordance with Section 4A of the Securities Act (15 U.S.C. 77d-1) and this part must file with the Commission on EDGAR and post on the issuer's website an annual report of its results of operations as described in § 227.201(s) and financial statements of the issuer for the highest aggregate target offering amount previously provided under § 227.201(t). The report also must include the disclosure required by paragraphs (a), (b), (c), (d), (e), (f), (m), (p), (q), and (r) of § 227.201. The report must be filed in accordance with the requirements of § 227.203 and Form C (§ 239.900 of this chapter) and no later than 120 days after the end of the fiscal year covered by the report.

(b) An issuer must continue to comply with the ongoing reporting requirements until:

(1) The issuer becomes a reporting company required to file reports under Section 13(a) or Section 15(d) of the Exchange Act (15 U.S.C. 78m(a) or 78o(d));

(2) The issuer or another party repurchases all of the securities issued in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), including any payment in full of debt securities or any complete redemption of redeemable securities; or

(3) The issuer liquidates or dissolves its business in accordance with state law.

§ 227.203 Filing requirements and form.

(a) Form C – Offering Statement and Amendments (§ 239.900 of this chapter).

(1) *Offering Statement.* An issuer offering or selling securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) and in accordance with Section 4A of the

Securities Act (15 U.S.C. 77d-1) and this part must file with the Commission on EDGAR, provide to investors and the relevant intermediary, and make available to potential investors a Form C: Offering Statement (Form C) (§ 239.900 of this chapter) prior to the commencement of the offering of securities. The Form C must include the information required by § 227.201 of Regulation Crowdfunding

Instruction to paragraph (a)(1). An issuer shall input the following information in the XML-based portion of Form C (§ 239.900 of this chapter): name, legal status and contact information of the issuer; name, Commission file number and CRD number (as applicable) of the intermediary through which the offering will be conducted; amount of compensation paid to the intermediary, including the amount of referral and other fees associated with the offering; type of security offered; number of securities offered; offering price; target offering amount and maximum offering amount (if different from the target offering amount); whether oversubscriptions will be accepted and, if so, how they will be allocated; deadline to reach the target offering amount; current number of employees; and selected financial data for the prior two fiscal years (including total assets, cash and cash equivalents, accounts receivable, short-term debt, long-term debt, revenues/sales, cost of goods sold, taxes paid and net income).

(2) *Amendments to Offering Statement.* An issuer must file with the Commission on EDGAR, provide to investors and the relevant intermediary, and make available to potential investors an amendment to the offering statement filed on Form C (§ 239.900 of this chapter) to disclose any material changes, additions or updates to information that it provides to investors through the intermediary's platform, only if the offering has not yet been completed or terminated. The amendment must be filed on Form C: Amendment (Form C-A) (§ 239.900 of this chapter), and if the amendment reflects material changes, additions or updates, the issuer

shall check the box indicating that investors must reconfirm an investment commitment within five business days or the investor's commitment will be considered withdrawn.

Instruction to paragraph (a)(2). An issuer may file an amendment on Form C-A (§ 239.900 of this chapter) to reflect changes, additions or updates that it considers not material, and in such circumstance, an issuer should not check the box indicating that investors must reconfirm the investment commitment within five business days.

(3) *Progress Updates.* An issuer must file with the Commission on EDGAR, provide to investors and the relevant intermediary, and make available to potential investors a Form C: Progress Update (Form C-U) (§ 239.900 of this chapter) to disclose its progress in meeting the target offering amount no later than five business days after the issuer reaches one-half and 100 percent of the target offering amount. If the issuer will accept proceeds in excess of the target offering amount, the issuer must file with the Commission on EDGAR, provide to investors and the relevant intermediary, and make available to potential investors, no later than five business days after the offering deadline, a final Form C-U to disclose the total amount of securities sold in the offering.

Instruction 1 to paragraph (a)(3). An issuer shall input the progress update in the XML-based portion of Form C-U (§ 239.900 of this chapter).

Instruction 2 to paragraph (a)(3). If multiple Forms C-U (§ 239.900 of this chapter) are triggered within the same five business day period, the issuer may consolidate such progress updates into one Form C-U, so long as the Form C-U discloses the most recent threshold that was met and the Form C-U is filed with the Commission on EDGAR, provided to investors and the relevant intermediary, and made available to potential investors by the day on which the first progress update is due.

Instruction 1 to paragraph (a). An issuer would satisfy the requirement to provide to the relevant intermediary the information required by § 227.203(a) if the issuer provides to the relevant intermediary a copy of the disclosures filed with the Commission on EDGAR.

Instruction 2 to paragraph (a). An issuer would satisfy the requirement to provide to investors and to make available to potential investors the information required by § 227.203(a) if the issuer refers investors to the information on the intermediary's platform by means of a posting on the issuer's website or by e-mail.

(b) *Form C: Annual Report* (§ 239.900 of this chapter). (1) An issuer that sold securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) and in accordance with Section 4A of the Securities Act (15 U.S.C. 77d-1) and this part must file an annual report on Form C: Annual Report (Form C-AR) (§ 239.900 of this chapter) with the Commission no later than 120 days after the end of the fiscal year covered by the report. The annual report shall include the information required by § 227.202(a).

Instruction to paragraph (b)(1). An issuer shall input the following information in the XML-based portion of Form C-AR (§ 239.900 of this chapter): name, legal status and contact information of the issuer; current number of employees; and selected financial data for the prior two fiscal years (including total assets, cash and cash equivalents, accounts receivable, short-term debt, long-term debt, revenues/sales, cost of goods sold, taxes paid and net income).

(2) An issuer eligible to terminate its obligation to file annual reports with the Commission pursuant to § 227.202(b) must file, within five business days from the date on which the issuer becomes eligible to terminate is reporting obligation, Form C: Termination of Reporting (Form C-TR) (§ 239.900 of this chapter) with the Commission to advise investors that the issuer will cease reporting pursuant to this part.

§ 227.204 Advertising.

(a) An issuer may not advertise directly or indirectly the terms of an offering made in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), except for notices that direct investors to the intermediary's platform.

(b) A notice regarding the terms of an issuer's offering in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) that directs investors to the intermediary's platform may include no more than the following:

(1) A statement that the issuer is conducting an offering pursuant to Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), the name of the intermediary through which the offering is being conducted and a link directing the potential investor to the intermediary's platform;

(2) The terms of the offering; and

(3) Factual information about the legal identity and business location of the issuer, limited to the name of the issuer of the security, the address, phone number and website of the issuer, the e-mail address of a representative of the issuer and a brief description of the business of the issuer.

(c) Notwithstanding the prohibition on advertising the terms of the offering, an issuer may communicate with investors and potential investors about the terms of the offering through communication channels provided by the intermediary on the intermediary's platform, provided that an issuer identifies itself as the issuer in all communications.

Instruction to § 227.204. For purposes of this section, *terms of the offering* means the amount of securities offered, the nature of the securities, the price of the securities and the closing date of the offering period.

§ 227.205 Promoter compensation.

(a) An issuer shall be permitted to compensate or commit to compensate, directly or indirectly, any person to promote its offerings in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through communication channels provided by an intermediary on the intermediary's platform, but only if the issuer takes reasonable steps to ensure that such person clearly discloses the receipt, past or prospective, of such compensation with any such communication. A founder or an employee of the issuer that engages in promotional activities on behalf of the issuer through the communication channels provided by the intermediary must disclose, with each posting, that he or she is engaging in those activities on behalf of the issuer.

(b) Other than as set forth in paragraph (a) of this section, an issuer shall not compensate or commit to compensate, directly or indirectly, any person to promote its offerings in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), unless such promotion is limited to notices permitted by, and in compliance with, § 227.204.

SUBPART C – Requirements for Intermediaries

§ 227.300 Intermediaries.

(a) *Requirements*. A person acting as an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) must:

(1) Be registered with the Commission as a broker under Section 15(b) of the Exchange Act (15 U.S.C. 78*o*(b)) or as a funding portal in accordance with the requirements of § 227.400; and

(2) Be a member of the Financial Industry Regulatory Authority or any other applicable national securities association registered under Section 15A of the Exchange Act (15 U.S.C. 78*o*-3).

(b) *Prohibitions*. An intermediary and any director, officer or partner, or any person occupying a similar status or performing a similar function may not have a financial interest in an issuer that is offering or selling securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through the intermediary's platform, or receive a financial interest in an issuer as compensation for the services provided to or for the benefit of the issuer in connection with the offer or sale of such securities. For purposes of this paragraph, a *financial interest in an issuer* means a direct or indirect ownership of, or economic interest in, any class of the issuer's securities.

(c) *Definitions*. For purposes of this part:

(1) *Associated person of a funding portal* or *person associated with a funding portal* means any partner, officer, director or manager of a funding portal (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling or controlled by such funding portal, or any employee of a funding portal, except that any person associated with a funding portal whose functions are solely clerical or ministerial shall not be included in the meaning of such term for purposes of Section 15(b) of the Exchange Act (15 U.S.C. 78*o*(b)) (other than paragraphs (4) and (6) thereof).

(2) *Funding portal* means a broker acting as an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), that does not:

(i) Offer investment advice or recommendations;

(ii) Solicit purchases, sales or offers to buy the securities displayed on its platform;

(iii) Compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its platform; or

(iv) Hold, manage, possess, or otherwise handle investor funds or securities.

(3) *Intermediary* means a broker registered under Section 15(b) of the Exchange Act (15 U.S.C. 78*o*(b)) or a funding portal registered under § 227.400 and includes, where relevant, an associated person of the registered broker or registered funding portal.

(4) *Investor* refers to any investor or any potential investor, as the context requires.

(5) *Self-regulatory organization* or *SRO* has the meaning as defined in Section 3(a)(26) of the Exchange Act (15 U.S.C. 78c(a)(26)), and includes the Financial Industry Regulatory Authority (FINRA) and any other national securities association registered with the Commission.

§ 227.301 Measures to reduce risk of fraud.

An intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) must:

(a) Have a reasonable basis for believing that an issuer seeking to offer and sell securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through the intermediary's platform complies with the requirements in Section 4A(b) of the Act (15 U.S.C. 77d-1(b)) and the related requirements in this part. In satisfying this requirement, an intermediary may rely on the representations of the issuer concerning compliance with these requirements unless the intermediary has reason to question the reliability of those representations;

(b) Have a reasonable basis for believing that the issuer has established means to keep accurate records of the holders of the securities it would offer and sell through the intermediary's platform. In satisfying this requirement, an intermediary may rely on the representations of the issuer concerning compliance with this requirement unless the intermediary has reason to question the reliability of those representations.

(c) Deny access to its platform to an issuer if the intermediary:

(1) Has a reasonable basis for believing that the issuer or any of its officers, directors (or any person occupying a similar status or performing a similar function) or beneficial owners of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power, is subject to a disqualification under § 227.503. In satisfying this requirement, an intermediary must, at a minimum, conduct a background and securities enforcement regulatory history check on each issuer whose securities are to be offered by the intermediary and on each officer, director or beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power.

(2) Believes that the issuer or the offering presents the potential for fraud or otherwise raises concerns regarding investor protection. In satisfying this requirement, an intermediary must deny access if it believes that it is unable to adequately or effectively assess the risk of fraud of the issuer or its potential offering. In addition, if an intermediary becomes aware of information after it has granted access that causes it to believe that the issuer or the offering presents the potential for fraud or otherwise raises concerns regarding investor protection, the intermediary must promptly remove the offering from its platform, cancel the offering, and return (or, for funding portals, direct the return of) any funds that have been committed by investors in the offering.

§ 227.302 Account opening.

(a) *Accounts and Electronic Delivery*. (1) No intermediary or associated person of an intermediary may accept an investment commitment in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) until the

investor has opened an account with the intermediary and the intermediary has obtained from the investor consent to electronic delivery of materials.

(2) An intermediary must provide all information that is required to be provided by the intermediary under Subpart C (§§ 227.300-305), including, but not limited to, educational materials, notices and confirmations, through electronic means. Unless otherwise indicated in the relevant rule of Subpart C, in satisfying this requirement, an intermediary must provide the information through an electronic message that contains the information, through an electronic message that includes a specific link to the information as posted on intermediary's platform, or through an electronic message that provides notice of what the information is and that it is located on the intermediary's platform or on the issuer's website. Electronic messages include, but are not limited to, e-mail messages.

(b) *Educational Materials*. (1) In connection with establishing an account for an investor, an intermediary must deliver educational materials to such investor that explain in plain language and are otherwise designed to communicate effectively and accurately:

(i) The process for the offer, purchase and issuance of securities through the intermediary and the risks associated with purchasing securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6));

(ii) The types of securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) available for purchase on the intermediary's platform and the risks associated with each type of security, including the risk of having limited voting power as a result of dilution;

(iii) The restrictions on the resale of a security offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6));

(iv) The types of information that an issuer is required to provide under § 227.202, the frequency of the delivery of that information and the possibility that those obligations may terminate in the future;

(v) The limitations on the amounts an investor may invest pursuant to § 227.100(a)(2);

(vi) The limitations on an investor's right to cancel an investment commitment and the circumstances in which an investment commitment may be cancelled by the issuer;

(vii) The need for the investor to consider whether investing in a security offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) is appropriate for that investor; and

(viii) That following completion of an offering conducted through the intermediary, there may or may not be any ongoing relationship between the issuer and intermediary.

(2) An intermediary must make the most current version of its educational material available on its platform at all times and, if at any time, the intermediary makes a material revision to its educational materials, it must make the revised educational materials available to all investors before accepting any additional investment commitments or effecting any further transactions in securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

(c) *Promoters*. In connection with establishing an account for an investor, an intermediary must inform the investor that any person who promotes an issuer's offering for compensation, whether past or prospective, or who is a founder or an employee of an issuer that engages in promotional activities on behalf of the issuer on the intermediary's platform, must clearly disclose in all communications on the intermediary's platform, respectively, the receipt of the compensation and that he or she is engaging in promotional activities on behalf of the issuer.

(d) *Compensation Disclosure*. When establishing an account for an investor, an intermediary must clearly disclose the manner in which the intermediary is compensated in connection with offerings and sales of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

§ 227.303 Requirements with respect to transactions.

(a) *Issuer Information*. An intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) must make available to the Commission and to investors any information required to be provided by the issuer of the securities under §§ 227.201 and 203(a).

(1) This information must be made publicly available on the intermediary's platform, in a manner that reasonably permits a person accessing the platform to save, download, or otherwise store the information;

(2) This information must be made publicly available on the intermediary's platform for a minimum of 21 days before any securities are sold in the offering, during which time the intermediary may accept investment commitments;

(3) This information, including any additional information provided by the issuer, must remain publicly available on the intermediary's platform until the offer and sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) is completed or cancelled; and

(4) An intermediary may not require any person to establish an account with the intermediary to access this information.

(b) *Investor Qualification*. Each time before accepting any investment commitment (including any additional investment commitment from the same person), an intermediary must:

(1) Have a reasonable basis for believing that the investor satisfies the investment limitations established by Section 4(a)(6)(B) of the Act (15 U.S.C. 77d(a)(6)(B)) and Regulation Crowdfunding (§§ 227.100 *et seq*.). An intermediary may rely on an investor's representations concerning compliance with the investment limitation requirements concerning the investor's annual income, net worth, and the amount of the investor's other investments made pursuant to Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) unless the intermediary has reason to question the reliability of the representation.

(2) Obtain from the investor:

(i) A representation that the investor has reviewed the intermediary's educational materials delivered pursuant to § 227.302(b), understands that the entire amount of his or her investment may be lost, and is in a financial condition to bear the loss of the investment; and

(ii) A questionnaire completed by the investor demonstrating the investor's understanding that:

(A) There are restrictions on the investor's ability to cancel an investment commitment and obtain a return of his or her investment;

(B) It may be difficult for the investor to resell securities acquired in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)); and

(C) Investing in securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) involves risk, and the investor should not invest any funds in an offering made in reliance on Section 4(a)(6) of the Securities Act unless he or she can afford to lose the entire amount of his or her investment.

