

ROCKETHUB

IMPLEMENTATION OF CROWDFUNDING

BUILDING ON TITLE III OF THE JOBS ACT

WHITEPAPER 2.0

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ROCKETHUB.COM

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Introduction

In the months since the publication of RocketHub’s initial whitepaper, RocketHub has received numerous requests to comment on crowdfunding practices and the implementation of the JOBS Act. This whitepaper elaborates on opinions expressed in RocketHub’s first whitepaper, “Regulation Of Crowdfunding: Building On The Jumpstart Our Business Startups Act” (publicly available at <http://www.sec.gov/comments/jobstitle-iii/jobstitleiii-39.pdf>), and addresses additional topics.

Understanding the spirit of the Act and its intent to revitalize the US economy, encourage job creation, and foster domestic innovation, we discuss:

- Investor protection rules and suggested practices;
- Security purchase mechanics; and
- Potential Portal practices.

Key Industry Drivers

Crowdfunding has thrived under the perks-based system because it provides a low-cost fundraising method. In part, this is due to the lack of upfront expenses. This low barrier to entry has encouraged many individuals to attempt crowdfunding campaigns, without risking the negative financial impact of an unsuccessful raise. While adopting investor protections, the Commission must also consider the perspective of the issuer, and understand that providing additional documents, or submitting to robust background checks will result in considerable upfront expenses being born by the issuer. When that figure becomes financially unattractive, many viable businesses will opt out of attempting a crowdfunding campaign, defeating the legislative intent of the JOBS Act.

Crowdfunding Portals (a “funding portal” as defined in Section 304 of the JOBS Act) are able to operate efficiently because they are web-based. The Commission must also recognize that funding Portals differ from large brokerage houses in that they may or may not have any direct contact with issuers or investors off-line. Therefore, required disclosure documents, including but not limited to company financial statements, business plans, financial projections, issuer background check results, etc., must be easily deliverable via digital delivery methods in a standardized format.

IMPLEMENTATION OF INVESTOR RISK REDUCTION

Sources of Investor Risk

When investing in a company via a crowdfunding Portal, investors face three broad categories of risk:

1. Underperformance of the issuer's endeavor;
2. Misrepresentation or fraud by the issuer; and
3. Investor misunderstanding of the nature and risks of the investment.

While issuer fraud is the least likely risk to investors, the media has fixated on the possibility that criminals may create fraudulent issuances, and attempt to bilk the new investor class. We believe the risk of loss due to underperformance of a legitimate start-up or small business far outweighs the likelihood of loss due to fraud or omission.

The JOBS Act specifically addresses methods for reducing these risks to investors. They include:

1. Annual investment limits on the dollar amount investors are permitted to commit;
2. Investor education;
3. Mandated issuer disclosures; and
4. Issuer background checks.

While some commentators have called for additional anti-fraud protections, we believe these will generally add to the upfront expense of crowdfunding and will not provide sufficient benefits. The costs of these measures would largely be borne by legitimate issuers, not by the few disreputable individuals the regulation would be targeted to exclude. Instead we advocate that risk reduction rely on the power of the Internet to inform and provide feedback.

Annual Investment Limits

The JOBS Act reduces investor risk, by limiting the amount that an investor may put at risk. This type of limitation, on an individual's decision on how much to invest in an enterprise, is, at the very least, paternalistic, and not the type of restriction that we believe should guide future regulation of the crowdfunding industry.

The Act imposes the restriction in two ways, as a limit on sales by an issuer to an investor, and then again as an aggregate limit (with the same dollar cap) on an investor's purchases from all crowdfunding issuers. As a practical matter, these standards raise substantial difficulties and may not be possible to achieve absent reliance on investor representations. As a legal requirement, we expect that Portals will need to show that each investor is unique, and that each investor is investing within the investor's permitted limit.

