



The Crowdfund Investing Regulatory Advocates
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By Email (rule-comments@sec.gov) and U.S. Mail

June 5, 2012

U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090
Attn: Ms. Elizabeth M. Murphy, Secretary

Re: Public comments on SEC Regulatory Initiative under the JOBS Act pertaining to General Solicitation in Titles II & Titles III

Ladies and Gentlemen:

I am writing on behalf of the Crowdfund Intermediary Regulatory Advocates (“CfIRA”). On behalf of CfIRA, I wish to thank you for the opportunity to submit these written comments relating to the implementation of Title III of the Jumpstart Our Business Startups Act (the “Act”). In drafting rules and regulations to implement the Act, we wanted to propose certain safe-harbors that would address certain fundamental issues that have arisen with regard to the Act and to the development of the crowdfunding industry.

I. POSTING CRITERIA

A. Background: The Investment Advisers Act of 1940, as amended, defines an “investment adviser” as anyone who (i) for compensation, (ii) is engaged in the business of (iii) providing advice to others or issuing reports or analysis regarding securities.

B. Question: Is a funding portal that refuses to post the offerings of certain issuers an investment adviser?

C. Considerations: CfIRA agrees that any funding portal that directly engages in subjective evaluation of businesses for purposes of directing investors on its website to the offerings of such businesses would be engaged in the business of providing advice to others regarding securities and, as a result, should be regulated as an investment adviser. However, we do think that funding portals should be permitted to enforce objective listing criteria without being deemed to be an investment adviser. For example, we expect that certain intermediaries will solely focus on debt offerings, while others will list only equity offerings. Certain of our members have also indicated their intent to not list offerings of businesses that they find objectionable, whether from a moral or legal perspective. For example, certain portals may

refuse to list any business relating to: (i) firearms, (ii) tobacco, and (iii) sex-oriented businesses. Similarly, some of our members have indicated their intent to focus on certain size of offerings or issuers, limiting their offerings to those that either exceed or are less than a certain threshold or to issuers meeting certain metrics (i.e., valuation/EBITDA/revenue). Finally, we expect portals to focus on niche segments of the economy, such as the arts and film or socially conscious investing.

D. Conclusion: We believe that funding portals should be permitted to enforce objective and clearly disclosed listing criteria for issuers without behind deemed to be investment advisers. In practice, the safe-harbor should be relatively broad, allowing for niche funding portals (for example, portals that focus solely on the film-making industry) to develop as the crowdfunding industry develops.

E. Proposed Safe-Harbor: Any funding portal that refuses to list or sell the securities of an issuer, or that only lists or sells the securities of certain issuers, in each case as a result of objective and clearly disclosed listing criteria, shall not be deemed, as a result of the promulgation and enforcement of such criteria, to be an investment adviser within the meaning of Section 202(a)(11) of the Investment Advisers Act of 1940, as amended.

II. FRAUD AND RISK OF FRAUD

A. Background: The Investment Advisers Act of 1940, as amended, defines an “investment adviser” as anyone who (i) for compensation, (ii) is engaged in the business of (iii) providing advice to others or issuing reports or analysis regarding securities.

B. Question: Is a funding portal that refuses to post the offerings of certain issuers an investment adviser?

C. Considerations: Part of the rationale behind crowdfunding is the “intelligence of the crowd,” and incidences of fraud are discovered by the crowd on existing crowdfunding platforms not involving the sale of securities.¹ Additionally, it is expected that intermediaries, whether through their own diligence efforts, the due diligence of third-party service providers, and/or the diligence of crowd vetting will discover certain indicia of fraud or potentially fraudulent activity.

D. Conclusion: The Act in no way mandates that intermediaries list or sell the stock of all issuer that desire to use the services of said intermediary. In fact, the Act requires intermediaries to take measures to reduce the risk of fraud. We believe that funding portals should have the ability to refuse to list or sell the securities of an issuer, or remove an existing listing of an issuer, if the funding portal has some reasonable basis for believing that an offering or those participating in an offering may be fraudulent or presents a heightened risk of fraud to investors.

F. Proposed Safe-Harbor: Any funding portal that refuses to list or sell the securities of an issuer, or cancels a listed offering, because such funding portal suspects, with or

¹ For example, please see: <http://betabeat.com/2012/04/this-is-what-a-kickstarter-scam-looks-like/>

without evidence, that an offering may be fraudulent or presents a risk of fraud to investors shall not be deemed, as a result of such refusal, to be an investment adviser within the meaning of Section 202(a)(11) of the Investment Advisers Act of 1940, as amended.