(c) *Communication Channels*. An intermediary must provide on its platform communication channels by which persons can communicate with one another and with

representatives of the issuer about offerings made available on the intermediary's platform, provided:

(1) If the intermediary is a funding portal, it does not participate in these communications other than to establish guidelines for communication and remove abusive or potentially fraudulent communications;

(2) The intermediary permits public access to view the discussions made in the communication channels;

(3) The intermediary restricts posting of comments in the communication channels to those persons who have opened an account with the intermediary on its platform; and

(4) The intermediary requires that any person posting a comment in the communication channels clearly and prominently disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or is otherwise compensated, whether in the past or prospectively, to promote the issuer's offering.

(d) *Notice of Investment Commitment*. An intermediary must promptly, upon receipt of an investment commitment from an investor, give or send to the investor a notification disclosing:

(1) The dollar amount of the investment commitment;

(2) The price of the securities, if known;

(3) The name of the issuer; and

(4) The date and time by which the investor may cancel the investment commitment.

(e) *Maintenance and Transmission of Funds*. (1) An intermediary that is a registered broker must comply with the requirements of 17 CFR 240.15c2-4.

(2) An intermediary that is a funding portal must direct investors to transmit the money or other consideration directly to a qualified third party that has agreed in writing to hold the funds for the benefit of, and to promptly transmit or return the funds to, the persons entitled thereto in accordance with paragraph (e)(3)of this section. For purposes of this Subpart C (§§ 227.300-305), a qualified third party means a bank that has agreed in writing either to hold the funds in escrow for the persons who have the beneficial interests therein and to transmit or return such funds directly to the persons entitled thereto when so directed by the funding portal as described in paragraph (e)(3)of this section, or to maintain a bank account (or accounts) for the exclusive benefit of investors and the issuer.

(3) A funding portal that is an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) shall promptly direct the qualified third party to:

(i) Transmit funds from the qualified third party to the issuer when the aggregate amount of investment commitments from all investors is equal to or greater than the target amount of the offering and the cancellation period as set forth in § 227.304 has elapsed, *provided that* in no event may the funding portal direct this transmission of funds earlier than 21 days after the date on which the intermediary makes publicly available on its platform the information required to be provided by the issuer under §§ 227.201 and 203(a);

(ii) Return funds to an investor when an investment commitment has been cancelled in accordance with § 227.304 (including for failure to obtain effective reconfirmation as required under § 227.304(c)); and

(iii) Return funds to investors when an issuer does not complete the offering.

(f) *Confirmation of Transaction*. (1) An intermediary must, at or before the completion of a transaction in a security in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), give or send to each investor a notification disclosing:

(i) The date of the transaction;

(ii) The type of security that the investor is purchasing;

(iii) The identity, price, and number of securities purchased by the investor, as well as the number of securities sold by the issuer in the transaction and the price(s) at which the securities were sold;

(iv) If a debt security, the interest rate and the yield to maturity calculated from the price paid and the maturity date;

(v) If a callable security, the first date that the security can be called by the issuer; and

(vi) The source and amount of any remuneration received or to be received by the intermediary in connection with the transaction, including the amount and form of any remuneration that is received, or will be received, by the intermediary from persons other than the issuer.

(2) An intermediary satisfying the requirements of paragraph (1) of this section is exempt from the requirements of 17 CFR 240.10b-10 with respect to a transaction in a security offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

§ 227.304 Completion of offerings, cancellations and reconfirmations.

(a) *Generally*. An investor may cancel an investment commitment for any reason until 48 hours prior to the deadline identified in the issuer's offering materials. During the 48 hours prior to such deadline, an investment commitment may not be cancelled except as provided in paragraph (c) below.

(b) *Early Completion of Offering*. If an issuer reaches the target offering amount prior to the deadline identified in its offering materials pursuant to § 227.201(g), the issuer may close the offering on a date earlier than the deadline identified in its offering materials pursuant to § 227.201(g), *provided that:*

(1) The offering remains open for a minimum of 21 days pursuant to § 227.303(a);

(2) The intermediary provides notice to any potential investors, and gives or sends notice to investors that have made investment commitments in the offering, of:

(i) The new, anticipated deadline of the offering;

(ii) The right of investors to cancel investment commitments for any reason until 48 hours prior to the new offering deadline; and

(iii) Whether the issuer will continue to accept investment commitments during the 48-hour period prior to the new offering deadline.

(3) The new offering deadline is scheduled for and occurs at least five business days after the notice required in paragraph b(2) of this section is provided; and

(4) At the time of the new offering deadline, the issuer continues to meet or exceed the target offering amount.

(c) *Cancellations and Reconfirmations Based on Material Changes*. (1) If there is a material change to the terms of an offering or to the information provided by the issuer, the intermediary must give or send to any investor who has made an investment commitment notice of the material change and that the investor's investment commitment will be cancelled unless the investor reconfirms his or her investment commitment within five business days of receipt of the notice. If the investor fails to reconfirm his or her investment within those five business days, the intermediary within five business days thereafter must:

(i) Give or send the investor a notification disclosing that the commitment was cancelled, the reason for the cancellation and the refund amount that the investor is expected to receive; and

(ii) Direct the refund of investor funds.

(2) If material changes to the offering or to the information provided by the issuer regarding the offering occur within five business days of the maximum number of days that an offering is to remain open, the offering must be extended to allow for a period of five business days for the investor to reconfirm his or her investment.

(d) *Return of Funds If Offering Is Not Completed*. If an issuer does not complete an offering, an intermediary must within five business days:

(1) Give or send each investor a notification of the cancellation, disclosing the reason for the cancellation, and the refund amount that the investor is expected to receive;

(2) Direct the refund of investor funds; and

(3) Prevent investors from making investment commitments with respect to that offering on its platform.

§ 227.305 Payments to third parties.

(a) *Prohibition on Payments for Personally Identifiable Information*. An intermediary may not compensate any person for providing the intermediary with the personally identifiable information of any investor or potential investor in securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

(b) *Certain permitted payments*. Subject to paragraph (a) of this section, an intermediary may compensate a person for directing issuers or potential investors to the intermediary's platform, *provided that* unless the compensation is made to a registered broker or dealer, the compensation is not based, directly or indirectly, on the purchase or sale of a security offered in

reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) on or through the intermediary's platform.

(c) For purposes of this rule, personally identifiable information means information that can be used to distinguish or trace an individual's identity, either alone or when combined with other personal or identifying information that is linked or linkable to a specific individual.

SUBPART D – Funding Portal Regulation

§227.400 Registration of funding portals.

(a) *Registration*. A funding portal must register with the Commission, by filing a complete Form Funding Portal (§ 249.1500 of this chapter) in accordance with the instructions on the form, and become a member of the Financial Industry Regulatory Authority or any other applicable national securities association registered under Section 15A of the Exchange Act (15 U.S.C. 78*o*-3). The registration will be effective the later of:

(1) 30 calendar days after the date that the registration is received by the Commission; or

(2) The date the funding portal is approved for membership by the Financial Industry Regulatory Authority or any other applicable national securities association registered under Section 15A of the Exchange Act (15 U.S.C. 78*o*-3).

(b) *Amendments to Registration*. A funding portal must file an amendment to Form Funding Portal (§ 249.1500 of this chapter) within 30 days of any of the information previously submitted on Form Funding Portal becoming inaccurate for any reason.

(c) *Successor Registration*. (1) If a funding portal succeeds to and continues the business of a registered funding portal, the registration of the predecessor will remain effective as the registration of the successor if the successor, within 30 days after such succession, files a registration on Form Funding Portal (§ 249.1500 of this chapter) and the predecessor files a

withdrawal on Form Funding Portal; *provided*, *however*, that the registration of the predecessor funding portal will be deemed withdrawn 45 days after registration on Form Funding Portal is filed by the successor.

(2) Notwithstanding paragraph (c)(1) of this section, if a funding portal succeeds to and continues the business of a registered funding portal and the succession is based solely on a change of the predecessor's date or state of incorporation, form of organization, or composition of a partnership, the successor may, within 30 days after the succession, amend the registration of the predecessor on Form Funding Portal (§ 249.1500 of this chapter) to reflect these changes.

(d) *Withdrawal*. A funding portal must promptly file a withdrawal of registration on Form Funding Portal (§ 249.1500 of this chapter) in accordance with the instructions on the form upon ceasing to operate as a funding portal. Withdrawal will be effective on the later of 30 days after receipt by the Commission, after the funding portal is no longer operational, or within such longer period of time as to which the funding portal consents or which the Commission by order may determine as necessary or appropriate in the public interest or for the protection of investors.

(e) *Applications and Reports*. The applications and reports provided for in this section shall be considered filed when a complete Form Funding Portal (§ 249.1500 of this chapter) is submitted with the Commission or its designee. Duplicate originals of the applications and reports provided for in this section must be filed with surveillance personnel designated by any registered national securities association of which the funding portal is a member.

(f) *Fidelity Bond*. As a condition to becoming registered as a funding portal, the funding portal must have in place and thereafter maintain, for the duration of the period when it maintains such registration, fidelity bond coverage that:

(1) Has a minimum coverage of $100,000;

(2) Covers any associated person of the funding portal unless otherwise excepted in the rules set forth by the Financial Industry Regulatory Authority or any applicable national securities association that is registered under Section 15A of the Exchange Act (15 U.S.C. 78*o*-3) of which it is a member; and

(3) Meets any other applicable requirements as set forth by the Financial Industry Regulatory Authority or any applicable national securities association that is registered under Section 15A of the Exchange Act (15 U.S.C. 78*o*-3) of which it is a member.

(g) *Nonresident Funding Portals*. Registration pursuant to this section by a nonresident funding portal shall be conditioned upon there being an information sharing arrangement in place between the Commission and the competent regulator in the jurisdiction under the laws of which the nonresident funding portal is organized or where it has its principal place of business, that is applicable to the nonresident funding portal.

(1) *Definition*. For purposes of this section, the term *nonresident funding portal* shall mean a funding portal incorporated in or organized under the laws of a jurisdiction outside of the United States or its territories, or having its principal place of business in any place not in the United States or its territories.

(2) *Power of Attorney*. (i) Each nonresident funding portal registered or applying for registration pursuant to this section shall obtain a written consent and power of attorney appointing an agent in the United States, other than the Commission or a Commission member, official or employee, upon whom may be served any process, pleadings or other papers in any action. This consent and power of attorney must be signed by the nonresident funding portal and the named agent(s) for service of process.

(ii) Each nonresident funding portal registered or applying for registration pursuant to this section shall, at the time of filing its application on Form Funding Portal (§ 249.1500 of this chapter), furnish to the Commission the name and address of its United States agent for service of process on Schedule C to the Form.

(iii) Any change of a nonresident funding portal's agent for service of process and any change of name or address of a nonresident funding portal's existing agent for service of process shall be communicated promptly to the Commission through amendment of the Schedule C to Form Funding Portal (§ 249.1500 of this chapter).

(iv) Each nonresident funding portal must promptly appoint a successor agent for service of process if the nonresident funding portal discharges its identified agent for service of process or if its agent for service of process is unwilling or unable to accept service on behalf of the nonresident funding portal.

(v) Each nonresident funding portal must maintain, as part of its books and records, the written consent and power of attorney identified in paragraph (g)(2)(i) of this section for at least three years after the agreement is terminated.

(3) *Access to Books and Records*.

(i) *Certification and Opinion of Counsel*. Any nonresident funding portal applying for registration pursuant to this section shall certify on Schedule C to Form Funding Portal (§ 249.1500 of this chapter) and provide an opinion of counsel that the nonresident funding portal can, as a matter of law, provide the Commission and any national securities association of which it is a member with prompt access to the books and records of such nonresident funding portal and can, as a matter of law, submit to onsite inspection and examination by the Commission and any national securities association of which it is a member.

(ii) *Amendments*. The nonresident funding portal shall re-certify, on Schedule C to Form Funding Portal (§ 249.1500 of this chapter), within 90 days after any changes in the legal or regulatory framework that would impact the nonresident funding portal's ability to provide, or the manner in which it provides, the Commission, or any national securities association of which it is a member, with prompt access to its books and records or that would impact the Commission's or such national securities association's ability to inspect and examine the nonresident funding portal. The re-certification shall be accompanied by a revised opinion of counsel describing how, as a matter of law, the nonresident funding portal can continue to meet its obligations to provide the Commission and such national securities association with prompt access to its books and records and to be subject to Commission and national securities association inspection and examination under the new regulatory regime.

§ 227.401 Exemption.

(a) A funding portal that is registered with the Commission pursuant to § 227.400 is exempt from the broker registration requirements of Section 15(a)(1) of the Exchange Act (15 U.S.C. 78*o*(a)(1)) in connection with its activities as a funding portal.

(b) Notwithstanding paragraph (a) of this section, for purposes of 31 CFR chapter X, a funding portal is "required to be registered" as a broker or dealer with the Commission under the Exchange Act.

§ 227.402 Conditional safe harbor.

(a) *General*. Under Section 3(a)(80) of the Exchange Act (15 U.S.C. 78c(a)(80)), a funding portal acting as an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) may not: offer investment advice or recommendations; solicit purchases, sales, or offers to buy the securities

offered or displayed on its platform or portal; compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its platform or portal; hold, manage, possess, or otherwise handle investor funds or securities; or engage in such other activities as the Commission, by rule, determines appropriate. This section is intended to provide clarity with respect to the ability of a funding portal to engage in certain activities, consistent with the prohibitions under Section 3(a)(80) of the Exchange Act. No presumption shall arise that a funding portal has violated the prohibitions under Section 3(a)(80) of the Exchange Act or this part by reason of the funding portal or its associated persons engaging in activities in connection with the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act that do not meet the conditions specified in paragraph (b) of this section. The antifraud provisions and all other applicable provisions of the federal securities laws continue to apply to the activities described in paragraph (b) of this section.

(b) *Permitted Activities*. A funding portal may, consistent with the prohibitions under Section 3(a)(80) of the Exchange Act (15 U.S.C. 78c(a)(80)) and this part:

(1) Apply objective criteria to limit the securities offered in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through the funding portal's platform where:

(i) The criteria are reasonably designed to result in a broad selection of issuers offering securities through the funding portal's platform, are applied consistently to all potential issuers and offerings and are clearly displayed on the funding portal's platform; and

(ii) The criteria may include, among other things, the type of securities being offered (for example, common stock, preferred stock or debt securities), the geographic location of the issuer and the industry or business segment of the issuer, *provided* that a funding portal may not deny

access to an issuer based on the advisability of investing in the issuer or its offering, except to the extent described in paragraph (b)(10) of this section;

(2) Apply objective criteria to highlight offerings on the funding portal's platform where:

(i) The criteria are reasonably designed to highlight a broad selection of issuers offering securities through the funding portal's platform, are applied consistently to all issuers and offerings and are clearly displayed on the funding portal's platform;

(ii) The criteria may include, among other things, the type of securities being offered (for example, common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the number or amount of investment commitments made, progress in meeting the issuer's target offering amount or, if applicable, the maximum offering amount; and the minimum or maximum investment amount; *provided* that a funding portal may not highlight an issuer or offering based on the advisability of investing in the issuer or its offering; and

(iii) The funding portal does not receive special or additional compensations for highlighting one or more issuers or offerings on its platform;

(3) Provide search functions or other tools that investors can use to search, sort, or categorize the offerings available through the funding portal's platform according to objective criteria where;

(i) The objective criteria may include, among other things, the type of securities being offered (for example, common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the number or amount of investment commitments made, progress in meeting the issuer's target offering amount or, if applicable, the maximum offering amount; and the minimum or maximum investment amount; and

(ii) The objective criteria may not include, among other things, the advisability of investing in the issuer or its offering, or an assessment of any characteristic of the issuer, its business plan, its key management or risks associated with an investment.