Portals must be able to establish that each investor using the Portal is unique. Otherwise, an investor could set up multiple accounts to fund one or more issuers on the Portal.¹ Were an investor able to establish multiple accounts with a single crowdfunding Portal, either intentionally or accidentally, the investor could circumvent the Portal's efforts to enforce annual investment caps. Therefore, when registering with the Portal, we believe each investor should be required to supply the following information:

1. Full legal name
2. Social Security Number (SSN)
3. Date of birth
4. Full mailing address

The Portal can crosscheck this data against public and/or private databases to confirm the individual's identity. Access to these databases often comes at a cost per inquiry, which may be passed along to the user as a registration fee, or covered by the Portal, and reclaimed as an increased fee to a successful issuer. Given the economics of crowdfunding, this cost eventually decreases the net proceeds raised by the issuer, impacting both issuer and investor pool.

While these methods should enable Portal operators to monitor account compliance on their Portal, these methods do not address an investor who seeks to open accounts on multiple Portals. We do not believe that Portals can, or should, be asked to police this aspect of investor behavior.²

The risk of requiring Portals to cross-check accounts with other Portals³ greatly outweighs any benefits. Those risks include:

- Information exposure in transit:
 - Bad actors may intercept data in transit. If exposed, it would be impossible to ascertain how far the sensitive information has spread. The increased transmission rate of this data between Portals may significantly increase the risk of identity theft;
- Information exposure in storage:
 - Each platform will have different security standards and protocols. If bad actors are able to penetrate the security measures of one Portal, the data of all connected funding Portals could be compromised;
- Privacy concerns, including encouraging intrusive behavior from funding Portals; and
- Competiveness and anti-trust concerns that may arise where competitors are regularly required to share data.

¹ The risk of one investor setting up multiple accounts to fund a single issuer may be more apparent than real, however, as an investor with interest and sufficient funds could contact an issuer directly and make a legal, private investment utilizing other securities laws means.

² It is unclear how prevalent this behavior would be.

³ The SEC would need to define the universe of Portals, the personal data to be cross-checked and the method and protocol of communication.

In order to effectively and securely share information directly between platforms, the Commission would have to establish a new open standard for data interoperability. The IJIS Institute 2009 report for the U.S. Department of Justice on data interoperability states that there is “no question that governance issues are the most challenging part of implementing data interoperability, especially if the data needs to be shared across both jurisdictional and discipline boundaries. The critical first step is to put in place a governance group of agency decision makers, as they will have the necessary ‘clout’ to achieve the desired results... This stage of the process can be frustrating and time consuming, but it must be completed effectively.”⁴ Creating a new open standard to share information would be an exceptionally costly process that would burden funding Portals, Self Regulatory Organization (SROs), and the Commission, as all parties would have to be involved in the governance and technology development process.

However, if the Commission were to mandate that funding Portals send information into a central database, either the SRO or the Commission itself would be tasked with the responsibility of developing and maintaining a cloud based repository to store this confidential information.

Neither FINRA nor the Commission currently has systems in place to undertake this responsibility. Therefore significant development costs would be required to establish this secure central database. Furthermore, maintenance of a large central database is exceptionally costly due to constant security concerns, and skilled staffing requirements. These expenses will drive up transactional costs. The Commission should recognize that providing this level of investor activity oversight would be unnecessary, costly, and overly complex. As a result, Portals must only be required to police their own platforms, and must be permitted to rely on representations from the investor. The Portal cannot be held liable for intentional deceptions by an investor.

We believe the only practical solution is investor self-certification. The investor should affirm that it is investing within the applicable limits, and face liability if the investor is seeking to violate the law.

Portals must establish an investor’s permitted investment limit.

The JOBS Act sets two tiers of potential investment by investors. If an investor’s annual income or net worth is less than \$100,000, the investor may invest the greater of \$2,000 or 5% of such amount each year. If the investor’s annual income or net worth is \$100,000 or more, the investor may invest up to 10% of the investor’s annual income or net worth up to a maximum of \$100,000. This requirement imposes significant additional challenges for Portals. Keep in mind that crowdfunding relies on a large number of small investors. Therefore, Portals must be able to uniquely identify each investor and establish an appropriate account for each investor at a low-cost. Otherwise, too much of the investor’s or issuer’s funds will go towards administration and legal compliance.