III. CROWD COMMENTARY

A. Background: The power of crowdfunding is, in part, based on its strong connection with social media. In our view, the success of crowdfunding will be based upon the quick and efficient exchange of information. As stated above, the crowd is powerful at discovering fraud. However, we also expect crowd interaction with entrepreneurs to be a powerful factor in building strong companies, offering suggestions on improving businesses and products. We expect this information to consist of objective analysis and subjective thoughts and concerns about an offering, and we believe each is appropriate to be exchanged between investors. We highly suggest the staff review the interaction on existing crowdfunding (non-security) sites, such as www.kickstarter.com, to discover how powerful these exchanges of information can be.

B. Question: May a funding portal host discussion boards and other interactive information exchanges?

C. Considerations: The reality is, whether hosted on a funding portal's site or not, the crowd is going to exchange information about offerings via social media and their social networks. Once information exists on the internet, there is no way for a funding portal or for an issuer to control or limit the spread of such information. Given this expectation, we suggest it would be most efficient to host such informational exchanges and message boards on the funding portal's site. In this way, investors can share information, and ask questions of issuers. In short, the crowd will vet and discuss the issuers and their businesses. Issuers can respond and interact with their investors (and potential investors), and learn more about their products and prospects.

D. Conclusion: Information will be exchanged about issuers, the only question is where. For a variety of reasons, including encouraging a transparent crowdfunding marketplace, we believe that funding portals should be permitted to host message boards and other information exchanges. Importantly, by hosting informational exchanges, the portals will be helping to avoid asymmetry of information, as a centralized location for information should provide a mechanism for the open and transparent exchange of information.

E. Proposed Safe-Harbor: A funding portal which hosts discussion panels and other mediums for the exchange of information between investors and issuers shall not be required to register as a broker or dealer under Section 15(a)(1) of the Securities Exchange Act of 1934, as amended, and shall not be deemed to be an investment adviser within the meaning of Section 202(a)(11) of the Investment Advisers Act of 1940, as amended, so long as the funding portal, its officers, directors, and employees, do not participate (other than moderating discussions and removing postings that are abusive) in such discussion forums other than to enforce clearly disclosed rules regarding posting and the exchange of information.

V. PEER-TO-PEER LENDING

A. Background: Obviously, crowdfunding can take many forms. However, we would posit that when most people think of crowdfunding, they think of equity crowdfunding. In fact, however, debt crowdfunding, or peer-to-peer lending, is probably going to be the most utilized crowdfunding capital raising mechanism in the small business space. The reasons are two-fold. First, “idea” or growth companies are more likely to need to use “equity” returns to entice investors. These early-stage businesses fail at a high rate, and investors will need to be compensated for taking this risk. Existing small businesses, however, present a completely different investment opportunity. First, existing businesses will have been in business for some period of time. Second, these businesses will have (i) financial records, (ii) a credit history and (iii) cash flow. As a result of these attributes, investors will be willing to accept a more limited return, as the investment will be less risky. The issue with peer-to-peer lending is, of course, that someone has to set an interest rate. Given the various attributes of a business, what is the risk of that loan defaulting and, as a result, what interest rate should be charged to compensate for that risk? Early in the history of the two existing peer-to-peer lending institutions, Prosper and LendingClub, the “auction” process was utilized. In effect, borrowers set the interest rate and lenders decided whether or not to invest. From what we understand, the auction model was not successful because the interest rates were tied to the popularity of the offering rather than objective measures of credit risk. In effect, “ideas” were being funded at interest rates that did not compensate the investors for objective credit risk, defaults were high and the system was abandoned. Both Prosper and LendingClub have moved to the underwriting model, where objective criteria are used to create a credit rating and the interest rate charged on a loan are based on that credit rating.

B. Question: Is a funding portal that uses objective criteria to set interest rates acting as an investment adviser?

C. Considerations:

a. Security: in an equity crowdfunding raise, investors will most likely purchase common stock, which is the last to get paid. On the other hand, a peer-to-peer investor will have a security that is paid prior to any equity security (including preferred stock). In addition, unlike equity offerings, which may not require the payment of dividends and are not required to explain the process for the return of capital, debt securities will have set maturity dates and a clear process to liquidity. Investors are by definition purchasing a “safer,” security in the peer-to-peer lending arena, with a clearer liquidity path.

b. Objective criteria: we agree that subjective underwriting is an activity that is best regulated under the broker/dealer or investment adviser laws. However, it is also true that there are objective measures of credit risk. Quite simply, the less time a business has been operating, the more likely that a loan to that business is to default. Similarly, the higher the debt/equity ratio, the more likely a loan is to default. An objective underwriting process will result in such loans with these characteristics paying a higher interest rate – compensating (and thus protecting) investors from this risk.