(4) Provide communication channels by which investors can communicate with one another and with representatives of the issuer through the funding portal's platform about offerings through the platform, so long as the funding portal (and its associated persons):

(i) Does not participate in these communications, other than to establish guidelines for communication and remove abusive or potentially fraudulent communications;

(ii) Permits public access to view the discussions made in the communication channels;

(iii) Restricts posting of comments in the communication channels to those persons who have opened an account on its platform; and

(iv) Requires that any person posting a comment in the communication channels clearly disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or is otherwise compensated, whether in the past or prospectively, to promote an issuer's offering;

(5) Advise an issuer about the structure or content of the issuer's offering, including assisting the issuer in preparing offering documentation;

(6) Compensate a third party for referring a person to the funding portal, so long as the third party does not provide the funding portal with personally identifiable information of any potential investor, and the compensation, other than that paid to a registered broker or dealer, is not based, directly or indirectly, on the purchase or sale of a security in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) offered on or through the funding portal's platform;

(7) Pay or offer to pay any compensation to a registered broker or dealer for services in connection with the offer or sale of securities by the funding portal in reliance on Section 4(a)(6) of the Act(15 U.S.C. 77d(a)(6)), provided that:

(i) Such services are provided pursuant to a written agreement between the funding portal and the registered broker or dealer;

(ii) Such compensation is permitted under this part and is not otherwise prohibited under § 227.305; and

(iii) Such compensation complies with and is not prohibited by the rules of any registered national securities association of which the funding portal is required to be a member;

(8) Receive any compensation from a registered broker or dealer for services provided by the funding portal in connection with the offer or sale of securities by the funding portal in reliance on Section 4(a)(6) of the Act (15 U.S.C. 77d(a)(6)), provided that:

(i) Such services are provided pursuant to a written agreement between the funding portal and the registered broker or dealer;

(ii) Such compensation is permitted under this part; and

(iii) Such compensation complies with and is not prohibited by the rules of any registered national securities association of which the funding portal is required to be a member;

(9) Advertise the existence of the funding portal and identify one or more issuers or offerings available on the portal on the basis of objective criteria, as long as:

(i) The criteria are reasonably designed to identify a broad selection of issuers offering securities through the funding portal's platform, and are applied consistently to all potential issuers and offerings;

(ii) The criteria may include, among other things, the type of securities being offered (for example, common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the expressed interest by investors, as measured by number or amount of investment commitments made, progress in meeting the issuer's target offering amount or, if applicable, the maximum offering amount; and the minimum or maximum investment amount; and

(iii) The funding portal does not receive special or additional compensation for identifying the issuer or offering in this manner;

(10) Deny access to its platform to, or cancel an offering of, an issuer that the funding portal believes may present the potential for fraud or otherwise raises investor protection concerns;

(11) Accept, on behalf of an issuer, an investment commitment for securities offered in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) by that issuer on the funding portal's platform;

(12) Direct investors where to transmit funds or remit payment in connection with the purchase of securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)); and

(13) Direct a qualified third party, as required by § 227.303(e), to release proceeds to an issuer upon completion of a crowdfunding offering or to return proceeds to investors in the event an investment commitment or an offering is cancelled.

§ 227.403 Compliance.

(a) *Policies and Procedures*. A funding portal must implement written policies and procedures reasonably designed to achieve compliance with the federal securities laws and the rules and regulations thereunder relating to its business as a funding portal.

(b) *Anti-Money Laundering*. A funding portal must comply with the requirements of 31 CFR chapter X applicable to registered brokers.

(c) *Privacy*. A funding portal must comply with the requirements of 17 CFR 248 as they apply to brokers.

(d) *Inspections and Examinations*. A funding portal shall permit the examination and inspection of all of its business and business operations that relate to its activities as a funding portal, such as its premises, systems, platforms, and records by representatives of the Commission and of the national securities association of which it is a member.

§ 227.404 Records to be made and kept by funding portals.

(a) *Generally*. A funding portal shall make and preserve the following records for five years, the first two years in an easily accessible place:

(1) All records related to an investor who purchases or attempts to purchase securities through the funding portal;

(2) All records related to issuers who offer and sell or attempt to offer and sell securities through the funding portal and the control persons of such issuers;

(3) Records of all communications that occur on or through its platform;

(4) All records related to persons that use communication channels provided by a funding portal to promote an issuer's securities or communicate with potential investors;

(5) All records required to demonstrate compliance with the requirements of Subparts C (§§ 227.300-305) and D (§§ 227.400-404);

(6) All notices provided by such funding portal to issuers and investors generally through the funding portal's platform or otherwise, including, but not limited to, notices addressing hours of funding portal operations (if any), funding portal malfunctions, changes to funding portal procedures, maintenance of hardware and software, instructions pertaining to access to the funding portal and denials of, or limitations on, access to the funding portal;

(7) All written agreements (or copies thereof) entered into by such funding portal relating to its business as such;

(8) All daily, monthly and quarterly summaries of transactions effected through the funding portal, including:

(i) Issuers for which the target offering amount has been reached and funds distributed; and

(ii) Transaction volume, expressed in:

(A) Number of transactions;

(B) Number of securities involved in a transaction;

(C) Total amounts raised by, and distributed to, issuers; and

(D) Total dollar amounts raised across all issuers, expressed in U.S. dollars; and

(9) A log reflecting the progress of each issuer who offers or sells securities through the funding portal toward meeting the target offering amount.

(b) *Organizational Documents*. A funding portal shall make and preserve during the operation of the funding portal and of any successor funding portal, all organizational documents relating to the funding portal, including but not limited to, partnership agreements, articles of

incorporation or charter, minute books and stock certificate books (or other similar type documents).

(c) *Format*. The records required to be maintained and preserved pursuant to paragraph (a) of this section must be produced, reproduced, and maintained in the original, non-alterable format in which they were created or as permitted under 17 CFR §240.17a-4(f).

(d) *Third Parties*. The records required to be made and preserved pursuant to this section may be prepared or maintained by a third party on behalf of a funding portal. An agreement with a third party shall not relieve a funding portal from the responsibility to prepare and maintain records as specified in this rule. A funding portal must file with the registered national securities association of which it is a member, a written undertaking in a form acceptable to the registered national securities association, signed by a duly authorized person of the third party, stating in effect that such records are the property of the funding portal and will be surrendered promptly on request of the funding portal. The undertaking shall include the following provision:

> With respect to any books and records maintained or preserved on behalf of [name of funding portal], the undersigned hereby acknowledges that the books and records are the property of [name of funding portal], and hereby undertakes to permit examination of such books and records at any time, or from time to time, during business hours by representatives of the Securities and Exchange Commission and the national securities association of which the funding portal is a member, and to promptly furnish to the Commission, and the national securities association of which the funding portal is a member, a true, correct, complete and current hard copy of any, all, or any part of, such books and records.

(e) *Review of Records*. All records of a funding portal are subject at any time, or from time to time, to reasonable periodic, special, or other examination by the representatives of the Commission and the national securities association of which a funding portal is a member.

(f) *Financial Recordkeeping and Reporting of Currency and Foreign Transactions*. Every funding portal, as it is subject to the requirements of the Currency and Foreign Transactions Reporting Act of 1970 (15 U.S.C. 5311 *et seq.*), shall comply with the reporting, recordkeeping and record retention requirements of 31 CFR chapter X. Where 31 CFR chapter X and §§ 227.404(a) and 404(b) require the same records or reports to be preserved for different periods of time, such records or reports shall be preserved for the longer period of time.

SUBPART E – Miscellaneous Provisions

§ 227.501 Restrictions on resales.

(a) Securities issued in a transaction exempt from registration pursuant to Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) may not be transferred by the purchaser of such securities during the one-year period beginning on the date of purchase, unless such securities are transferred:

(1) To the issuer of the securities;

(2) To an accredited investor;

(3) As part of an offering registered with the Commission; or

(4) To a member of the family of the purchaser or the equivalent, to a trust controlled by the purchaser, to a trust created for the benefit of a member of the family of the purchaser or the equivalent, or in connection with the death or divorce of the purchaser or other similar circumstance.

(b) For purposes of this § 227.501, the term *accredited investor* shall have the same meaning given to such term in 17 CFR 230.501. To transfer securities to an accredited investor during the one-year period beginning on the date the securities were issued in a transaction exempt from registration pursuant to Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), the seller shall reasonably believe that the person receiving such securities is an accredited investor.

(c) For purposes of this section, the term *member of the family of the purchaser or the equivalent* includes a child, stepchild, grandchild, parent, stepparent, grandparent, spouse or spousal equivalent, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of the purchaser, and shall include adoptive relationships.

Instruction to paragraph (c). For purposes of this paragraph (c), the term *spousal equivalent* means a cohabitant occupying a relationship generally equivalent to that of a spouse.

§ 227.502 Insignificant deviations from a term, condition or requirement of Regulation Crowdfunding.

(a) A failure to comply with a term, condition, or requirement of this part will not result in the loss of the exemption from the requirements of Section 5 of the Securities Act (15 U.S.C. 77e) for any offer or sale to a particular individual or entity, if the issuer relying on the exemption shows:

(1) The failure to comply was insignificant with respect to the offering as a whole;

(2) The issuer made a good faith and reasonable attempt to comply with all applicable terms, conditions and requirements this part; and

(3) The issuer did not know of such failure where the failure to comply with a term, condition or requirement of this part was the result of the failure of the intermediary to comply with the requirements of Section 4A(a) of the Securities Act (15 U.S.C. 77d-1(a)) and the related

rules, or such failure by the intermediary occurred solely in offerings other than the issuer's offering.

(b) Notwithstanding the issuer's reliance on paragraph (a) of this section, the Commission may bring an enforcement action seeking any appropriate relief for the issuer's failure to comply with all applicable terms, conditions and requirements of this part.

§ 227.503 Disqualification

(a) No exemption under this Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) shall be available for a sale of securities if the issuer; any predecessor of the issuer; any affiliated issuer; any director, officer, general partner or managing member of the issuer; any beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power; any promoter connected with the issuer in any capacity at the time of such sale; any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with such sale of securities; or any general partner, director, officer or managing member of any such solicitor:

(1) Has been convicted, within 10 years before the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)) (or five years, in the case of issuers, their predecessors and affiliated issuers), of any felony or misdemeanor:

(i) In connection with the purchase or sale of any security;

(ii) Involving the making of any false filing with the Commission; or

(iii) Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;

(2) Is subject to any order, judgment or decree of any court of competent jurisdiction, entered within five years before the filing of the information required by Section 4A(b) of the

Securities Act (15 U.S.C. 77d-1(b)) that, at the time of such filing, restrains or enjoins such person from engaging or continuing to engage in any conduct or practice:

(i) In connection with the purchase or sale of any security;

(ii) Involving the making of any false filing with the Commission; or

(iii) Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;

(3) Is subject to a final order of a state securities commission (or an agency or officer of a state performing like functions); a state authority that supervises or examines banks, savings associations or credit unions; a state insurance commission (or an agency or officer of a state performing like functions); an appropriate federal banking agency; the U.S. Commodity Futures Trading Commission; or the National Credit Union Administration that:

(i) At the time of the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)), bars the person from:

(A) Association with an entity regulated by such commission, authority, agency or officer;

(B) Engaging in the business of securities, insurance or banking; or

(C) Engaging in savings association or credit union activities; or

(ii) Constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct and for which the order was entered within the 10-year period ending on the date of the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b));

Instruction to paragraph (a)(3). *Final order* shall mean a written directive or declaratory statement issued by a federal or state agency, described in § 227.503(a)(3), under applicable

statutory authority that provides for notice and an opportunity for hearing, which constitutes a final disposition or action by that federal or state agency.

(4) Is subject to an order of the Commission entered pursuant to Section 15(b) or 15B(c) of the Exchange Act (15 U.S.C. 78*o*(b) or 78*o*-4(c)) or Section 203(e) or (f) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(e) or (f)) that, at the time of the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)):

(i) Suspends or revokes such person's registration as a broker, dealer, municipal securities dealer or investment adviser;

(ii) Places limitations on the activities, functions or operations of such person; or

(iii) Bars such person from being associated with any entity or from participating in the offering of any penny stock;

(5) Is subject to any order of the Commission entered within five years before the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)) that, at the time of such filing, orders the person to cease and desist from committing or causing a violation or future violation of:

(i) Any scienter-based anti-fraud provision of the federal securities laws, including without limitation Section 17(a)(1) of the Securities Act (15 U.S.C. 77q(a)(1)), Section 10(b) of the Exchange Act (15 U.S.C. 78j(b)) and 17 CFR 240.10b-5, Section 15(c)(1) of the Exchange Act (15 U.S.C. 78o(c)(1)) and Section 206(1) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-6(1)) or any other rule or regulation thereunder; or

(ii) Section 5 of the Securities Act (15 U.S.C. 77e);

(6) Is suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or a registered national or

affiliated securities association for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade;

(7) Has filed (as a registrant or issuer), or was or was named as an underwriter in, any registration statement or Regulation A (17 CFR 230.251 *et seq*.) offering statement filed with the Commission that, within five years before the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)), was the subject of a refusal order, stop order, or order suspending the Regulation A exemption, or is, at the time of such filing, the subject of an investigation or proceeding to determine whether a stop order or suspension order should be issued; or

(8) Is subject to a United States Postal Service false representation order entered within five years before the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)), or is, at the time of such filing, subject to a temporary restraining order or preliminary injunction with respect to conduct alleged by the United States Postal Service to constitute a scheme or device for obtaining money or property through the mail by means of false representations.

(b) Paragraph (a) of this section shall not apply:

(1) With respect to any conviction, order, judgment, decree, suspension, expulsion or bar that occurred or was issued before [effective date of final rule];

(2) Upon a showing of good cause and without prejudice to any other action by the Commission, if the Commission determines that it is not necessary under the circumstances that an exemption be denied;

(3) If, before the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)), the court or regulatory authority that entered the relevant order, judgment

or decree advises in writing (whether contained in the relevant judgment, order or decree or separately to the Commission or its staff) that disqualification under paragraph (b) of this section should not arise as a consequence of such order, judgment or decree;

(4) If the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed under paragraph (b) of this section.

Instruction to paragraph (b)(4). An issuer will not be able to establish that it has exercised reasonable care unless it has made factual inquiry into whether any disqualifications exist. The nature and scope of the factual inquiry will vary based on the facts and circumstances concerning, among other things, the issuer and the other offering participants.

(c) For purposes of paragraph (a) of this section, events relating to any affiliated issuer that occurred before the affiliation arose will be not considered disqualifying if the affiliated entity is not:

(1) In control of the issuer; or

(2) Under common control with the issuer by a third party that was in control of the affiliated entity at the time of such events.

(d) A person that is subject to a statutory disqualification as defined in Section 3(a)(39) of the Exchange Act (15 U.S.C. 78c(a)(39)) may not act as, or be an associated person of, an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) unless so permitted pursuant to Commission rule or order.

Instruction to paragraph (d). 17 CFR 240.17f-2 generally requires the fingerprinting of every person who is a partner, director, officer or employee of a broker, subject to certain exceptions.

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PART 232 – REGULATION S-T – GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

4. The authority citation for part 232 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77z-3, 77sss(a), 78c(b), 781, 78m, 78n, 78o(d), 78w(a), 78ll, 80a-6(c), 80a-8, 80a-29, 80a-30, 80a-37, and 7201 et seq.; and 18 U.S.C. 1350.

* * * * *

5. Amend §232.101 by:

a. In paragraph (a)(1)(xii) removing "and" at the end of the paragraph;

b. In paragraph (a)(1)(xiii) removing the period at the end of the paragraph and adding in its place a semicolon;

c. In paragraph (a)(1)(xvi) removing the period at the end of the paragraph and adding in its place "; and"; and

d. Adding paragraph (a)(1)(xvii).

The addition reads as follows:

§ 232.101 Mandated electronic submissions and exceptions.

(a) * * *

(1) * * *

(xvii) Form C (§239.900 of this chapter).

* * * * *

PART 239 – FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

6. The authority citation for part 239 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78o-7 note, 78u-5, 78w(a), 78ll, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

* * * * *

7. Add § 239.900 to read as follows:

§ 239.900 Form C.

This form shall be used for filings under Regulation Crowdfunding.

Note: The text of Form C will not appear in the Code of Federal Regulations.