⁴ http://www.ijis.org/docs/Guide_Info_Sharing_Data%20Interoperability_Local_Comm_Ctrs_FINAL.pdf

As a practical matter, there are only a few ways to confirm an investor's annual income and none of them are low-cost or quick. While the Internal Revenue Service's Income Verification Express Service would allow Portals to compare an investor's stated income with official records, it does not allow for instantaneous or easily processed/interpreted results. Results are "generally" delivered within two business days, and could be cost prohibitive.⁵ Furthermore, crowdfunding offerings are inherently time sensitive. Any delay in investor account approval could cost the investor the opportunity to participate in the offering. Since we believe most individual investors are likely to participate in a crowdfunding offering because they have a connection with a specific issuer, and not as a result of seeking asset diversification through exposure to crowdfunding, a delay or difficulty in opening an account is likely to cause them not to participate in crowdfunding at all. One compliance method that has been suggested is to require a Portal to review an issuer's Form W-2 or pay stubs. Requiring an investor to submit copies of original documents, however, again raises privacy concerns and would require that someone at the Portal manually confirm the information, which significantly increases time and costs to the Portal (and thus to the issuer). This also raises the specter of investors falsifying documents, or Portals misinterpreting the results of submitted documents.

Establishing an investor's net worth is not currently practical. There is no third-party resource that Portals have access to which would permit them to accurately judge an investor's net worth. Portals could ask investors to provide documentation of assets and liabilities, but again, this process would impose significant administrative costs on the Portal; costs that are disproportionate to the amounts generally expected to be invested through crowdfunding. It is a mistake to regulate a crowdfunding account, which is likely to be small and be used for only a few investments, in the same manner as a brokerage account that may be orders of magnitude larger.

To resolve these issues, we believe that Portals should be able to rely on self-certification by investors. Portals can ask investors to submit information electronically, have the investor affirm the accuracy of the statement and then calculate the appropriate investment limit. Disclosure of the reason behind these limits (i.e., the risk of losing the investment) will help investors understand the reason to stay within the limits.

The risk of not being able to rely on self-certification is that Portals may simply find it impractical to allow investor accounts where the investor seeks to invest more than \$2,000. This *de facto* limitation would defeat Congress's intent in passing the JOBS Act.

Investor Education

The JOBS Act provides a mechanism for low-cost, small dollar capital raises. These raises will permit participation by investors seeking to invest small amounts, which allows issuers to engage a new class of investor. Some of these investors will be unfamiliar with the mechanics of investing in ventures of this type. Therefore, the

⁵ <http://www.irs.gov/Individuals/Income-Verification-Express-Service>.

educational materials provided by the funding Portal are critical in protecting and informing investors.

Disclosure by Portals

Under Section 302(b) of the JOBS Act, Portals are required to, “provide such disclosures, including disclosures related to risks and other investor education materials as the Commission shall, . . . determine appropriate.”

In addition, the JOBS Act specifically requires Portals to:

- (4) ensure that each investor—
 - (A) reviews investor-education information, in accordance with standards established by the Commission, by rule;
 - (B) positively affirms that the investor understands that the investor is risking the loss of the entire investment, and that the investor could bear such a loss; and
 - (C) answers questions demonstrating
 - (i) an understanding of the level of risk generally applicable to investments in startups, emerging businesses, and small issuers;
 - (ii) an understanding of the risk of illiquidity; and
 - (iii) an understanding of such other matters as the Commission determines appropriate, by rule;

To implement these requirements, investors should be made aware of the following information before making an investment:

1. 100% of the funds invested are at risk because the business may fail;
2. Even if the business is “successful,” the investor may never get any money back because either:
 - a. The business never becomes successful enough, or
 - b. If investor payout (or other structure) is not guaranteed, management may decide there are better uses for the funds;
3. The investor may not have any say in how the business is run; and
4. The investor may not be able to sell his/her stake in the business either because
 - a. No one wants to buy, or
 - b. It may be difficult to find a willing purchaser, or
 - c. It may be difficult to transfer.

Investors should be required to acknowledge these risks before “clicking through” to make an investment. To take advantage of the web-based nature of funding Portals, the Commission should allow for both time tested, and new delivery methods for educational content. Those methods could include, but are not be limited to text, audio, pictures, video, and live seminars. All efforts should also be made to maximize engagement while presenting the educational content, and minimize the volume of required lessons. RocketHub intends to use interactive text and images, time tracking, click tracking, and live webinars to make the material easy to understand and retain.

