

MEMORANDUM

FROM: Timothy White
Special Counsel
Office of the Chief Counsel, Division of Trading and Markets
U.S. Securities and Exchange Commission

RE: Meeting with Representatives from NACHA

DATE: April 15, 2013

On April 15, 2013, Commission staff spoke with representatives of NACHA, to discuss issues regarding the implementation of Title III of the Jumpstart Our Business Startups Act, including payment mechanism for funding portals.

The following Commission representatives participated: Joseph Furey, Joanne Rutkowski, Leila Bham, Timothy White, and WonJu Sul from the Division of Trading and Markets; Tamara Brightwell and Sebastian Gomez-Abero from the Division of Corporation Finance; and Dorothy McCuaig from the Office of the General Counsel.

The following representatives of NACHA participated: Michael Herd, Managing Director, ACH Network Rules; Jane Larimer, Executive VP, ACH Network Services, and General Counsel.

The attached memorandum below was provided to the representatives of NACHA in advance of the meeting.

Background Memorandum on Crowdfunding: Payment Mechanisms

Background on Crowdfunding

The JOBS Act creates a new class of exempt public offerings: so-called “crowdfunding” offerings, in which an issuer would seek to raise a target amount of funds through an offer of securities on the Internet. During the offer period, investors would make investment commitments, and once the target amount of funds is reached, the funds would be transferred to the issuer in exchange for the securities.

The crowdfunding exemption is subject to several conditions, one of which is that an issuer may raise only up to \$1 million through such offerings in any 12-month period. Investors are also subject to limits on the amount they can invest in crowdfunding offerings in any 12-month period; the limit generally ranges from \$2,000 to \$100,000, depending on the income and net worth of the individual investor.

The exemption also requires that crowdfunding offerings must be conducted through an intermediary, who is either a registered broker, or a registered “funding portal,” a new category of limited purpose broker. Under the statute, funding portals are prohibited from, among other things, holding, managing, possessing, or handling customer funds or securities.

Although securities-based crowdfunding cannot occur until the Commission adopts rules in this area, there currently exist many donation- and contribution-based crowdfunding platforms. We understand from discussions with industry participants that they often rely on electronic payment mechanisms such as PayPal, rather than credit cards or wire transfers, reflecting a decision that is driven in large part by costs.

We are trying to gain a better understanding of these mechanisms, and any potential regulatory gaps, as we work on the proposed rulemaking. We set forth a few specific questions below.

Questions on Payment Mechanisms

1. Could you please explain to us the rules governing electronic payment mechanisms, in particular in light of the need to protect investors, assure cleared funds, and maintain secure transfers.
2. We understand that a transfer of funds for the purchase of securities would not be an “electronic funds transfer” for purposes of the Electronic Funds Transfer Act and Regulation E. How would this impact the use of ACH for the purchase of securities, in terms of what investor or other protections would (and would not) be in place?
3. What happens if monies are misdirected or misappropriated during the time when ACH payments are pending clearance? What kind of rights would investors have, and under what circumstances?

4. In general, what are the pitfalls in effecting payments? For instance, what could go wrong in the process? How are investors protected, and what recourse do they have if something goes wrong?
5. Are there any regulatory gaps that would emerge were we to permit the use of ACH or any other particular methods for payment? If so, how might they be addressed in our rulemaking?