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM C

UNDER THE SECURITIES ACT OF 1933

[ ] Form C: Offering Statement
[ ] Form C-U: Progress Update: _____
[ ] Form C-A: Amendment
[ ] Check box if Amendment is material and investors will have five business days to reconfirm
[ ] Form C-AR: Annual Report
[ ] Form C-TR: Termination of Reporting

Name of issuer: _____
Legal status of issuer (form, jurisdiction and date of organization): _____
Physical address of issuer: _____
Website of issuer: _____

Name, Commission file number and CRD number (as applicable) of intermediary through which the offering will be conducted:

_____

Amount of compensation paid to the intermediary, including referral and other fees: _____
Type of security offered: _____
Number of securities to be offered: _____
Price (or method for determining price): _____
Target offering amount: _____
Maximum offering amount (if different from target offering amount): _____
Oversubscriptions accepted: [ ] Yes [ ] No If yes, disclose how oversubscriptions will be allocated: [ ] Pro-rata basis [ ] First-come, first-served basis [ ] Other – provide a description

_____

Deadline to reach the target offering amount: _____
Current number of employees: _____

Total Assets:	Most recent fiscal year: _____	Prior fiscal year: _____
Cash & Cash Equivalents:	Most recent fiscal year: _____	Prior fiscal year: _____
Accounts Receivable:	Most recent fiscal year: _____	Prior fiscal year: _____
Short-term Debt:	Most recent fiscal year: _____	Prior fiscal year: _____
Long-term Debt:	Most recent fiscal year: _____	Prior fiscal year: _____
Revenues/Sales:	Most recent fiscal year: _____	Prior fiscal year: _____
Cost of Goods Sold:	Most recent fiscal year: _____	Prior fiscal year: _____
Taxes Paid:	Most recent fiscal year: _____	Prior fiscal year: _____
Net Income:	Most recent fiscal year: _____	Prior fiscal year: _____

GENERAL INSTRUCTIONS

I. Eligibility Requirements for Use of Form C

This Form shall be filed by any issuer offering or selling securities in reliance on the exemption in Securities Act Section 4(a)(6) and in accordance with Section 4A and Regulation Crowdfunding (§ 227.100-503). This Form also shall be used for an annual report required pursuant to Rule 202 of Regulation Crowdfunding (§ 227.202) and for the termination of reporting required pursuant to Rule 203(b)(2) of Regulation Crowdfunding (§ 227.203(b)(2)). Careful attention should be directed to the terms, conditions and requirements of the exemption.

II. Preparation and Filing of Form C

Information on the cover page will be generated based on the information provided in XML format. Other than the cover page, this Form is not to be used as a blank form to be filled

in, but only as a guide in the preparation of Form C. General information regarding the preparation, format and how to file this Form is contained in Regulation S-T, (§ 232 *et seq.*).

III. Information to be Included in the Form

Item 1. Offering Statement Disclosure Requirements

An issuer filing this Form for an offering in reliance on Section 4(a)(6) of the Securities Act and pursuant to Regulation Crowdfunding (§ 227.100-503) must file the Form prior to the commencement of the offering and include the information required by Rule 201 of Regulation Crowdfunding (§ 227.201).

Other than the information required to be provided in XML format, an issuer may provide the required information in the format included on the intermediary's platform, including by submitting copies of screen shots of the relevant information, as appropriate and necessary.

Item 2. Legends

(a) An issuer filing this Form for an offering in reliance on Section 4(a)(6) of the Securities Act and pursuant to Regulation Crowdfunding (§ 227.100-503) must include the following legends:

> A crowdfunding investment involves a risk. You should not invest any funds in this offering unless you can afford to lose your entire investment.
>
> In making an investment decision, investors must rely on their own examination of the issuer and the terms of the offering, including the merits and risks involved. These securities have not been recommended or approved by any federal or state securities commission or regulatory authority. Furthermore, these authorities have not passed upon the accuracy or adequacy of this document.

The U.S. Securities and Exchange Commission does not pass upon the merits of any securities offered or the terms of the offering, nor does it pass upon the accuracy or completeness of any offering document or literature.

These securities are offered under an exemption from registration; however, the U.S. Securities and Exchange Commission has not made an independent determination that these securities are exempt from registration.

(b) An issuer filing this Form for an offering in reliance on Section 4(a)(6) of the Securities Act and pursuant to Regulation Crowdfunding (§ 227.100-503) must disclose in the offering statement that it will file a report on EDGAR annually and post the report on its website, no later than 120 days after the end of each fiscal year covered by the report. The issuer must also disclose how an issuer may terminate its reporting obligations in the future in accordance with Rule 202(b) of Regulation Crowdfunding (§ 227.202(b)).

Item 3. Annual Report Disclosure Requirements

An issuer filing this Form for an annual report, as required by Regulation Crowdfunding (§ 227.100-503), must file the Form no later than 120 days after the issuer's fiscal year end covered by the report and include the information required by Rule 201(a), (b), (c), (d), (e), (f), (m), (p), (q), (r), (s), and (t) of Regulation Crowdfunding (§§ 227.201(a), (b), (c), (d), (e), (f), (m), (p), (q), (r), (s), and (t)). For purposes of paragraph (t), the issuer shall provide financial statements for the highest aggregate target offering amount previously provided in an offering statement.

SIGNATURE

Pursuant to the requirements of Sections 4(a)(6) and 4A of the Securities Act of 1933 and Regulation Crowdfunding (§ 227.100-503), the issuer certifies that it has reasonable grounds to

believe that it meets all of the requirements for filing on Form C and has duly caused this Form to be signed on its behalf by the duly authorized undersigned.

_____
(Issuer)

By

_____
(Signature and Title)

Pursuant to the requirements of Sections 4(a)(6) and 4A of the Securities Act of 1933 and Regulation Crowdfunding (§ 227.100-503), this Form C has been signed by the following persons in the capacities and on the dates indicated.

_____
(Signature)

_____
(Title)

_____
(Date)

Instructions.

1. The form shall be signed by the issuer, its principal executive officer or officers, its principal financial officer, its controller or principal accounting officer and at least a majority of the board of directors or persons performing similar functions.

2. The name of each person signing the form shall be typed or printed beneath the signature.

PART 240 - GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

8. The authority citation for part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1,

78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 et. seq., and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111-203, 939A, 124 Stat. 1376, (2010), unless otherwise noted.

9. Add § 240.12g-6 to read as follows:

§ 240.12g-6 Exemption for securities issued pursuant to Section 4(a)(6) of the Securities Act of 1933.

For purposes of determining whether an issuer is required to register a security with the Commission pursuant to Section 12(g)(1) of the Act (15 U.S.C. 78*l*(g)(1)), the definition of *held of record* shall not include securities issued pursuant to the offering exemption under Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

* * * * *

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

10. The authority citation for part 249 continues to read, in part, as follows:

Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; 12 U.S.C. 5461 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

11. Add § 249.1500 to read as follows:

§ 249.1500 Form Funding Portal

This form shall be used for filings by funding portals under Regulation Crowdfunding (§§ 227.100 *et seq.*).

Note: The text of Form Funding Portal will not appear in the Code of Federal Regulations.

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM FUNDING PORTAL

UNDER THE SECURITIES EXCHANGE ACT OF 1934

WARNING: Failure to complete this form truthfully, to keep this form current and to file accurate supplementary information on a timely basis, or the failure to keep accurate books and records or otherwise to comply with the provisions of law applying to the conduct of business as a funding portal, would violate the Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

Check the appropriate box:
This is:

□ an initial application to register as a *funding portal* with the *SEC*.

□ an amendment to any part of the *funding portal's* most recent Form Funding Portal, including a successor registration.

□ a withdrawal of the *funding portal's* registration with the *SEC*.

Schedule A must be completed as part of all initial applications. Amendments to Schedule A must be provided on Schedule B.

Item 1 – Identifying Information

Exact name, principal business address, mailing address, if different, and telephone number of the funding portal:

A. Full name of the funding portal: _____

B. Name(s) under which business is conducted, if different from Item 1A:
_____

C. IRS Empl. Ident. No.: _____

D. If full legal name has changed since the *funding portal*'s most recent Form Funding Portal, enter the previous name and specify whether the name change is of the □ *funding portal* name (1A), or □ *business name* (1B).

Previous name: _____

E. Funding portal's main street address (Do not use a P.O. Box):
_____
_____

F. Mailing address(es) (if different) and office locations (if more than one) :

_____
_____

G. Contact Information
Telephone Number:_____
Facsimile number: _____
Website(s) URL: _____
E-mail:_____

H. Contact employee
Name:_____
Title:_____
Direct Telephone Number: _____
Facsimile:_____
Direct E-mail:_____

I. Registrations

Was the *applicant* previously registered on Form Funding Portal as a *funding portal* or with the Commission in any other capacity?

□ □ Yes SEC File No. _____
□ □ No

J. Foreign registrations

1. Is the *applicant* registered with a foreign financial regulatory authority?
Answer "no" even if affiliated with a business that is registered with a foreign financial regulatory authority.

□Yes □No

If "yes," complete Section J.2. below.

2. List the name, in English, of each *foreign financial regulatory authority* and country with which the *applicant* is registered. A separate entry must be completed for each *foreign financial regulatory authority* with which the *applicant* is registered.

Check only one box: ☐ Add ☐ Delete ☐ Amend

English Name of *Foreign Financial Regulatory Authority*

_____

Registration Number (if any) _____

Name of Country _____

Item 2 – Form of Organization

A. Indicate legal status of *applicant*. __Corporation __Sole Proprietorship
__ Partnership __Limited Liability Company
__Other (specify) _____

B. If other than a sole proprietor, indicate date and place *applicant* obtained its legal status (*i.e.*, state or country where incorporated, where partnership agreement was filed, or where *applicant* entity was formed):

State/Country of formation_____
Date of Formation_____

Item 3 – Successions

A. Is the *applicant* at the time of this filing succeeding to the business of a currently registered funding portal?

□ Yes □ No

Do not report previous successions already reported on Form Funding Portal. If "yes," complete Section 3.B. below.

B. Complete the following information if succeeding to the business of a currently-registered *funding portal*. If the *applicant* acquired more than one *funding portal* in the succession being reported on this Form Funding Portal, a separate entry must be completed for each acquired firm.

Check only one box: ☐ Add ☐ Delete ☐ Amend

Name of Acquired *Funding Portal*

_____

Acquired *Funding Portal*'s *SEC* File No.: _____

A. Briefly describe details of the *succession* including any assets or liabilities not assumed by the *successor*.

_____

Item 4 – Control Persons

In this Item, identify every *person* that, directly or indirectly, *controls* the *applicant*, *controls* management or policies of the *applicant*, or that the *applicant* directly or indirectly *controls*.

_____

_____

If this is an initial application, the applicant also must complete Schedule A. Schedule A asks for information about direct owners and executive officers. If this is an amendment updating information reported on the Schedule A filed with the applicant's initial application, the applicant must complete Schedule B.

Item 5 – Disclosure Information

In this Item, provide information about the *applicant*'s disciplinary history and the disciplinary history of all associated persons of the *applicant*. This information is used to determine whether to approve an application for registration, to decide whether to revoke registration, to place limitations on the *applicant*'s activities as a funding portal, and to identify potential problem areas on which to focus during examinations. One event may result in the requirement to answer "yes" to more than one of the questions below.

If the answer is "yes" to any question in this Item, the *applicant* must complete the appropriate Disclosure Reporting Page ("DRP") – Criminal, Regulatory, Civil Judicial, Bankruptcy, Bond, Judgment – for which the corresponding DRP will pop-up automatically.

A. Criminal Action Disclosure

If the answer is "yes" to any question in Part A or B below, complete a Criminal Action DRP.

Check all that apply:

1. In the past ten years, has the *applicant* or any *associated person*:

   (a) been convicted of any *felony*, or pled guilty or nolo contendere ("no contest") to any *charge* of a *felony*, in a domestic, foreign, or military court?

   □Yes □ No

   The response to the following question may be limited to charges that are currently pending:

   (b) been *charged* with any *felony*?

   □Yes □No

2. In the past ten years, has the *applicant* or any *associated person*:

   (a) been convicted of any misdemeanor, or pled guilty or nolo contendere ("no contest"), in a domestic, foreign, or military court to any charge of a misdemeanor in a case involving: investment-related business, or any

fraud, false statements, or omissions, wrongful taking of property, bribery, perjury, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses?

□Yes □No

The response to the following question may be limited to charges that are currently pending:

(b) been charged with a misdemeanor listed in Item 5-A(2)(a)?

□Yes □No

B. Regulatory Action Disclosure

If the answer is "yes" to any question in Item 5-B below, complete a Regulatory Action DRP.

Check all that apply:

1. Has the *SEC* or the Commodities Futures Trading Commission ("CFTC") ever:

(a) *found* the *applicant* or any *associated person* to have made a false statement or omission?

□Yes □No

(b) *found* the *applicant* or any *associated person* to have been *involved* in a violation of any *SEC* or *CFTC* regulation or statute?

□Yes □No

(c) *found* the *applicant* or any *associated person* to have been a cause of the denial, suspension, revocation, or restriction of the authorization of an *investment related* business to operate?

□Yes □No

(d) entered an *order* against the *applicant* or any *associated person* in connection with *investment-related* activity?

□Yes □No

(e) imposed a civil money penalty on the *applicant* or any *associated person*, or *ordered* the *applicant* or any *associated person* to cease and desist from any activity?

□Yes □No

2. Has any other federal regulatory agency, any state regulatory agency, or any *foreign financial regulatory authority*:

(a) ever *found* the *applicant* or any *associated person* to have made a false statement or omission, or been dishonest, unfair, or unethical?

□Yes □No

(b) ever *found* the *applicant* or any *associated person* to have been *involved* in a violation of *investment-related* regulations or statutes?

□Yes □No

(c) ever *found* the *applicant* or any *associated person* to have been the cause of a denial, suspension, revocation, or restriction of the authorization of an *investment-related* business to operate?

□Yes □No

(d) in the past ten years entered an *order* against the *applicant* or any *associated person* in connection with an *investment-related* activity?

□Yes □No

(e) ever denied, suspended, or revoked the registration or license of the *applicant* or that of any associated person, or otherwise prevented the *applicant* or any associated person of the *applicant*, by order, from associating with an investment-related business or restricted the activities of the *applicant* or any *associated person*?

□Yes □No

3. Has any self-regulatory organization or commodities exchange ever:

(a) found the *applicant* or any *associated person* to have made a false statement or omission?

□Yes □No

(b) found the *applicant* or any *associated person* to have been *involved* in a violation of its rules (other than a violation designated as a "minor rule violation" under a plan approved by the *SEC*)?

□Yes □No

(c) found the *applicant* or any *associated person* to have been the cause of a denial, suspension, revocation or restriction of the authorization of an *investment-related* business to operate?

□Yes □No

(d) disciplined the *applicant* or any *associated person* by expelling or suspending the *applicant* or the *associated person* from membership, barring or suspending the *applicant* or *the associated person* from association with other members, or by otherwise restricting the activities of the *applicant* or the *associated person*?

□Yes □No

4. Has the *applicant* or any *associated person* ever had an authorization to act as an attorney, accountant, or federal contractor revoked or suspended?

□Yes □No

5. Is the *applicant* or any *associated person* currently the subject of any regulatory *proceeding* that could result in a "yes" answer to any part of Item 5-B(1), 5-B(2), or 5-B(3)?

□Yes □No

C. Civil Judicial Disclosure

If the answer is "yes" to a question below, complete a Civil Judicial Action DRP

Check all that apply:

1. Has any domestic or foreign court:

(a) in the past ten years *enjoined* the *applicant* or any *associated person* in connection with any *investment-related* activity?

□Yes □No

(b) ever *found* that the *applicant* or any *associated person* was *involved* in a violation of *investment-related* statutes or regulations?

□Yes □No

(c) ever dismissed, pursuant to a settlement agreement, an *investment-related* civil action brought against the *applicant* or any *associated person* by a state or *foreign financial regulatory authority*?

□Yes □No

2. Is the *applicant* or any *associated person* now the subject of any civil *proceeding* that could result in a "yes" answer to any part of Item 5-C(1)?

□Yes □No

3. In the past ten years, has the *applicant* or a *control affiliate* of the *applicant* ever been a securities firm or a *control affiliate* of a securities firm that:

(a) has been the subject of a bankruptcy petition?

□Yes □No

(b) has had a trustee appointed or a direct payment procedure initiated under the Securities Investor Protection Act?