In order to meet the Acts' standard of "ensure," at the close of an educational module, perspective investors should be required to answer questions that demonstrate their understanding of the risks involved. Any questions that are specifically required by the Commission should be presented in plain English. The Commission should provide guidance on what "ensure" requires in this context.

Disclosure by Issuers

The Act also requires an issuer to disclose information to prospective investors regarding the company's financial condition and performance. This is an important investor protection, as it provides the investor with information about the company that is generally unavailable to the public. As a practical matter, we expect that much of the required disclosure will be provided by the issuer through the Portal and in a format mandated by the Portal.

Crowdfunding will attract many smaller issuers who do not have experience with capital markets or the specifics of the JOBS Act. These issuers may not have legal representation. As a result, they will look to the Portals for guidance in preparing certain required disclosures.

This makes sense, and has some positive impacts as the Portal will want standardized disclosure relating to pricing, offering periods, and withdrawal rights. Additionally, Portals will want to limit the variety of corporate forms and will want to require issuers to prepare a package of shareholder rights. This will provide greater comfort to investors by providing uniformity allowing comparability as well as aiding in transparency of disclosure.

Issuers are, however, subject to liability for misstatements and omissions. This liability can keep issuers honest, but it can also deter issuers from seeking to raise funds in the first place. Issuers with limited capital raising experience may be scared off by the threat of securities litigation. As a result, the Commission, in implementing these rules, must provide standards, including a safe harbor, that are attainable by inexperienced and unrepresented issuers and that results in plain English disclosure of general risks to investors. No risk disclosure can cover every possible risk, and requiring issuers to draft complex and highly specific risk disclosure will add significant cost to fundraising. Given the nature of start-ups and small businesses, investors need to appreciate that all such ventures are high-risk, and that they will have limited ability to control the issuer or to exit the investment. Requiring a specific analysis of why a particular business may not succeed misses the forest for the trees.

The Act also requires disclosure of specified financial information. While we feel the triggering dollar thresholds are too low and the cost of preparation of this information is too high, the requirements have the advantage of being easily understood.

SEC.302(b)/SEC4A.(b)(1)(D) – FINANCIAL CONDITION OF ISSUER

(D) a description of the financial condition of the issuer, including, for offerings that, together with all other offerings of the issuer under section 4(6) within the preceding 12-month period, have, in the aggregate, target offering amounts of—

(i) \$100,000 or less—

(I) the income tax returns filed by the issuer for the most recently completed year (if any); and

(II) 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;

(ii) more than \$100,000, but not more than \$500,000, financial statements reviewed by a public accountant who is independent of the issuer, using professional standards and procedures for such review or standards and procedures established by the Commission, by rule, for such purpose; and

(iii) more than \$500,000 (or such other amount as the Commission may establish by rule), audited financial statements;

RocketHub recommends the Commission permits issuers to digitally enter the data from their original documents, instead of submitting digital scans. This will protect the issuers from accidental disclosure of confidential information, and will allow investors to view the information in a structured and consistent manner. For example, if each issuer were to upload their version of a financial statement, the responsibility of learning to understand each format would fall to the investor. Standardized formats for financial projections, financial statements, and business plans will allow investors to quickly compare issuances and more readily evaluate investment opportunities.

Issuer Background Checks

The Act specifically requires issuers to undergo background and securities enforcement regulatory history checks. But, it also allows for the Commission to add additional requirements as it sees fit.

SEC.302(b)/SEC4A.(a)(5) – ISSUER BACKGROUND CHECKS

(5) take such measures to reduce the risk of fraud with respect to such transactions, 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;

As a matter of policy, any and all required background checks should follow guidelines outlined by the Fair Credit Reporting Act (FCRA)⁶ and the Equal Employment Opportunity Commission (EEOC).⁷ Furthermore, the Commission must clearly define whether, or under what circumstances, the results of such checks need to be made public or should prevent an issuer from utilizing crowdfunding. The Commission's guidance should encompass the results of improved and more comprehensive databases in the future. At a minimum the Commission must offer answers to the following questions:

1. Which databases, if any, must be queried for records in the issuer's name?
2. If a record is found, what specific infraction or information will require exclusion?
3. If a record is found, but exclusion is not required, what specific information must be disclosed to prospective investors?