c. Cost: our members have no intent to advise investors on the advisability of purchasing any security and, therefore, plan to limit their underwriting solely to applying their objective criteria of credit risk. By mandating registration under the broker/dealer and/or investment adviser rules, the cost of such registration will be passed on to issuers and investors with no tangible benefits to either.

d. Small businesses: the cost of registration will also be placed on the segment of crowdfunding least able to accept such costs. The average commercial peer-to-peer loan is \$18,000. If peer-to-peer intermediaries are required to register as a broker/dealer and/or investment adviser, it will be forced to pass on that cost to issuers/investors. Doing so will raise the cost of raising capital on the segment of our economy that currently faces the biggest hurdles raising capital – small businesses.² This incremental cost increase will make peer-to-peer lending inefficient at best, and could even be fatal to peer-to-peer lending.

D. Conclusion: We believe that interest rates can be set by objective criteria. We understand, however, that there is a fine line between providing objective underwriting and providing objective and subjective investment advice. We think the combination of (i) disclosure and (ii) investor education can be used to address these concerns.

E. Proposed Safe-Harbor: A funding portal which engages in underwriting activities for the purpose of setting interest rates for debt instruments which are to be sold or offered for sale by such intermediary shall not be required to register as a broker or dealer under Section 15(a)(1) of the Securities Exchange Act of 1934, as amended, and shall not be deemed to be an investment adviser within the meaning of Section 202(a)(11) of the Investment Advisers Act of 1940, as amended, so long as:

a. the underwriting is based upon objective criteria such as years in business, credit score, loan-to-asset ratios and debt-to-income ratios;

b. the funding portal prominently discloses that it does limited underwriting, solely for the purposes of setting interest rates, based on objective information provided by the issuer; and

c. The funding portal holds itself out as a listing or matching service and not as providing any other securities-related services except for the limited underwriting discussed above.

² We believe that “idea” and early-stage companies are most likely going to be required to issue equity, as investors will demand unlimited upside for the significant risk of investing in early-stage companies. On the other hand, existing small businesses will gravitate toward debt instruments, which will have a fixed rate of interest and known maturity date.

VII. MATCHING

A. Background: We anticipate that funding portals will provide search and other information management tools so that investors can focus their efforts on companies that meet certain criteria. So, for example, we anticipate that an investor will be able to search by industry, years in business, size of business (whether by revenue or some measure of profitability), size of offering, number of investors, average size of investment, geographic location and percentage of offering funded. We also anticipate that the portals will notify investors when companies meeting their criteria register with the funding portal.

B. Question: Can a funding portal provide search and information management tools to investors, and provide notices to investors when companies meeting their criteria register with such portal?

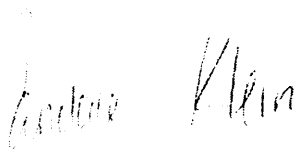
C. Considerations: As indicated elsewhere in this letter, we expect social media and social networks to play a huge role in the success of crowdfunding. As can be seen by the success of crowdfunding on existing platforms (non-security), investors want to invest in their communities, whether that is geographically based or, instead, based on some other criteria (such as industry). While we do expect niche crowdfunding sites to develop, we also expect that generalized sites will provide information management tools so that investors can find businesses meeting their criteria for investment. Such tools will permit investors to more easily find companies meeting their investment criteria.

D. Conclusion: A portal that provides information management tools, such as search functions and automatic notification mechanism, should not be deemed to be acting as an investment adviser.

E. Proposed Safe-Harbor: A funding portal which provides information management, search and automatic notification tools shall not be required to register as a broker or dealer under Section 15(a)(1) of the Securities Exchange Act of 1934, as amended, and shall not be deemed to be an investment adviser within the meaning of Section 202(a)(11) of the Investment Advisers Act of 1940, as amended, so long as such tools are based solely on objective criteria (such as industry, years in business, size of business (whether by revenue or some measure of profitability), size of offering, geographic location and percentage of offering funded) and the funding portal holds itself out as a listing or matching service and not as providing any other securities-related services.

We are available to further discuss the recommendations and concerns expressed in this letter. We further expect to provide additional safe-harbor requests in the future, as we have several working groups gathering information on what “best practices” can be developed to serve issuers and investors alike. We look forward to supporting the work of the Staff over the course of the next few months and to making crowdfunding a success for investors, small business and entrepreneurs.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Candace Klein". The signature is written in a cursive style with a large initial 'C'.

Candace Klein
Founder & CEO, SoMoLend

A handwritten signature in black ink, appearing to read "Vince Molinari". The signature is written in a cursive style with a large initial 'V'.

Vince Molinari
Founder & CEO, GATE Technologies