□Yes □No

4. Has a bonding company ever denied, paid out on, or revoked a bond for the *applicant*?

□Yes □No

5. Does the *applicant* have any unsatisfied judgments or liens against it?

□Yes □No

Item 6 – Non-Securities Related Business

Does *applicant* engage in any non-securities related business?

□Yes □No

If "yes," briefly describe the non-securities business.

_____

_____

Item 7 - Escrow Arrangements; Compensation Arrangements; and Fidelity Bond

A. Escrow. Complete the following information for each person that will hold investor funds in escrow pursuant to the requirements of Rule 303(e) of Regulation Crowdfunding (17 CFR 24_.309).

Check only one box: ☐ Add ☐ Delete ☐ Amend

Name of person:_____
Address:_____
Phone Number: _____

B. Compensation. Please describe any compensation arrangements *funding portal* has with issuers.

_____

C. Fidelity Bond. Does *funding portal* maintain fidelity bond coverage that has a minimum coverage of $100,000, covers any associated person of the funding portal unless otherwise excepted in the rules set forth by FINRA or any other registered national securities association of which it is a member, and meets any other applicable requirements as set forth by FINRA or any applicable national securities association that is registered under Section 15A?

□Yes □No

If "yes," provide the following information.

Bonding Company Name:_____
Bonding Company Address:_____
Phone Number: _____
Policy #_____ Expiration Date:_____

Item 8 – Withdrawal

If this is a withdrawal of registration:

A. The date the *funding portal* ceased business or withdrew its registration request:

Date (MM/DD/YYYY): _____

B. Location of Books and Records after Registration Withdrawal

Complete the following information for each location at which the *applicant* will keeps books and records after withdrawing its registration.

Check only one box: ☐ Add ☐ Delete ☐ Amend

Name and address of entity where books and records are kept:

_____

_____

_____

(area code) (telephone number) (area code) (fax number)

This is (check one): ☐ one of *applicant*'s branch offices or affiliates.
☐ a third party unaffiliated recordkeeper.
☐ other.

If this address is a private residence, check this box: ☐

Briefly describe the books and records kept at this location.

_____

_____

_____

_____

C. Is the *funding portal* now the subject of or named in any investment-related

1. Investigation

□Yes □No

2. Investor initiated complaint

□Yes □No

3. Private civil litigation

□Yes □No

EXECUTION

The funding portal consents that service of any civil action brought by or notice of any proceeding before the Securities and Exchange Commission or any self-regulatory organization in connection with the funding portal's investment-related business may be given by registered or certified mail to the funding portal's contact person at the main address, or mailing address, if different, given in Items 1.E, 1.F., and 1.H. If the applicant is a nonresident funding portal, it must complete Schedule C to designate a U.S. agent for service of process.

The undersigned represents and warrants that he/she has executed this form on behalf of, and is duly authorized to bind, the funding portal. The undersigned and the funding portal represent that the information and statements contained herein and other information filed herewith, all of which are made a part hereof, are current, true and complete. The undersigned and the funding portal further represent that, if this is an amendment, to the extent that any information previously submitted is not amended, such information is currently accurate and complete.

Date: _____

Full Legal Name of Funding Portal: _____

By _____
(signature)

Title: _____

FORM FUNDING PORTAL
SCHEDULE A

Direct Owners and Executive Officers

1. Complete Schedule A only if submitting an initial application. Schedule A asks for information about the *applicant*'s direct owners and executive officers. Use Schedule B to amend this information.

2. Direct Owners and Executive Officers. List below the names of:

   (a) each Chief Executive Officer, Chief Financial Officer, Chief Operations Officer, Chief Legal Officer, Chief Compliance Officer, director and any other individuals with similar status or functions;

   (b) if *applicant* is organized as a corporation, each shareholder that is a direct owner of 5% or more of a class of the *applicant*'s voting securities, unless *applicant* is a public reporting company (a company subject to Section 13 or 15(d) of the Exchange Act);

   Direct owners include any *person* that owns, beneficially owns, has the right to vote, or has the power to sell or direct the sale of 5% or more of a class of the *applicant*'s voting securities. For purposes of this Schedule, a *person* beneficially owns any securities: (i) owned by his/her child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, sharing the same residence; or (ii) that he/she has the right to acquire, within 60 days, through the exercise of any option, warrant, or right to purchase the security.

   (c) if the *applicant* is organized as a partnership, <u>all</u> general partners and those limited and special partners that have the right to receive upon dissolution, or have contributed, 5% or more of the *applicant*'s capital;

   (d) in the case of a trust, (i) a *person* that directly owns 5% or more of a class of the *applicant*'s voting securities, or that has the right to receive upon dissolution, or has contributed, 5% or more of the *applicant*'s capital, (ii) the trust and (iii) each trustee; and

   (e) if the *applicant* is organized as a limited liability company ("LLC"), (i) those members that have the right to receive upon dissolution, or have contributed, 5% or more of the *applicant*'s capital, and (ii) if managed by elected managers, all elected managers.

3. In the DE/FE/NP column below, enter "DE" if the owner is a domestic entity, "FE" if the owner is an entity incorporated or domiciled in a foreign country, or "NP" if the owner or executive officer is a natural person.

4. Complete the Title or Status column by entering board/management titles; status as partner, trustee, sole proprietor, elected manager, shareholder, or member; and for shareholders or members, the class of securities owned (if more than one is issued).

5. Ownership codes are:

NA - less than 5%	B - 10% but less than 25%	D - 50% but less than 75%
A - 5% but less than 10%	C - 25% but less than 50%	E - 75% or more

6.

(a) In the *Control Affiliate* column, enter "Yes" if the *person* has *control* as defined in the Glossary of Terms to Form Funding Portal, and enter "No" if the *person* does not have *control*. Note that under this definition, most executive officers and all 25% owners, general partners, elected managers, and trustees are *control persons*.

(b) In the PR column, enter "PR" if the owner is a public reporting company under Section 13 or 15(d) of the Exchange Act.

(c) Complete each column.

FULL LEGAL NAME (**Natural Persons: Last Name, First Name, Middle Name**)	**DE/FE/NP**	**Title or Status**	**Date Title or Status Acquired**		**Ownership Code**	**Control Affiliate**		***CRD* No.** (**If None: S.S. No. and Date of Birth, IRS Tax No., or Employer ID No.**)
			MM	YYYY		Yes/No	PR	

FORM FUNDING PORTAL
SCHEDULE B

Amendments to Schedule A

1. Use Schedule B only to amend information requested on Schedule A. Refer to Schedule A for specific instructions for completing this Schedule B. Complete each column. File with a completed Execution Page.

2. In the Type of Amendment column, indicate "A" (addition), "D" (deletion), or "C" (change in information about the same *person*).

3. Ownership codes are:

NA - less than 5%
A - 5% but less than 10%
B - 10% but less than 25%
C - 25% but less than 50%
D - 50% but less than 75%
E - 75% or more
G - Other (general partner, trustee, or elected member)

4. List below all changes to Schedule A (Direct Owners and Executive Officers):

FULL LEGAL NAME (Natural Persons: Last Name, First Name, Middle Name)	**DE/FE/NP**	**Type of Amend-ment**	**Title or Status**	**Date Title or Status Acquired**		**Ownership Code**	***Control Affiliate***		***CRD* No. (If None: S.S. No. and Date of Birth, IRS Tax No., or Employer ID No.)**
				MM	YYYY		Yes/No	PR	

Schedule C of FORM FUNDING PORTAL
Nonresident Funding Portals

Applicant Name:

Date:_____ SEC File No:

Official Use

Service of Process and Certification Regarding Access to Records

Each nonresident funding portal applicant shall use Form to identify its United States agent for service of process and to certify that it can

(1) provide the Commission and the national securities association of which it is a member with prompt access to its books and records, and (2) submit to onsite inspection and examination by the Commission.

1. Service of Process:

A. Name of United States person *applicant* designates and appoints as agent for service of process

B. Address of United States person *applicant* designates and appoints as agent for service of process

The above identified agent for service of process may be served any process, pleadings, subpoenas, or other papers in

(a) any investigation or administrative proceeding conducted by the Commission that relates to the *applicant* or about which the

applicant may have information; and

(b) any civil or criminal suit or action or proceeding brought against the *applicant* or to which the *applicant* has been joined as defendant or respondent, in any appropriate court in any place subject to the jurisdiction of any state or of the United States or of any of its territories or possessions or of the District of Columbia, to enforce the Exchange Act. The *applicant* has stipulated and agreed that any such suit, action or administrative proceeding may be commenced by the service of process upon, and that service of an administrative subpoena shall be effected by service upon, the above-named Agent for Service of Process, and that service as aforesaid shall be taken and held in all courts and administrative tribunals to be valid and binding as if personal service thereof had been made.

2.

Certification regarding access to records:

Applicant can as a matter of law;

(1) provide the Commission and any national securities association of which it is a member with prompt access to its books and records, and

(2) submit to onsite inspection and examination by the Commission.

Applicant must attach to this Form Funding Portal a copy of the opinion of counsel it is required to obtain in accordance with Rule 400(g) of Regulation Crowdfunding.

Signature:

Name and Title:

Date:

CRIMINAL ACTION DISCLOSURE REPORTING PAGE (FP)

General Instructions

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-A of Form Funding Portal.

Check item(s) being responded to: ☐ 5-A(1)(a) ☐ 5-A(1)(b) ☐ 5-A(2)(a) ☐ 5-A(2)(b)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

Multiple counts of the same *charge* arising out of the same event(s) should be reported on the same DRP. Use this DRP to report all *charges* arising out of the same event. Unrelated criminal actions, including separate cases arising out of the same event, must be reported on separate DRPs. One event may result in more than one affirmative answer to the items listed above.

Part 1

Check all that apply:

A. The *person*(s) or entity(ies) for whom this DRP is being filed is (are) the:

☐ *Applicant*
☐ *Applicant* and one or more *associated persons*
☐ One or more of *applicant*'s *associated persons*

If this DRP is being filed for the *applicant*, and it is an amendment that seeks to remove a DRP concerning the *applicant* from the record, the reason the DRP should be removed is:

☐ The *applicant* is registered or applying for registration, and the event or *proceeding* was resolved in the *applicant*'s favor.
☐ The DRP was filed in error.

If this DRP is being filed for an *associated person*:

This *associated person* is: ☐ a firm ☐ a natural person
The *associated person* is: ☐ registered with the *SEC* ☐ not registered with the *SEC*

Full name of the *associated person* (including, for natural persons, last, first and middle names):

_____

If the *associated person* has a *CRD* number, provide that number. _____

If this is an amendment that seeks to remove a DRP concerning the *associated person*, the reason the DRP should be removed is:

☐ The *associated person*(s) is (are) no longer associated with the *applicant*.
☐ The event or *proceeding* was resolved in the *associated person*'s favor.
☐ The event or *proceeding* occurred more than ten years ago.
☐ The DRP was filed in error. Explain the circumstances:

_____
_____

Part 2

1. If *charge*(s) were brought against a firm or organization over which the *applicant* or an *associated person* exercised *control*:

Enter the firm or organization's name _____

Was the firm or organization engaged in an *investment-related* business? ☐ Yes ☐ No

What was the relationship of the *applicant* with the firm or organization? (In the case of an *associated person*, include any position or title with the firm or organization.)

_____

2. Formal *charge*(s) were brought in: (include the name of Federal, Military, State or Foreign Court, Location of Court - City or County and State or Country, and Docket/Case number).

Name of court: _____
Location: _____
Docket/Case number: _____

3. Event Disclosure Detail (Use this for both organizational and individual *charges*.)

A. Date First *Charged* (MM/DD/YYYY): _____ ☐ Exact ☐ Explanation

If not exact, provide explanation:

_____

B. Event Disclosure Detail (include *charge*(s)/*charge* Description(s), and for each *charge* provide: (1) number of counts, (2) *felony* or *misdemeanor*, (3) plea for each *charge*, and (4) product type if *charge* is *investment-related*).

_____

C. Did any of the *charge*(s) within the event *involve* a *felony*? ☐ Yes ☐ No

D. Current status of the event? ☐ Pending ☐ On Appeal ☐ Final

E. Event status date (Complete unless status is pending) (MM/DD/YYYY):

_____

☐ Exact ☐ Explanation

If not exact, provide explanation:

_____

4. Disposition Disclosure Detail: Include for each *charge* (a) Disposition Type (e.g., convicted, acquitted, dismissed, pretrial, etc.), (b) Date, (c) Sentence/Penalty, (d) Duration (if sentence-suspension, probation, etc.), (e) Start Date of Penalty, (f) Penalty/Fine Amount, and (g) Date Paid.

_____

5. Provide a brief summary of circumstances leading to the *charge*(s) as well as the disposition. Include the relevant dates when the conduct that was the subject of the *charge*(s) occurred. (The response must fit within the space provided.)

_____

_____

REGULATORY ACTION DISCLOSURE REPORTING PAGE (FP)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-B of Form Funding Portal.

Check item(s) being responded to: ☐ 5-B(1)(a) ☐ 5-B(1)(b) ☐ 5-B(1)(c) ☐ 5-B(1)(d) ☐ 5-B(1)(e) ☐ 5-B(2)(a) ☐ 5-B(2)(b) ☐ 5-B(2)(c) ☐ 5-B(2)(d) ☐ 5-B(2)(e) ☐ 5-B(3)(a) ☐ 5-B(3)(b) ☐ 5-B(3)(c) ☐ 5-B(3)(d) ☐ 5-B(4) ☐ 5-B(5)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Items 5-B(1), 5-B(2), 5-B(3), 5-B(4) or 5-B(5). Use only one DRP to report details related to the same event. If an event gives rise to actions by more than one regulator, provide details for each action on a separate DRP.

Part 1

The *person*(s) or entity(ies) for whom this DRP is being filed is (are) the:

- ☐ *Applicant* (the *funding portal*)
- ☐ *Applicant* and one or more of the *applicant*'s *associated person*(s)
- ☐ One or more of *applicant*'s *associated person*(s)

If this DRP is being filed for the *applicant* and it is an amendment that seeks to remove a DRP concerning the *applicant* from the record, the reason the DRP should be removed is:

- ☐ The *applicant* is registered or applying for registration, and the event or *proceeding* was resolved in the *applicant*'s favor.
- ☐ The DRP was filed in error.

If this DRP is being filed for an *associated person*:

This *associated person* is: ☐ a firm ☐ a natural person

The *associated person* is: ☐ registered with the *SEC* ☐ not registered with the *SEC*

Full name of the *associated person* (including, for natural persons, last, first and middle names):

_____

If the *associated person* has a *CRD* number, provide that number. _____

If this is an amendment that seeks to remove a DRP concerning the *associated person*, the reason the DRP should be removed is:

☐ The *associated person*(s) is (are) no longer associated with the *applicant*.
☐ The event or *proceeding* was resolved in the *associated person*'s favor.
☐ The DRP was filed in error. Explain the circumstances:

_____
_____

Part 2

1. Regulatory Action was initiated by:

☐ *SEC* ☐ Other Federal Authority ☐ State ☐ *SRO* ☐ Foreign Authority

(Full name of regulator, *foreign financial regulatory authority*, federal authority, state or *SRO*)

_____
_____
_____

2. Principal Sanction (check appropriate item):

☐ Civil and Administrative Penalty(ies)/Fine(s) ☐ Disgorgement ☐ Restitution

☐ Bar	☐ Expulsion	☐ Revocation
☐ Cease and Desist	☐ Injunction	☐ Suspension
☐ Censure	☐ Prohibition	☐ Undertaking
☐ Denial	☐ Reprimand	☐ Other

Other Sanctions:

_____
_____
_____

3. Date Initiated (MM/DD/YYYY): _____ ☐ Exact ☐ Explanation

   If not exact, provide explanation:

   _____
   _____
   _____
   _____

4. Docket/Case Number: _____

5. *Associated person*'s Employing Firm when activity occurred that led to the regulatory action (if applicable):

_____
_____
_____

6. Principal Product Type (check appropriate item):

☐ Annuity(ies) - Fixed ☐ Derivative(s) ☐ Investment Contract(s)
☐ Annuity(ies) - Variable ☐ Direct Investment(s) - DPP & LP Interest(s)
☐ Money Market Fund(s) ☐ No Product
☐ CD(s) ☐ Equity - OTC ☐ Mutual Fund(s)
☐ Commodity Option(s) ☐ Equity Listed (Common & Preferred Stock)
☐ Debt - Asset Backed ☐ Futures - Commodity ☐ Options
☐ Debt - Corporate ☐ Futures - Financial ☐ Penny Stock(s)
☐ Debt - Government ☐ Index Option(s) ☐ Unit Investment Trust(s)
☐ Debt - Municipal ☐ Insurance ☐ Other

Other Product Types:

_____
_____
_____

7. Describe the allegations related to this regulatory action. (The response must fit within the space provided.)

_____
_____
_____

8. Current status? ☐ Pending ☐ On Appeal ☐ Final

9. If on appeal, to whom the regulatory action was appealed (*SEC*, *SRO*, Federal or State Court) and date appeal filed:

_____
_____

If Final or On Appeal, complete all items below. For Pending Actions, complete Item 13 only.