RocketHub encourages the Commission to note that accessing 3rd party databases comes at a cost, which in most instances will be passed on to the users in some fashion (both investor and issuer). In order to uphold the spirit of the Act, it is imperative to keep friction-based costs such as these as low as possible.

⁶ <http://www.ftc.gov/os/statutes/031224fcra.pdf>

⁷ <http://www.eeoc.gov/>

SECURITIES PURCHASE MECHANICS

The Continuing Role of the Crowdfunding Portal

Once an issuer has provided appropriate disclosure, lawfully attracted investors, and priced the sale of securities, a new set of challenges arise. These challenges originate in the restrictions placed on crowdfunding Portals and the potential obstacles they place on the Portal's ability to play a ministerial role in aiding issuers.

As most crowdfunding issuers will have little experience with securities sales, it will benefit the issuers and the investors if the Portal assists the issuer in:

- Collecting and transferring funds from investor accounts to the issuer;
- Keeping a record of investors, amounts invested and securities purchased for the issuer; and
- Transferring evidence of investment, such as a stock certificate, to the investor.

Given the web-based nature of crowdfunding Portals, issuers and investors will expect that these services be provided for a low-cost and delivered electronically. Portals will naturally be in the best position to provide these services, as they will have collected the information in connection with the securities sale.

While Portals could allow issuers to transfer the information over to a third-party provider, or perform these tasks themselves, we believe that allowing the Portal to provide these services will reduce cost to the issuer and investor, while also improving transparency and decreasing investor risk.

Processing of Investor Funds

In its first whitepaper, RocketHub offers a brief overview of its accounting methodologies, and policies pertaining to the processing of users' funds. RocketHub operates on a virtual currency system that allows contributors to purchase RocketHub credits. Those credits are then allocated to support a particular campaign. RocketHub does not handle user funds. When credits are purchased, user funds are maintained in a segregated account throughout the life of those credits. All user activity is registered through movement of virtual currency. RocketHub's ledger states how many credits of virtual currency each user has purchased, or has available, and how they have committed those credits. If a user has a balance of uncommitted credits, they are entitled to a full refund of the value of those credits. Figure 1 is a visual representation of the flow of money on RocketHub's platform.

