

July 26, 2010

Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street N.E.
Washington, DC 20549

Dear Ms. Murphy:

I am pleased at the opportunity to comment on Title III of the JOBS Act, because I have long believed in the positive potential of equity crowdfunding. I first [proposed](#) a "crowdfunding exemption" to securities laws in late 2009, and collaborated with the [Sustainable Economies Law Center \(SELC\)](#) to [crowdfund](#) and write their July 1, 2010 [petition](#) to the SEC advocating such an exemption, "Request for rulemaking to exempt securities offerings up to \$100 from registration under Section 5 of the Securities Act of 1933." I discussed the SELC's petition with SEC staff and guests at the 2010 SEC Government-Business Forum on Small Business Capital Formation. Meanwhile, I have also been working with many others to refine and promote the idea, and covering our progress on my blog, [Change Crowdfunding Law](#).

I respectfully submit the following contributions to the discussion of the new crowdfunding legislation, and I thank the Commission for the interest and care that they are clearly bringing to the rulemaking process.

Small local investments. Among the more recent other public comments on Title III of the JOBS Act, I especially want to "second" the [letter from the American Sustainable Business Council](#) (July 16, 2012) proposing a two-tier approach that specifically recognizes small local investments. I believe this would bring communities together and foster their economic vitality and resilience.

Prohibit dynamic pricing. Section 4A(b)(1)(G) requires that issuers make available to potential investors "the price to the public of the securities or the method for determining the price." I favor requiring offerings to include fixed prices, and prohibiting any dynamic pricing schemes, because they

might be constructed to apply time pressure: "Shares are available right now for \$5, but will go up 50 cents for every hour you wait-- act now!"

Centralized database. In my [August 26, 2010 comment letter on the SELC petition](#), I suggest that the SEC might itself operate the back-end of the sole legal crowdfunding market, and publish an API that allows front-end "crowdfunding platforms" ("intermediaries" and "funding portals" in the legislation) to create and manipulate the underlying database objects representing users, offerings, transactions, and other elements of the market. I believe such an approach deserves additional consideration given that under section 4A(a)(8) of the new legislation, investors can't be allowed to purchase CF-exempt securities beyond the annual limits, even from multiple issuers via multiple intermediaries. A centralized database approach would make such aggregate checks very simple. As also noted in the letter, such an approach could be self-funding ("a 'cash cow,'" in the original letter's wording), through the SEC's taking a small fee from each transaction.

Investor education and qualification exam. Sec. 302(a) of the JOBS Act requires crowdfunding intermediaries to ensure that each investor reviews educational material about the risks of investing, answers questions demonstrating that they understand the material, and affirm that they may lose their entire investment and can bear the loss. The rest of this comment letter addresses these requirements.

As a general approach, crowdfunding intermediaries can publish the required information online, and operate an automated, multiple-choice qualifying examination that "educationally accredits" potential investors who answer all questions correctly and make the required affirmations. I suggest the following four general strategies for this examination's content and presentation:

1. Randomized multiple-choice order and wordings

To discourage easy cheats via shared answer keys, require servers to randomize the order of the choices presented (keeping track, of course, when scoring the answers). If needed, the traditional "None of the above" and "All of the above" may be reworded with "...the other choices."

As a further deterrent to would-be cheats, write all multiple-choice answers using multiple interchangeable terms for grammatical parts of each sentence. Require servers to then randomly generate different choices using these parts for different users. For example, the template:

If I am {smart, intelligent, wise} about {investing, how I invest}, I {will, am sure to} make money.

...will generate twelve functionally equivalent choices, starting with, "If I am smart about investing, I will make money."

On the software side, this randomized string substitution scheme would be extremely simple to implement. A bad actor could write corresponding software to "outwit" this scheme and auto-fill correct answers nevertheless, but doing so would demand more effort and leave a more traceable trail than simply distributing text-based answer keys.

2. Accessible language

To maximize understanding of the text, use clear, non-legalistic language, while retaining an appropriately authoritative tone. To maximize retention, employ language that is vivid, but avoid the possibility of its sounding dated or unfamiliar.

3. "Socratic" multiple-choice

Use the multiple-choice medium to express how and how not to think about the risks described, rather than making the incorrect choices tricky or subtle for the sake of exam difficulty. As incorrect choices, list thoughts and feelings that are common and appealing but nevertheless reflect the risk being described. Judicious use of parody can help underscore the incorrectness of such choices, reinforcing the lesson.