10. How was matter resolved (check appropriate item):

☐ Acceptance, Waiver & Consent (AWC) ☐ Dismissed ☐ Vacated
☐ Consent ☐ *Order* ☐ Withdrawn
☐ Decision ☐ Settled ☐ Other
☐ Decision & *Order* of Offer of Settlement ☐ Stipulation and Consent

11. Resolution Date (MM/DD/YYYY): _____ ☐ Exact ☐ Explanation

If not exact, provide explanation:

_____

_____

12. Resolution Detail:

A. Were any of the following Sanctions *Ordered* (check all appropriate items)?

☐ Monetary/Fine ☐ Revocation/Expulsion/Denial ☐ Disgorgement/Restitution
Amount: $_____ ☐ Censure ☐ Cease and Desist/Injunction
☐ Bar ☐ Suspension

B. Other Sanctions *Ordered*:

_____

_____

C. Sanction detail: If suspended, *enjoined* or barred, provide duration including start date and capacities affected (General Securities Principal, Financial Operations Principal, etc.). If requalification by exam/retraining was a condition of the sanction, provide length of time given to requalify/retrain, type of exam required and whether condition has been satisfied. If disposition resulted in a fine, penalty, restitution, disgorgement or monetary compensation, provide total amount, portion levied against the *applicant* or an *associated person*, date paid and if any portion of penalty was waived:

_____

_____

13. Provide a brief summary of details related to the action status and (or) disposition, and include relevant terms, conditions and dates.

_____

_____

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (FP)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-C. of Form Funding Portal.

Check item(s) being responded to: ☐ 5-C(1)(a) ☐ 5-C(1)(b) ☐ 5-C(1)(c) ☐ 5-C(2) ☐ 5-C(3)(a) ☐ 5-C(3)(b)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Item 5-C. Use only one DRP to report details related to the same event. Unrelated civil judicial actions must be reported on separate DRPs.

Part 1

The *person*(s) or entity(ies) for whom this DRP is being filed is (are) the:

☐ *Applicant* (the *funding portal*)
☐ *Applicant* and one or more of the *applicant*'s *associated person*(s)
☐ One or more of the *applicant*'s *associated person*(s)

If this DRP is being filed for the *applicant* and it is an amendment that seeks to remove a DRP concerning the *applicant* from the record, the reason the DRP should be removed is:

☐ The *applicant* is registered or applying for registration, and the event or *proceeding* was resolved in the *applicant*'s favor.
☐ The DRP was filed in error.

If this DRP is being filed for an *associated person*:

This *associated person* is: ☐ a firm ☐ a natural person
The *associated person* is: ☐ registered with the *SEC* ☐ not registered with the *SEC*

Full name of the *associated person* (including, for natural persons, last, first and middle names):

_____

If the *associated person* has a *CRD* number, provide that number. _____

If this is an amendment that seeks to remove a DRP concerning the *associated person*, the reason the DRP should be removed is:

☐ The *associated person*(s) is (are) no longer associated with the *applicant*.
☐ The event or *proceeding* was resolved in the *associated person*'s favor.
☐ The DRP was filed in error. Explain the circumstances:

_____

_____

Part 2

1. Court Action initiated by: (Name of regulator, *foreign financial regulatory authority*, *SRO*, commodities exchange, agency, firm, private plaintiff, etc.)

2. Principal Relief Sought (check appropriate item):

☐ Cease and Desist ☐ Disgorgement ☐ Money Damages (Private/Civil Complaint)
☐ Restraining Order ☐ Civil Penalty(ies)/Fine(s)
☐ Injunction ☐ Restitution
☐ Other _____

Other Relief Sought:_____

3. Filing Date of Court Action (MM/DD/YYYY): _____ ☐ Exact ☐ Explanation

If not exact, provide explanation:

_____

4. Principal Product Type (check appropriate item):

☐ Annuity(ies) - Fixed ☐ Derivative(s) ☐ Investment Contract(s)
☐ Annuity(ies) - Variable ☐ Direct Investment(s) - DPP & LP Interest(s)
☐ Money Market Fund(s) ☐ CD(s) ☐ Equity - OTC
☐ Mutual Fund(s) ☐ Commodity Option(s) ☐ No Product
☐ Equity Listed (Common & Preferred Stock) ☐ Options
☐ Debt - Asset Backed ☐ Futures - Commodity ☐ Penny Stock(s)
☐ Debt - Corporate ☐ Futures - Financial ☐ Unit Investment Trust(s)
☐ Debt - Government ☐ Index Option(s) ☐ Other
☐ Debt - Municipal ☐ Insurance

Other Product Types:

_____

5. Formal Action was brought in (include the name of the Federal, State or Foreign Court, Location of Court - City or County and State or Country, and Docket/Case Number):

_____

6. *Associated person*'s Employing Firm when activity occurred that led to the civil judicial action (if applicable):

_____

7. Describe the allegations related to this civil action (the response must fit within the space provided):

_____

_____

8. Current status? ☐ Pending ☐ On Appeal ☐ Final

9. If on appeal, court to which the action was appealed (provide name of the court) and Date Appeal Filed (MM/DD/YYYY):

_____

_____

10. If pending, date notice/process was served (MM/DD/YYYY): _____

☐ Exact ☐ Explanation

If not exact, provide explanation:

_____

If Final or On Appeal, complete all items below. For Pending Actions, complete Item 14 only.

11. How was matter resolved (check appropriate item):

☐ Consent ☐ Judgment Rendered ☐ Settled ☐ Dismissed ☐ Opinion
☐ Withdrawn ☐ Other _____

12. Resolution Date (MM/DD/YYYY): _____ ☐ Exact ☐ Explanation

If not exact, provide explanation:

_____

_____

13. Resolution Detail:

A. Were any of the following Sanctions *Ordered* or Relief Granted (check appropriate items)?

☐ Monetary/Fine ☐ Revocation/Expulsion/Denial ☐ Disgorgement/Restitution
Amount: $_____ ☐ Censure ☐ Cease and
Desist/Injunction ☐ Bar ☐ Suspension

B. Other Sanctions *Ordered*:

_____
_____
_____

C. Sanction detail: If suspended, *enjoined* or barred, provide duration including start date and capacities affected (General Securities Principal, Financial Operations Principal, etc.). If requalification by exam/retraining was a condition of the sanction, provide length of time given to requalify/retrain, type of exam required and whether condition has been satisfied. If disposition resulted in a fine, penalty, restitution, disgorgement or monetary compensation, provide total amount, portion levied against the *applicant* or an *associated person*, date paid and if any portion of penalty was waived:

_____
_____
_____
_____
_____
_____

14. Provide a brief summary of circumstances related to the action(s), allegation(s), disposition(s) and/or finding(s) disclosed above.

_____
_____
_____

BANKRUPTCY/SIPC DISCLOSURE REPORTING PAGE (FP)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-C(3) of Form Funding Portal.

Check item(s) being responded to: ☐ 5-C(3)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Item 5-C(3). Use only one DRP to report details related to the same event. Unrelated civil judicial actions must be reported on separate DRPs.

Part 1

Check all that apply:

A. The *person*(s) or entity(ies) for whom this DRP is being filed is (are) the:

☐ *Applicant*
☐ *Applicant* and one or more *control affiliates*
☐ One or more of *control affiliates*

If this DRP is being filed for a *control affiliate*, give the full name of the *control affiliate* below (for individuals, Last name, First name, Middle name).

If the *control affiliate* is registered with the CRD, provide the CRD number. If not, indicate "non-registered'' by checking the appropriate checkbox.

FP DRP - CONTROL AFFILIATE

_____
Control *Affiliate CRD Number* This *control affiliate* is: ☐ a firm ☐ a natural person

Registered: ☐ Yes ☐ No

Full name of the *control affiliate* (including, for natural persons, last, first and middle names):

_____

☐ This is an amendment that seeks to remove a DRP record because the *control affiliate(s)* is (are) no longer associated with the funding portal.

B. If the *control affiliate* is registered through the CRD, has the *control affiliate* submitted a DRP (with Form U-4) or BD DRP to the CRD System for the event? If the answer is "Yes,'' no other information on this DRP must be provided.

☐ Yes ☐ No

NOTE: The completion of this Form does not relieve the *control affiliate* of its obligation to update its CRD records.

Part 2

1. Action Type: (check appropriate item)

☐ Bankruptcy ☐ Declaration ☐ Receivership

☐ Compromise ☐ Liquidated ☐ Other_____

2. Action Date (MM/DD/YYYY):_____ ☐ Exact ☐ Explanation

   If not exact, provide explanation:_____

3. If the financial action relates to an organization over which the *applicant* or *control affiliate* exercise(d) *control*, enter organization name and the *applicant's* or *control affiliate's* position, title or relationship:

   _____

   Was the Organization investment-related? ☐ Yes ☐ No

4. Court action brought in (Name of Federal, State or Foreign Court), Location of Court (City or County and State or Country), Docket/Case Number and Bankruptcy Chapter Number (if Federal Bankruptcy Filing):

   _____

5. Is action currently pending? ☐ Yes ☐ No

6. If not pending, provide Disposition Type: (check appropriate item)

   ☐ Direct Payment Procedure ☐ Dismissed ☐ Satisfied/Released
   ☐ Discharged ☐ Dissolved ☐ SIPA Trustee Appointed

☐ Other _____

7. Disposition Date (MM/DD/YYYY): ☐ Exact ☐ Explanation

   If not exact, provide explanation: _____

8. Provide a brief summary of events leading to the action, and if not discharged, explain. (The information must fit within the space provided.):_____

9. If a SIPA trustee was appointed or a direct payment procedure was begun, enter the amount paid by you; or the name of trustee:_____

Currently Open? ☐ Yes ☐ No

Date Direct Payment Initiated/Filed or Trustee Appointed (MM/DD/YYYY):_____

☐ Exact ☐ Explanation

If not exact, provide explanation:_____

10. Provide details to any status disposition. Include details as to creditors, terms, conditions, amounts due and settlement schedule (if applicable):_____

BOND DISCLOSURE REPORTING PAGE (FP)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-C(4) of Form Funding Portal.

Check item(s) being responded to: ☐ 5-C(4)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Item 5-C(4). Use only one DRP to report details related to the same event. If an event gives rise to actions by more than one regulator, provide details for each action on a separate DRP.

1. Firm Name: (Policy Holder)

_____
_____

2. Bonding Company Name:

_____
_____

3. Disposition Type: (check appropriate item)

☐ Denied ☐ Payout ☐ Revoked

4. Disposition Date (MM/DD/YYYY): ☐ Exact ☐ Explanation

If not exact, provide explanation:

_____
_____
_____

5. If disposition resulted in Payout, list Payout Amount and Date Paid:

_____
_____
_____

6. Summarize the details of circumstances leading to the necessity of the bonding company action:

_____
_____
_____
_____
_____

JUDGMENT / LIEN DISCLOSURE REPORTING PAGE (FP)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-C(5) of Form Funding Portal.

Check item(s) being responded to: ☐ 5-C(5)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page. One event may result in more than one affirmative answer to Item 5-C(5). Use only one DRP to report details related to the same event. If an event gives rise to actions by more than one regulator, provide details for each action on a separate DRP.

1. Judgment/Lien Amount:_____
2. Judgment/Lien Holder:_____

3. Judgment/Lien Type: (check appropriate item)

   ☐ Civil ☐ Default ☐ Tax

4. Date Filed (MM/DD/YYYY):_____ ☐ Exact ☐ Explanation

   If not exact, provide explanation:_____

5. Is Judgment/Lien outstanding? ☐ Yes ☐ No

   If No, provide explanation:_____

If No, how was matter resolved? (check appropriate item)

☐ Discharged ☐ Released ☐ Removed ☐ Satisfied

6. Court (Name of Federal, State or Foreign Court), Location of Court (City or County and State or Country) and Docket/Case Number:

_____

7. Provide a brief summary of events leading to the action and any payment schedule details, including current status (if applicable):_____

FORM FUNDING PORTAL INSTRUCTIONS

A. GENERAL INSTRUCTIONS

1. EXPLANATION OF FORM

- This is the form that a funding portal must use to register with the Securities and Exchange Commission ("SEC" or "Commission"), to amend its registration and to withdraw from registration.
- The Commission may make publicly accessible all current Forms Funding Portal, including amendments and registration withdrawal requests, which may be searchable by the public, with the exception of certain personally identifiable information or other information with significant potential for misuse (including the contact employee's direct phone number and e-mail address and any IRS Employer Identification Number, social security number, date of birth, or any other similar information).

2. WHEN TO FILE FORM FUNDING PORTAL

- A funding portal's registration must become effective before offering or selling any securities in reliance on Section 4(a)(6) through a platform. Under Rule 400, a funding portal's registration will be effective the later of: (1) 30 calendar days after the date a complete Form Funding Portal is received by the Commission or (2) the date the funding portal is approved for membership by a national securities association registered under Section 15A of the Securities Exchange Act of 1934 ("Exchange Act").

- A registered funding portal must promptly file an amendment to Form Funding Portal when any information previously submitted on Form Funding Portal becomes inaccurate or incomplete for any reason.

- A successor funding portal may succeed to the registration of a registered funding portal by filing a registration on Form Funding Portal within 30 days after the succession.

- If a funding portal succeeds to and continues the business of a registered funding portal and the succession is based solely on a change of the predecessor's date or state of incorporation, form of organization, or composition of a partnership or similar reason, the successor may, within 30 days of the succession, amend the registration on Form Funding Portal to reflect these changes.

- A funding portal must also file a withdrawal on Form Funding Portal promptly upon ceasing to operate as a funding portal. Withdrawal will be effective on the later of 30 days after receipt by the Commission, after the funding portal is no longer operational, or

within such longer period of time as to which the funding portal consents or which the Commission by order may determine as necessary or appropriate in the public interest or for the protection of investors.

- A Form Funding Portal filing will not be considered complete unless it complies with all applicable requirements.

3. ELECTRONIC FILING – The *applicant* must file Form Funding Portal electronically using the web-enabled system, and must utilize this system to file and amend Form Funding Portal electronically to assure the timely acceptance and processing of those filings.

4. CONTACT EMPLOYEE – The individual listed as the contact employee must be authorized to receive all compliance information, communications, and mailings, and be responsible for disseminating it within the *applicant*'s organization.

5. FEDERAL INFORMATION LAW AND REQUIREMENTS

- The principal purpose of this form is to provide a mechanism by which a funding portal can register with the Commission, amend its registration and withdraw from registration. The Commission maintains a file of the information on this form and will make certain information collected through the form publicly available. The SEC will not accept forms that do not include the required information.

- Section 4A(a) of the Securities Act of 1933 [15 U.S.C. §77d-1(a)] and Sections 3(h) and 23(a) the Exchange Act [15 U.S.C. §§78c(h) and 78w(a)] authorize the SEC to collect the information required by Form Funding Portal. The SEC collects the information for regulatory purposes. Filing Form Funding Portal is mandatory for persons that are registering as funding portals with the SEC.

- Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate on this Form and any suggestions for reducing this burden. This collection of information has been reviewed by the Office of Management and Budget in accordance with the clearance requirements of 44 U.S.C. §3507. The information contained in this form is part of a system of records subject to the Privacy Act of 1974, as amended. The Securities and Exchange Commission has published in the Federal Register the Privacy Act Systems of Records Notice for these records.