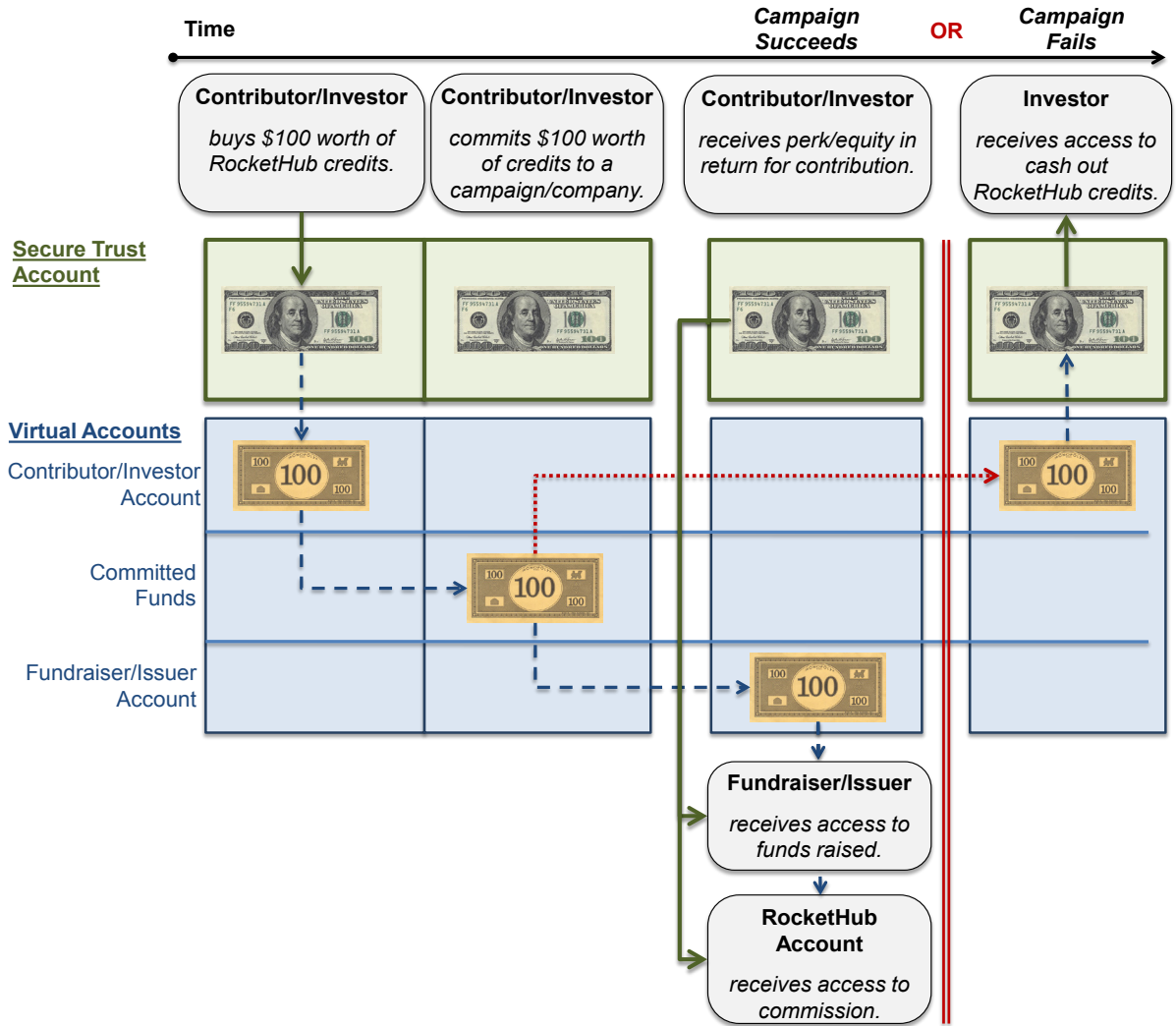


Figure 1

RocketHub suggests extending this methodology to the equity crowdfunding model established under the JOBS Act. Throughout the life of a campaign, funds are maintained in a segregated trust account to prevent the “co-mingling” of RocketHub funds with user funds. They remain untouched until the campaign ends, at which point the investor is either committed, or receives a credit to his/her account balance with the option to withdraw funds. RocketHub believes this system provides full oversight on flow of funds while providing a high-level of security for the issuer, investor, and Portal. Furthermore, the investor has the flexibility to allocate funds as they see fit, and withdraw funds when they deem necessary.

This system is a prime example of the proper handling of capital, in a manner compliant with the JOBS Act, and concerns reflected by the Commission during recent discussions. RocketHub’s proposed system has tax compliance, OFAC, AML, Anti-Terror, Anti-Narcotics compliance, as well as money handling compliance as broken down below.

Tax Compliance

All individuals receiving funds from RocketHub’s platform will be required to fill out (and digitally sign) digital versions of tax forms as part of their self-registration with RocketHub. For RocketHub’s US based users, a W-9 (Request for Taxpayer Identification Number and Certification) will be required. For Non-US entities, RocketHub will require a declaration from the entities stating that they are not a “US Person” as per the Internal Revenue Services (the “IRS”) definitions.

OFAC, AML, Anti-Terror, Anti-Narcotics Compliance

Before a payout is made to a user, RocketHub will automatically crosscheck payee identities against lists of restricted individuals and entities. This will occur before each and every payout cycle. RocketHub leverages a 3rd party database that is updated weekly with the latest information as published by the US Treasury Department's Office of Foreign Assets Control⁸ (OFAC) in its SDN (Specially Designated Nationals) List.⁹

Money Handling Compliance

RocketHub has a single bank account used to fund all payments to all payees. In partnership with a major bank and a PCI¹⁰ compliant 3rd party, RocketHub has relinquished control of the account to the unaffiliated 3rd party. RocketHub is an owner of the account in writing only, but has no formal rights or ability to access the funds directly. RocketHub has outsourced the mechanics of the pay-out process while maintaining complete control over payment frequency, payment methods, and cost to payees. This system allows RocketHub to reduce costs well below those associated with traditional escrow accounts, pass the savings on to the user, and maintain the same level of protection in handling funds associated with traditional escrow accounts.