4. Time delay for resubmission

Users should be required to answer 100% of the questions correctly before being allowed to invest. If they do not, the server should give them the opportunity to try again. To encourage users to engage with the content

rather than their (or their automated agents') simply trying different checkbox combinations and clicking "Submit" until they get through, the server should time out for 5 minutes or so after each submission.

Examples

Listed below are some ideas for the examination's content, example questions and multiple-choice answers, organized around the investment prospectus concept of "Risk Factors." I like this term here, but "Red Flags" might be more accurate, because the advice is not tailored to specific offerings.

Some of these examples (noted and grouped at the end) are lifted from the SEC publication "[Investor Alert: Social Media and Investing - Avoiding Fraud](#)" (January, 2012). For consistency, the correct answers are always listed last, but in real life the multiple-choice ordering should be randomized by the server, as described above. I haven't written the answers in the randomizable-wording format also described above, but could go ahead if the Commission so desires.

Risk Factors / Red Flags

Honest Financial Loss

Most new businesses fail, no matter how hardworking or capable the people behind it are, or how good their plan is. [According to the US Bureau of Labor Statistics](#), about 1/3 of new businesses don't last more than 3 years, and most don't survive past 6 years. Similarly, creative arts agents tell of piles of unsold manuscripts, screenplays, demo recordings, independent films, and other efforts, in contrast to the few that yield business contracts or otherwise become profitable. If you invest in a new business or other project, you will probably lose your money. The success rate may be higher if you invest in an expansion by an already healthy, existing business, but there are no guarantees.

Choose the statement below that makes the most sense.

- If someone works hard, they are sure to succeed, especially if they are starting a new business -- that's the American way.
- I know that most new businesses fail, but this one won't. The people behind it are too smart.
- I want to invest in this venture and help it succeed because I believe in it. But I recognize that statistically, it probably won't. I understand that I may lose my entire investment.

Liquidity

Even if your investment does increase in value (it may decrease or disappear entirely), you probably won't be able to cash it in at a time of your choosing. Expect it to be locked away for a while. You should not invest any money that you may need in the foreseeable future. Unlike stock in exchange-traded companies, crowdfunding stock cannot be readily converted into cash.

Choose the statement below that makes the most sense.

- I'll invest in this offering now, watch closely to see how it goes, and pull my money out if things seem to be going south.
- I'll need this money for tuition in September, but until then I'll try to make it work for me by investing in this.
- I'd like to invest in this because I'm interested in it. If it goes well, I might be able to cash out in a few years, but I'd rather just continue being a part of it.

Technical Complexity

Some offers are based on technology. The most trustworthy of these demonstrate a working prototype in a way it would be more difficult to fake than to create legitimately. With others, where an issuer promises a device or system not yet developed, they should be able to explain clearly how they will proceed, and answer relevant technical questions.

Beware any offering from someone who points to their purported credentials or past experience rather than answering technical questions directly, and beware of "technical explanations" that rely on comparisons or metaphor rather than describing the actual components of the proposed solution. Don't invest in any offering that you do not fully understand yourself, or that someone you know with relevant expertise hasn't reviewed and judged as trustworthy.

Choose the statement below that makes the most sense.

- It says that this cutting-edge research will discover a limitless source of energy by poking a tiny hole in the fabric of the universe. This should pay back big!
- The offeror can't divulge exactly how this wonder device will work because he's applied for several patents, but it says here that has a PhD from MIT and he used to work at NASA.
- This project combines all of the latest hot technologies to do something super cool. I don't understand it, but I want one -- and I certainly can't be the only one!
- This offering is described using lots of technical jargon, but I still don't get how it works. I'll ask my electrical engineer cousin Kim to check it out.

Photo and Video Manipulation

Today, photos and video can be manipulated and simulated in ways that our brains may not have caught up with. We know that verbal descriptions may sometimes be lies, but with our visual perception, "seeing is believing." Note that any photo or video that you see in a crowdfunding pitch (or elsewhere online) may have been faked. Fully trust only in what you can see in real life with your own eyes, and any offeror should be willing to demonstrate live anything that they have published photos or videos of.

Choose the statement below that makes the most sense.

- I wouldn't have believed it was possible if I hadn't seen the video -- wow, this is going to make millions!
- As soon as I saw the photo of it, I wanted to invest. I got it instantly, and that's all I needed.
- The offeror lives in Syracuse and has a public demo scheduled for next Thursday eve -- I'm going to see if my friend Pat can go to that.