B. FILING INSTRUCTIONS

1. FORMAT

- Items 1-7 must be answered and all fields requiring a response must be completed before the filing will be accepted. Item 8 must be answered if the funding portal wishes to withdraw from registration.

- *Applicant* must complete the execution screen certifying that Form Funding Portal and amendments thereto have been executed properly and that the information contained therein is accurate and complete.

- To amend information, the *applicant* must update the appropriate Form Funding Portal screens.

- A paper copy, with original manual signatures, of the initial Form Funding Portal filing and amendments to Disclosure Reporting Pages must be retained by the *applicant* and be made available for inspection upon a regulatory request.

2. **DISCLOSURE REPORTING PAGES (DRP)** – Information concerning the *applicant* or control affiliate that relates to the occurrence of an event reportable under Item 5 must be provided on the *applicant*'s appropriate DRP (FP). If a *control affiliate* is an individual or organization registered through the CRD, such *control affiliate* need only complete the *control affiliate* name and CRD number of the *applicant's* appropriate DRP. Details for the event must be submitted on the *control affiliate's* appropriate DRP or DRP(U-4). If a *control affiliate* is an individual or organization not registered through the CRD, provide complete answers to all of the questions and complete all fields requiring a response on the *applicant's* appropriate DRP (FP) screen.

3. **DIRECT OWNERS** - Amend the Direct Owners and Executive Officers screen when changes in ownership occur.

4. **NONRESIDENT APPLICANTS –** Any applicant that is a nonresident funding portal must complete Schedule C and attach the opinion of counsel referred to therein.

C. EXPLANATION OF TERMS

1. GENERAL

APPLICANT - The funding portal applying on or amending this form.

ASSOCIATED PERSON - Any partner, officer, director or manager of the funding portal (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling or controlled by the funding portal, or any employee of the funding portal, except that any person associated with a funding portal whose functions are solely clerical or ministerial shall not be included in the meaning of such term for purposes of section 15(b) of the Exchange Act (other than paragraphs (4) and (6) thereof).

CONTROL - The power, directly or indirectly, to direct the management or policies of the funding portal, whether through contract, or otherwise. A person is presumed to control a funding portal if that person: (1) is a director, general partner or officer exercising executive responsibility (or has a similar status or functions); (2) directly or indirectly has the right to vote

25 percent or more of a class of a voting security or has the power to sell or direct the sale of 25 percent or more of a class of voting securities of the funding portal; or (3) in the case of a partnership, has contributed, or has a right to receive, 25 percent or more of the capital of the funding portal. (This definition is used solely for the purposes of Form Funding Portal).

CONTROL AFFILIATE – A person named in Item 4 [as a control person] or any other individual or organization that directly or indirectly controls, is under common control with, or is controlled by, the *applicant*, including any current employee of the *applicant* except one performing only clerical, administrative, support or similar functions, or who, regardless of title, performs no executive duties or has no senior policy making authority.

FOREIGN FINANCIAL REGULATORY AUTHORITY – Includes (1) a foreign securities authority; (2) other governmental body or foreign equivalent of a *self-regulatory organization* empowered by a foreign government to administer or enforce its laws relating to the regulation of *investment* or *investment-related* activities*;* and (3) a foreign membership organization, a function of which is to regulate the participation of its members in the activities listed above.

FUNDING PORTAL - A broker acting as an intermediary in a transaction involving the offer or sale of securities offered and sold in reliance on Section 4(a)(6), that does not, directly or indirectly: (1) offer investment advice or recommendations; (2) solicit purchases, sales or offers to buy the securities displayed on its platform; (3) compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its platform; or (4) hold, manage, possess, or otherwise handle investor funds or securities.

JURISDICTION – Any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin Islands, any other territory of the United States, or any subdivision or regulatory body thereof.

NONRESIDENT FUNDING PORTAL – A funding portal incorporated in or organized under the laws of a jurisdiction outside of the United States or its territories, or having its principal place of business in any place not in the United States or its territories.

PERSON - An individual, partnership, corporation, trust, or other organization.

SELF-REGULATORY ORGANIZATION (SRO) – The Financial Industry Regulatory Authority ("FINRA") or any other national securities association registered with the Commission or any national securities exchange or registered clearing agency, as such terms are defined in Section 3 of the Exchange Act.

SUCCESSOR –A funding portal that assumes or acquires substantially all of the assets and liabilities, and that continues the business of, a registered predecessor funding portal that ceases its funding portal activities. See Rule 400(c) of Regulation Crowdfunding (17 CFR 24_.400(c)).

2. FOR THE PURPOSE OF ITEM 5

CHARGED - Being accused of a crime in a formal complaint, information, or indictment (or equivalent formal charge).

ENJOINED – Includes being subject to a mandatory injunction, prohibitory injunction, preliminary injunction, or temporary restraining order.

FELONY – For jurisdictions that do not differentiate between a felony and a misdemeanor, a felony is an offense punishable by a sentence of at least one year imprisonment and/or a fine of at least $1,000. The term also includes a general court martial.

FOUND – Includes adverse final actions, including consent decrees in which the respondent has neither admitted nor denied the findings, but does not include agreements, deficiency letters, examination reports, memoranda of understanding, letters of caution, admonishments, and similar informal resolutions of matters.

INVESTMENT OR INVESTMENT-RELATED – Pertaining to securities, commodities, banking, savings association activities, credit union activities, insurance, or real estate (including, but not limited to, acting as or being associated with a funding portal broker-dealer, municipal securities dealer, government securities broker or dealer, issuer, investment company, investment adviser, futures sponsor, bank, security-based swap dealer, major security-based swap participant, savings association, credit union, insurance company, or insurance agency).

INVOLVED – Doing an act or aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act.

MINOR RULE VIOLATION – A violation of a self-regulatory organization rule that has been designated as "minor" pursuant to a plan approved by the SEC or Commodity Futures Trading Commission. A rule violation may be designated as "minor" under a plan if the sanction imposed consists of a fine of $2,500 or less and if the sanctioned person does not contest the fine. (Check with the appropriate self-regulatory organization to determine if a particular rule violation has been designated as "minor" for these purposes).

MISDEMEANOR – For jurisdictions that do not differentiate between a felony and a misdemeanor, a misdemeanor is an offense punishable by a sentence of less than one year imprisonment and/or a fine of less than $1,000. The term also includes a special court martial.

ORDER – A written directive issued pursuant to statutory authority and procedures, including orders of denial, suspension, or revocation; does not include special stipulations, undertakings or agreements relating to payments, limitations on activity or other restrictions unless they are included in an order.

PROCEEDING – Includes a formal administrative or civil action initiated by a governmental agency, self-regulatory organization or a foreign financial regulatory authority; a felony criminal

indictment or information (or equivalent formal charge); or a misdemeanor criminal information (or equivalent formal charge). Does not include other civil litigation, investigations, or arrests or similar charges effected in the absence of a formal criminal indictment or information (or equivalent formal charge).

By the Commission.

Elizabeth M. Murphy
Secretary

Date: October 23, 2013

Note: The following exhibit will not appear in the Code of Federal Regulations.

Exhibit A

Comments Letters Received Regarding Title III of the JOBS Act

Proposal to Implement Regulation Crowdfunding (File No. S7-09-13)

ABA Letter 1:	Letter from Catherine T. Dixon, Chair, Federal Regulation of Securities Committee, American Bar Association, Mar. 20, 2013
ABA Letter 2:	Letter from Catherine T. Dixon, Chair, Federal Regulation of Securities Committee, American Bar Association, Jun. 26, 2013
ACA Letter:	Letter from Divina K. Westerfield, Esq., Manager, American Crowdfunding Association Inc., Oct. 8, 2013
ACFIA Letter 1:	Letter from John Vassilliw, American Crowdfunding Investment Association, Dec. 15, 2012
ACFIA Letter 2:	Letter from John Vassilliw, American Crowdfunding Investment Association, Jan. 3, 2013
ACFIA Letter 3:	Letter from John Vassilliw, American Crowdfunding Investment Association, Jan. 3, 2013
Acos Letter:	Letter from Jim Acos, Jun. 10, 2012
AKickInCrowd.com Letter:	Letter from Tony Reynolds, Founder, AKickInCrowd.Com, May 11, 2012
Alabama Development Office Letter:	Letter from S. Douglas Smith, Founding Director of the Alabama Development Office and the Alabama Department of Economic and Community Affairs, Oct. 22, 2012

ASBC Letter:	Letter from American Sustainable Business Council, Jul. 16, 2012
AngelList Letter:	Letter from Naval Ravikant, CEO, AngelList, May 23, 2012
AppleSeedz Letter:	Letter from EL Mazyck, President, AppleSeedz.com, Jul. 23, 2012
Applied Dynamite Letter:	Letter from Randall Lucas, CEO, Applied Dynamite Inc., May 4, 2012
ARS Letter:	Letter from Mark Norych, Esq., Executive Vice President, General Counsel, Board Member, Arbitration Resolution Services, Inc., Jul. 19, 2013
Arctic Island Letter:	Letter from Scott Purcell, Founder, Arctic Island Crowdfunding Portal, Jun. 26, 2012
Ayeni Letter:	Letter from Debo Ayeni, Dec. 23, 2012
Bach Letter:	Letter from David Bach, Apr. 18, 2012
Barnes Letter:	Letter from Ryan Barnes, Aug. 22, 2012
Basko Letter:	Letter from Sue Basko, Lawyer, Jun. 18, 2012
Becotte Letter:	Letter from Chase Becotte, Aug. 31, 2012
Bedford Letter:	Letter from Shante Jones, Vice President, Bedford Stuvyesant Unity Youth Resources, Inc., Feb. 14, 2013
BeFounders Letter:	Letter from William J. Mills, JD, BeFounders, Apr. 24, 2012
Begich Letter:	Letter from Sen. Mark Begich, U.S. Senator, Jul. 18, 2013

Bennet Letter:	Letter from Sen. Michael F. Bennet, U.S. Senator, Dec. 12, 2012
Black Letter:	Letter from Michael Black, Nov. 4, 2012
Blechman Letter:	Letter from Bruce Blechman, Apr. 13, 2012
BlueTree Letter:	Letter from Catherine V. Mott, Founder, BlueTree Allied Angels, Aug. 21, 2012
BrainThrob Laboratories Letter:	Letter from Erin C. DeSpain, President, BrainThrob Laboratories, Inc., Nov. 8, 2012
Brandon W Letter:	Letter from Brandon W., Apr. 16, 2012
Buffalo First Letter:	Letter from Kelly A. Maurer, Treasurer, Buffalo First Member, Buffalo Common Wealth LLC Assistant Treasurer, Buffalo Cooperative FCU, Apr. 16, 2012
Bulldog Investors Letter:	Letter from Philip Goldstein, Bulldog Investors, Jul. 18, 2012
Cera Technology Letter:	Letter from Michael Mace, CEO, Cera Technology, Apr. 13, 2012
CFA Institute Letter:	Letter from Kurt N. Schacht and Linda L. Rittenhouse, CFA Institute, Aug. 16, 2012
CFIRA Letter 1:	Letter from Sherwood E. Neiss, Crowdfund Investing Regulatory Advocates (CFIRA), May 15, 2012
CFIRA Letter 2:	Letter from Candace S. Klein, Chair and Vincent R. Molinari, Co-Chair, CFIRA, May 30, 2012
CFIRA Letter 3:	Letter from Candace S. Klein, Chair and Vincent R. Molinari, Co-Chair, CFIRA, Jun. 5, 2012

CFIRA Letter 4:	Letter from Kim Wales and Christine Landon, CFIRA, Aug. 9, 2012
CFIRA Letter 5:	Letter from Kim Wales, Founding member, and DJ Paul, Founding Member& CSO, CFIRA, Aug. 22, 2012
CFIRA Letter 6:	Letter from Lon David Varvel, Founding Member, CFIRA, Sept. 14, 2012
CFIRA Letter 7:	Letter from Chris Tyrrell, Kim Wales and Charles Sidman, Founding Members, CFIRA, Oct. 10, 2012
CFIRA Letter 8:	Letter from Chris Tyrrell, Kim Wales and Charles Sidman, Founding Members, CFIRA, Oct. 29, 2012
CFIRA Letter 9:	Letter from Kim Wales, Founding Member, CFIRA, Nov. 26, 2012
CFIRA Letter 10:	Letter from Scott Purcell, Board Member, CFIRA, Dec. 3, 2012
CFIRA Letter 11:	Letter from Kim Wales, Founding Member, CFIRA, Dec. 4, 2012
CFIRA Letter 12:	Letter from CFIRA, Jan. 21, 2013
CFIRA Letter 13:	Letter from Ryan Feit, Co-Founder & CEO, SeedInvest, and Kim Wales, Founding Member, CFIRA, Mar. 11, 2013
City First Letter:	Letter from John Hamilton, President, City First Enterprises, Jul. 4, 2013
CitySpark Letter:	Letter from David B. Haynie, CitySpark.com, Apr. 25, 2012
Coan Letter:	Letter from Marc C. Coan, Apr. 11, 2012

Coleman Letter:	Letter from Matthew R. Nutting, Esq., Coleman & Horowitt, LLP, Jan. 28, 2013
Commonwealth of Massachusetts Letter:	Letter from William F. Galvin, Secretary of the Commonwealth, Massachusetts, Aug. 8, 2012
CommunityLeader Letter:	Letter from Richard Weintraub, Chief Compliance Officer, CommunityLeader, Aug. 17, 2012
CompTIA Letter:	Letter from Lamar Whitman, Director, Public Advocacy, CompTIA, Jun. 28, 2012
Cones Letter:	Letter from John Cones, Apr. 19, 2012
Corporate Resolutions Letter:	Letter from Joelle Scott, Director of Business Intelligence, Corporate Resolutions Inc., Apr. 19, 2012
Crowd Startup Capital Letter:	Letter from Travis E. Chapman, Esq., Crowd Startup Capital, May 11, 2012
CrowdCheck Letter 1:	Letter from Sara Hanks, CEO, CrowdCheck, Inc., Apr. 30, 2012
CrowdCheck Letter 2:	Letter from Brian Knight, Vice President, CrowdCheck, Inc., Dec. 5, 2012
CrowdFund Capital Markets Letter:	Letter from Robert J. Thibodeau, President, CrowdFund Capital Markets, May 7, 2012
CrowdFund Connect Letter:	Letter from J. Randy Shipley, Founder, CrowdFund Connect, Social Gravity Inc., Jul. 28, 2012
Crowdfunding Offerings Ltd. Letter 1:	Letter from Anthony D. Edwards, Esq., Founder, Crowdfunding Offerings, Ltd., May 11, 2012

Crowdfunding Offerings Ltd. Letter 2:	Letter from Marshall Neel, Esq., Crowdfunding Offerings, Ltd., May 11, 2012
Crowdfunding Offerings Ltd. Letter 3:	Letter from Marshall Neel, Esq., Co-Founder, Crowdfunding Offerings, Ltd., May 11, 2012
Crowdfunding Offerings Ltd. Letter 4:	Letter from Marshall Neel, Esq., Co-Founder, Crowdfunding Offerings, Ltd., May 11, 2012
Crowdfunding Offerings Ltd. Letter 5:	Letter from Anthony D. Edwards, Esq., Founder, Crowdfunding Offerings, Ltd., May 11, 2012
Crowdfunding Offerings Ltd. Letter 6:	Letter from Anthony D. Edwards, Esq., Founder, Crowdfunding Offerings, Ltd., May 11, 2012
Crowdfunding Offerings Ltd. Letter 7:	Letter from Marshall Neel, Esq., Co-Founder, Crowdfunding Offerings, Ltd., Aug. 15, 2012
Crowdlever Letter 1:	Letter from Matt Morse, Sr., Feb. 1, 2013
Crowdlever Letter 2:	Letter from Matt Morse, Sr., Apr. 15, 2013
Cunningham Letter:	Letter from William Michael Cunningham, AM, MBA, Jan. 15, 2013
CyberIssues.com Letter:	Letter from T.W. Kennedy, BE, CEO of CyberIssues.com, Jun. 28, 2013
Dex Offshore Letter 1:	Letter from David E. Simpson, CFA, Founder, CEO of Dex Offshore Entertainment LLC, Apr. 14, 2012
Dex Offshore Letter 2:	Letter from David E. Simpson, Dex Offshore Entertainment LLC, Apr. 16, 2012