Virtuality

Exercise caution with investment offerings that are purely virtual, in that they don't have any identifiable people or verifiable physical locations associated with them. It helps to see a real person behind an offering, but some issuers may legitimately want to protect their privacy by not publishing their photo or video likeness. In either case, they should provide ways of verifying their identity through standard channels, not just through online profiles: passport numbers to check with the U.S. State Dep't, Driver License or State ID numbers to check with a state DMV, bank account numbers to check with a known bank. Similarly, the issuer should have a physical location in the U.S. where you can verify that they do business or are otherwise physically present and reachable. A good crowdfunding portal will check on these things themselves, but it's best not to rely on this.

Choose the statement below that makes the most sense.

- This solicitation video doesn't show any actual human beings, but that soundtrack sure is exciting, and those slick-looking graphs go up, up, up! I'm going to invest!
- This company doesn't seem to have any location, but there's a link to its owner John Smith's social network profile page. That gives me confidence-- there are probably a lot of John Smiths out there, but now I can see who it actually is.
- This business has no address, verifiable people, or other connection to physical reality. I don't trust it.

Personal Obligation

Be careful about investing in a friend or family member if you feel personal obligation around it. If you have doubts about the investment itself but want to help them out financially, it's clearer to just give or lend them some money directly, and write a simple contract that describes your agreement. Personal obligations around crowdfunding may be difficult to navigate, but you can do what you want with your own money, and you can express your thoughts and feelings for someone close to you more personally through your words, and through actions that don't require your money.

Choose the statement below that makes the most sense.

- I'm her grandmother; I need to write her the biggest check of all, or else people won't think I love her.
- I really don't think his singing voice is very good, but if I don't invest at least \$1000 in this recording project, the whole gang will hate me and make my life miserable.
- I love the guy, but he never follows through on anything. I'm going to talk with him about how I really can't afford this. Hopefully, the conversation will bring us closer.

Popularity

People will often have a higher opinion of something because it is popular with others, but "mass hysteria" is real, and crowds do stupid things together. Some of the most successful investors look for opportunities based on doing the *opposite* of what everyone else does.

Choose the statement below that makes the most sense.

- If everyone else jumps off of a bridge, I should too.
- No one has ever lost money following an investment fad.

- Participating in the excitement of a like-minded group is thrilling, because in means I don't have to ask questions or think critically.
- Sometimes it's wise to be suspicious of things that are too popular.

Personalization

Some people use their persuasive personalities to convince others to "invest" in questionable schemes. They emphasize the story they tell about themselves and the personal impression they make to steer people away from doing the harder and more tedious work of reviewing their work and checking their math. A charismatic personality can help enormously in entrepreneurship, but be careful of any offering that focuses on the person to the exclusion of thorough and specific detail.

Choose the statement below that makes the most sense.

- I'm not sure how this all adds up, but I will invest because after all that this person has revealed to me, I don't want to let them down.
- I am a good judge of character, and that's all that a successful investor needs.
- This person has such a compelling personal story that I want to give them my money. I mean, invest in them.
- Many successful ventures benefit from charismatic people behind them, but investors must know how to question and say "no" to such people.

Fame

The people that you interact with in your daily life are people that you hopefully know and trust. But there are also people you only recognize and know about through media, and who don't know you. It may feel like you genuinely "know" these people, but you don't, no matter how much their public personas may speak to

you. If they solicit investments, they need to make their case just like anyone else who is a stranger to you.

Choose the statement below that makes the most sense.

- I'm her number one fan, so I want to be her number one investor.
- I trust him with my money because he always plays trustworthy characters on television.
- He's super-famous among model railroad enthusiasts, so his model railroad venture has to be a good investment.
- I like her in movies, but I really don't know those came to be made or how good of a businessperson she is; I need to find out more before I invest.

Physical Distance (and Other Hindrances to Visitation)

People can misrepresent themselves more easily online than they can in person. If you live close to an offeror's residence, you can check them out more effectively by meeting in person or visiting their workplace, in addition to any phone or online investigation you do. Investing in people far away may be a great way to broaden your connections, but it demands extra caution.

Choose the statement below that makes the most sense.

- This business is far from where I live, in a place I've never heard of, and I don't know anyone who lives nearby -- but it needs my money, so I'm going to invest in it.
- This business is close to where I live, but they're too busy to schedule an investor open house or even open the door. That's good, because they need to focus on running their business rather than spending time with people like me.
- This business is located in another city, and on this online map, it looks like their "Suite 120" address is just at a mailboxes and packaging store. That seems suspicious, so I won't invest in them.

Contests or Lotteries

If an issuer promises to redistribute most or all of the collected investments to one or more of the investors, based on chance or any other factors, then it's likely that they are illegally running a private lottery or contest. Do not "invest" in any such offerings.

Choose the statement below that makes the most sense.

- Bernie is running a massive Super Bowl pool on this crowdfunding site, and the prize money's over \$5K already-- this will be fun!
- The local animal shelter is holding a sweepstakes on this funding portal. They're just taking 5% and the winner gets the rest. Aww-- look at those cute kitties! How can I say no?
- This looks like an illegal lottery; I will ask them about it, and possibly report it.

Unsolicited Offers [from SEC Investor Alert]

Investment fraud criminals look for victims on social media sites, chat rooms, and bulletin boards. If you see a new post on your wall, a tweet mentioning you, a direct message, an e-mail, or any other unsolicited – meaning you didn't ask for it and don't know the sender – communication regarding a so-called investment opportunity, you should exercise extreme caution. An unsolicited sales pitch may be part of a fraudulent investment scheme. If you receive an unsolicited message from someone you don't know containing a "can't miss" investment, your best move is to pass up the "opportunity" and report it to the SEC Complaint Center. Investor Assistance (800) 732-0330 www.investor.gov

Choose the statement below that makes the most sense.

[Example multiple-choice based on SEC warning language available upon request.]

"Can't Miss" Claims [from SEC Investor Alert]

Any investment that sounds too good to be true probably is. Be extremely wary of claims on a website that an investment will make “INCREDIBLE GAINS” or is a “BREAKOUT STOCK PICK” or has “HUGE UPSIDE AND ALMOST NO RISK!” Claims like these are hallmarks of extreme risk or outright fraud. Most fraudsters spend a lot of time trying to convince investors that extremely high returns are “guaranteed” or that the investment “can’t miss.” Don’t believe it.

Choose the statement below that makes the most sense.

[Example multiple-choice based on SEC warning language available upon request.]

Time Pressure [from SEC Investor Alert]

Don’t be pressured or rushed into buying an investment before you have a chance to think about – and investigate – the “opportunity.” Be especially skeptical of investments that are pitched as “once-in-a-lifetime” opportunities, particularly when the promoter bases the recommendation on “inside” or confidential information.

Choose the statement below that makes the most sense.

[Example multiple-choice based on SEC warning language available upon request.]

Affinity Group Mentions [from SEC Investor Alert]

Never make an investment based solely on the recommendation of a member of an organization or group to which you belong, especially if the pitch is made online. An investment pitch made through an online group of which you are a member, or on a chat room or bulletin board catered to an interest you have, may be an affinity fraud. Affinity fraud refers to investment scams that prey

upon members of identifiable groups, such as religious or ethnic communities, the elderly, or professional groups. Even if you do know the person making the investment offer, be sure to check out everything – no matter how trustworthy the person seems who brings the investment opportunity to your attention. Be aware that the person telling you about the investment may have been fooled into believing that the investment is legitimate when it is not.

Choose the statement below that makes the most sense.

[Example multiple-choice based on SEC warning language available upon request.]

Biased “Research Opinions,” Newsletters, and Spam Blasts [from SEC Investor Alert]

While legitimate online newsletters may contain useful information about investing, others are merely tools for fraud. Some companies pay online newsletters to “tout” or recommend their stocks. Touting isn’t illegal as long as the newsletters disclose who paid them, how much they’re getting paid, and the form of the payment, usually cash or stock. But fraudsters often lie about the payments they receive and their track records in recommending stocks. Fraudulent promoters may claim to offer independent, unbiased recommendations in newsletters when they stand to profit from convincing others to buy or sell certain stocks – often, but not always, penny stocks. The fact that these so-called “newsletters” may be advertised on legitimate websites, including on the online financial pages of news organizations, does not mean that they are not fraudulent. To learn more, read our tips for checking out newsletters.

[Example multiple-choice based on SEC warning language available upon request.]

I would be delighted to discuss any of this.

Respectfully submitted,

Paul Spinrad