Dex Offshore Letter 3:	Letter from David Simpson, Dex Offshore Entertainment LLC, Jul. 23, 2012
Dex Offshore Letter 4:	Letter from David Simpson, Dex Offshore Entertainment LLC, Jul. 24, 2012
Donovan Letter:	Letter from Doug Donovan, Oct. 1, 2012
Donovan P. Letter:	Letter from Patrick Donovan, Sep. 27, 2013
Durward Letter:	Letter from James Durward, May 7, 2012
EarlyShares Letter 1:	Letter from Maurice Lopes, CEO, EarlyShares.com, Inc., Jul. 10, 2012
EarlyShares Letter 2:	Letter from Maurice Lopes, CEO, EarlyShares.com, Inc., Aug. 16, 2012
EnVironmental Letter:	Letter from Richard W. Marks, President, EnVironmental Transportation Solutions, LLC, Jun. 14, 2012
Equistratus Letter:	Letter from T.H. Ison, Equistratus, Mar. 22, 2013.
Escrow.com Letter:	Letter from Brandon Abbey, President and Managing Director, Escrow.com, Aug. 31, 2012
ExpertBeacon Letter:	Letter from Mark Law, CEO, ExpertBeacon.com, Seattle, Washington, Apr. 14, 2012
Fairhurst Letter:	Letter from Kraig Fairhurst, Apr. 11, 2012
Feldman Letter:	Letter from Aleksandr Feldman, Aug. 17, 2012
Ferguson Letter:	Letter from Zachary Ferguson, Jun. 13, 2013
Franken Letter:	Letter from Sen. Al Franken, U.S. Senator, Jan. 4, 2013

Frankfurt Letter:	Letter from Thomas Selz, *et al.*, Frankfurt Kurnit Klein & Selz PC, Dec. 28, 2012
Friedman Letter:	Letter from Howard M. Friedman, Professor of Law Emeritus, University of Toledo, Apr. 27, 2012
Front Page Letter:	Letter from Robert Hoskins, Vice President, Media Relations, Front Page Public Relations, Mar. 2, 2013
Frost Letter:	Letter from Henry Frost, Sept. 17, 2012
FundaGeek Letter:	Letter from Cary Harwin, President, Co-Founder, FundaGeek.com, May 26, 2012
Genedyne Letter 1:	Letter from Thomas Braun, Genedyne Corporation, Aug. 16, 2012
Genedyne Letter 2:	Letter from Thomas Braun, Genedyne Corporation, Sept. 11, 2012
Gomez Letter 1:	Letter from Christian Gomez, Hayward, California, Nov. 12, 2012
Gomez Letter 2:	Letter from Chris Gomez, Hayward, California, Nov. 24, 2012
Gornick Letter:	Letter from Stephen Gornick, May 20, 2012
Gregory Letter:	Letter from Paul M. Gregory, Aug. 2, 2012
Grow VC Letter:	Letter from Jouko Ahvenainen and Valto Loikkanen, Co-founders, Grow VC, Jun. 15, 2012
Hakanson Letter:	Letter from Sten Erik Hakanson, Sep. 18, 2013
Hansen Letter:	Letter from Brian G. Hansen, Oct. 17, 2012

Hemlof Letter:	Letter from Loris Hemlof, Australia, Sept. 1, 2012
Hensel Letter:	Letter from Karl Hensel, May 15, 2012
High Tide Letter:	Letter from Albert Hartman, CEO, High Tide, Jun. 4, 2012
Holofy Letter:	Letter from Chris Nunes, Esq., CEO, Holofy, May 15, 2013
Hutchens Letter:	Letter from Matthew C. Hutchens, Sep. 29, 2013
Immix Letter:	Letter from Jerry Carleton, Robert Scott, Kane Lemley, and John French, Immix Law Group PC, Oct. 4, 2012
InitialCrowdOffering Letter:	Letter from Perry D. West, Esq., InitialCrowdOffering.com, May 4, 2012
International Franchise Association Letter:	Letter from Jay Perron, Vice President, Government Relations and Public Policy, International Franchise Association, Jan. 31, 2013
Isenberg Letter:	Letter from Daniel Isenberg, Ph.D., Apr. 15, 2012
Jain Letter:	Letter from Runjan A. Jain, Apr. 12, 2012
Koller Letter:	Letter from Jonathan Koller, May 2, 2012
Le Jeune Letter:	Letter from Yann Le Jeune, CEO, French Crowdfund Platform, Sept. 1, 2012
Landon Letter 1:	Letter from Christine Landon, Jul. 18, 2012
Landon Letter 2:	Letter from Christine Landon, Jul. 18, 2012
Larkey Letter:	Letter from Caren L. Larkey, Film Producer, May 23, 2012

LeGaye Letter:	Letter from Daniel E. LeGaye, The LeGaye Law Firm, P.C., Sept. 7, 2012
Li Letter:	Letter from H. Bruce Li, Ph.D. P.E., Apr. 27, 2012
Leonhardt Letter 1:	Letter from Howard J. Leonhardt, CEO, Leonhardt Ventures and CalXStars Business Accelerator, Co-Leader Startup, California, Sept. 29, 2012
Leonhardt Letter 2:	Letter from Howard J. Leonhardt, Founder, Leonhardt Ventures, Jul. 11, 2013
Liles Letter 1:	Letter from Mike Liles, Jr., Seattle, Apr. 17, 2012
Liles Letter 2:	Letter from Mike Liles, Jr., Apr. 18, 2012
Lingam Letter 1:	Letter from Kiran Lingam, Esq., Apr. 11, 2012
Lingam Letter 2:	Letter from Kiran Lingam, Apr. 24, 2012
Lingam Letter 3:	Letter from Kiran Lingam, May 1, 2012
Litwak Letter:	Letter from Mark Litwak, Apr. 17, 2012
Lumeo.com Letter:	Letter from Brian McDonough, CEO & Founder, Lumeo.com, Sept. 6, 2012
Loofbourrow Letter:	Letter from Joe Loofbourrow, Apr. 24, 2012
MacDonald Letter:	Letter from Larry A. MacDonald, May 1, 2012
Markay Letter:	Letter from Mark W. Kanter, Founder, Markay Company, Jun. 25, 2012
Markel Letter:	Letter from Thomas O. Markel, Jr., Apr. 26, 2012

Matthew Letter:	Letter from Matthew L., Aug. 19, 2012
Maugain Letter:	Letter from Etienne Maugain, Apr. 12, 2012
Merkley Letter:	Letter from Sen. Jeffrey A. Merkley, *et al.*, U.S. Senate, Dec. 10, 2012
Mollick Letter:	Letter from Dr. Ethan Mollick, Assistant Professor of Management, The Wharton School, University of Pennsylvania, Dec. 17, 2012
Moore Letter:	Letter from Jason Moore, Manager, Apr. 23, 2012
Moss Letter:	Letter from Frank H. Moss, Jr., Adjunct Professor of Info Systems & Tech, Sept. 26, 2012
Movie Stream Productions Letter:	Letter from Dorian S. Cole, Movie Stream Productions, Jun. 1, 2012
NanoIVD Letter:	Letter from Sunnie P. Kim, Founder, CEO, NanoIVD, Inc., May 18, 2012
NASAA Letter:	Letter from Jack Herstein, President, North American Securities Administrators Association, Jul. 3, 2012
NCA Letter:	Letter from National Crowdfunding Association, May 11, 2012
NSBA Letter:	Letter from David R. Burton, General Counsel, National Small Business Association, Jun. 12, 2012
Ohio Division of Securities Letter:	Letter from Andrea L. Seidt, Commissioner, Ohio Division of Securities, Jan. 9, 2013
Old Takoma Letter:	Letter from Patricia Baker, Executive Director, Old Takoma Business Association, May 24, 2013

P2PVenture.org Letter:	Letter from Frederic Baud, President P2PVenture.org, France, Sept. 1, 2012
Parker Letter:	Letter from Joe Parker, CEO, Apr. 12, 2012
Pearfunds Letter:	Letter from Hector Vizcarrondo, Co-founder & CEO, Pearfunds, LLC, Jul. 30, 2012
Pena Letter:	Letter from Fred Pena, May 10, 2012
Petazzoni Letter:	Letter from Enrico Petazzoni, Feb. 15, 2013
Philipose Letter 1:	Letter from Roy Philipose, Jun. 28, 2012
Philipose Letter 2:	Letter from Roy Philipose, Jun. 30, 2012
PMIRARQ Letter:	Letter from Steven A. Cinelli, Founder & CEO, PMIRARQ, Jul. 26, 2012
PPM Logix Letter:	Letter from Mike Stapleton, PPM Logix, May 22, 2012
Priore Letter:	Letter from Robert Priore, May 2, 2012
PREA Letter:	Letter from Paul White, Professional Real Estate Advisors Inc., Jul. 22, 2013
Projectheureka Letter:	Letter from Anthony and Erika Endres, Projectheureka LLC, Sep. 10, 2013
Ramos Letter:	Letter from Robert Ramos, Aug. 14, 2013
RDA Letter:	Letter from Harry Shamir, Principal, RDA Co., Apr. 16, 2012
RentalCompare Letter:	Letter from Darryl Aken, RentalCompare, Apr. 24, 2013
Replay Games Letter:	Letter from Paul Trowe, Replay Games, Sept. 4, 2012

Rey Media Letter:	Letter from David Rey, Rey Media, Apr. 24, 2013
RFPIA Letter 1:	Letter from T.W. Kennedy, BE., CEO, Kennedy Associates, Apr. 20, 2012
RFPIA Letter 2:	Letter from T.W. Kennedy, B.E., Regulated Funding Portal Industry Association, Jul. 25, 2012
RFPIA Letter 3:	Letter from T.W. Kennedy, B.E., Regulated Funding Portal Industry Association, Aug. 18, 2012
RFPIA Letter 4:	Letter from T.W. Kennedy, B.E., Regulated Funding Portal Industry Association, Aug. 18, 2012
RFPIA Letter 5:	Letter from T.W. Kennedy, B.E., Regulated Funding Portal Industry Association, Jul. 9, 2013
Risingtidefunding.com Letter:	Letter from Neal C. McCane, CFA, Co-Founder, risingtidefunding.com, Sept. 26, 2012
Richter Letter:	Letter from Paul W. Richter, PW Richter PLC, Feb. 7. 2013
Roberts Letter:	Letter from Ward Roberts, May 25, 2012
RocketHub Letter 1:	Letter from Alon Hillel-Tuch, Co-Founder & CFO, RocketHub.com, May 1, 2012
RocketHub Letter 2:	Letter from Alon Hillel-Tuch, Founder & CFO, RocketHub.com, Nov. 14, 2012
Rocketjet Letter:	Letter from Daniel E. Nelson, PhD, JD, Chairman, Rocketjet Corporation, Apr. 13, 2012
Romano Letter:	Letter from Robert Romano, Apr. 12, 2012

Schumer Letter:	Letter from Jacob J. Schumer, Staff Editor, Vanderbilt Journal of Entertainment and Technology Law, Sept. 4, 2012
Schwartz Letter:	Letter from Andrew A. Schwartz, Associate Professor of Law, University of Colorado, Jun. 13, 2013
Shefman Letter:	Letter from Michael Shefman, Aug. 21, 2013
Sidman Letter 1:	Letter from Charles L. Sidman, MBA, PhD, Manager, Crowdfunding Investment Angels, Nov. 30, 2012
Sidman Letter 2:	Letter from Charles L. Sidman, MBA, PhD, Manager, Crowdfunding Investment Angels, Mar. 8, 2013
Sjogren Letter:	Letter from Karl M. Sjogren, Apr. 25, 2013
Sklar Law Letter:	Letter from Navid More, Associate Attorney, Sklar Law, P.C., Jun. 24, 2012
Skweres Letter:	Letter from Mary Ann Skweres, Independent Film Professional, Jun. 3, 2012
Spinrad Letter 1:	Letter from Paul Spinrad, Jul. 26, 2012
Spinrad Letter 2:	Letter from Paul Spinrad, Jan. 2, 2013
STA Letter:	Letter from Charles V. Rossi, President, The Securities Transfer Association, Inc., Sept. 17, 2012
Stafford Letter:	Letter from Darrell M. Stafford, Apr. 11, 2012
Start.ac Letter:	Letter from Rod Turner, CEO and Founder, Start.ac CrowdFunding business, Jun. 12, 2012

Stephenson Letter:	Letter from Andrew D. Stephenson, Esq., Washington, May 14, 2012
Sutter Securities Letter:	Letter from Robert A. Muh, Chief Executive Officer, Sutter Securities Incorporated, Oct. 25, 2012
Sykes Letter:	Letter from Chad Sykes, Apr. 15, 2012
Tally Letter:	Letter from John Tally, May 28, 2012
TechnologyCrowdFund Letter 1:	Letter from Robert B. Nami, CEO/President, TechnologyCrowdFund.com, May 1, 2012
TechnologyCrowdFund Letter 2:	Letter from Robert B. Nami, President/CEO, TechnologyCrowdFund.com, May 30, 2012
TechnologyCrowdFund Letter 3:	Letter from Robert B. Nami, President/CEO, TechnologyCrowdFund.com, Jun. 5, 2012
TechnologyCrowdFund Letter 4:	Letter from Robert B. Nami, President/CEO, TechnologyCrowdFund.com, Jun. 7, 2012
TechnologyCrowdFund Letter 5:	Letter from Robert B. Nami, CEO/President TechnologyCrowdFund, Jun. 28, 2012
TechnologyCrowdFund Letter 6:	Letter from Robert B. Nami, CEO/President TechnologyCrowdFund, Jan. 16, 2013
The Growth Group Letter:	Letter from Elliott Dahan, Managing Partner, The Growth Group, May 1, 2012
The Motley Fool Letter:	Letter from Ilan L. Moscovitz and John Maxfield, The Motley Fool, Jun. 27, 2012
Tomkinson Letter:	Letter from Paul Tomkinson, Sept. 21, 2012
Totsie Productions Letter:	Letter from Kevin J. Tostado, Producer, Totsie Productions, Jan. 20, 2013
Tri Valley Law Letter:	Letter from Marc A. Greendorfer, Tri Valley Law, Apr. 27, 2012

Verdant Ventures Letter:	Letter from Ross Randrup, Managing Member, Verdant Ventures LLC, Jun. 17, 2012
Vermont Investors Letter:	Letter from Sebastian Sweatman, Vermont Investors Forum, Apr. 25, 2012
Vim Funding Letter:	Letter from Shane M. Fleenor, Vim Funding, Inc., Creator of Funding Launchpan, Co-founder and CLO, Apr. 27, 2012
Vogele Letter:	Letter from John Vogele, Dec. 26, 2012
VS Technology Letter:	Letter from Michael Van Steenburg, CEO of VS Technology Inc., Aug. 31, 2012
VTNGLOBAL Letter:	Letter from Peter Ojo, CEO, VTNGLOBAL, May 31, 2012
West Letter:	Letter from Perry D. West, Esq., Apr. 13, 2012
Whitacre Letter:	Letter from William L. Whitacre, Esq., Apr. 18, 2012
Whitaker Letter:	Letter from John R. Fahy, Partner, Whitaker Chalk Swindle Schwartz PLLC, Nov. 8, 2012
Windhom Letter:	Letter from Stevario Windhom, Jun. 13, 2012
Winfiniti Letter:	Letter from Dan Grady, CEO, Winfiniti, Inc., Apr. 11, 2012
Williams Letter:	Letter from John P. Williams, Feb. 7, 2013
Williams K. Letter:	Letter from Keith Williams, Mar. 2, 2013
Wright Letter 1:	Letter from Martin Wright, Aug. 7, 2012

Wright Letter 2:	Letter from Martin Wright, Aug. 7, 2012
Wright Place Letter:	Letter from Dr. Letitia S. Wright, May 4, 2012

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