RocketHub believes this accounting methodology should be permitted under the new JOBS Act regulation – as it provides significant cost savings to Portals and users, increased transparency in money-flow, as well as sophisticated reporting to government agencies.

Holding and Transferring Securities

The JOBS act does not explicitly cover the practical issuance, and transfer of securities at the end of a successful crowdfunding campaign, however per SEC.304(b)/Sec3(a)(80)(D), Portals are restricted from certain activities.

⁸ <http://www.treasury.gov/ofac/>

⁹ <http://www.treasury.gov/sdn>

¹⁰ The Payment Card Industry Security Standards Council was founded in 2006 by American Express, Discover Financial Services, JCB International, MasterCard Worldwide, and Visa.
<https://www.pcisecuritystandards.org/>

SEC.304(b)/SEC3(a)(80)(D) – FUNDING PORTALS

(80) FUNDING PORTAL.—The term ‘funding portal’ means any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to section 4(6) of the Securities Act of 1933 (15 U.S.C.77d(6)), that does not—

(D) hold, manage, possess, or otherwise handle investor funds or securities;

We believe Portals can comply with these limitations, while assisting issuers in allocating and transferring their securities to investors.

Investors have three choices when holding their securities:

1. Physical certificate
2. “Street name” registration
3. “Direct” registration

Physical certificates are simply that. A piece of paper that is the actual security. Ownership is evidenced by possession. That is the most basic method of allowing investors evidence of their ownership. The issuer and investors should retain the right to prepare and distribute physical certificates, however we believe that the time and cost involved, as well as the resulting lack of standardization (and lack of expertise that most issuers would have in this task), will make this an undesirable option for most issuers, and that most investors would prefer to have the convenience of an electronic system hosted by the Portal.

Under street name registration, the security is registered in the name of the brokerage firm on the books of the issuer; the brokerage firm holds the security in book-entry form. RocketHub believes that street name registration, when handled by Portals would be highly effective and low cost. However, this form of registration is currently only available to broker/dealers as this registration would require Portals to hold securities.

Portals should be able to facilitate issuance via a Direct Registration System (DRS). Under a DRS, the security is registered in the investor’s name on the issuer’s books, and the Portal tracks the security for the investor as a book-entry. Since the issuer controls this system, RocketHub believes this method allows the Portal to facilitate the registration and transfer of securities, without holding, managing, or possessing the securities. RocketHub believes the Commission should provide guidance on this issue.

The DRS will allow Portals to assist issuers with management of investor contact information, and by forwarding or posting on its website any correspondence from the issuer to the investor, including the annual reports discussed in SEC.302(b)/SEC4A.(b)(4). This also allows for oversight when the issuer is disseminating pertinent information to the investors.

The DRS will simplify transfer restriction enforcement under SEC.302(b)/SEC4A.(e)(1). Since the Portal holds a record of securities owned by investors, upon request by the issuer the Portal is able to print and provide paper certificates with transfer restrictions clearly visible.

RocketHub requests that statements of ownership, periodic account statements, dividends, annual reports, proxies, and other mailings are allowed to be distributed in digital format, either directly from the issuer, or from the Portal at the issuer's request. Furthermore, the issuer should be allowed to deposit the dividends owed to an investor into the investor's account with the Portal. Doing so will allow issuers to avoid many of the administrative tasks associated with issuing communication and dividend payments to large investor pools.

It is important to note, the Portal should be restricted to recording securities purchased on the Portal, or securities transferred from one Portal to another. Portals should not be permitted to act as a full-fledged brokerage firm or transfer agent, as that would violate SEC.304(b)/SEC3(a)(80).

The Commission should recognize that crowdfunding platforms are capable of providing additional services that are necessary and beneficial to issuers and investors. Portals should be permitted to assist issuers with ministerial corporate duties and by keeping corporate stock ledgers. The Commission should consider the efficiencies of having the Portal provide those services, and should not restrict the Portal as a service provider.

POTENTIAL PORTAL PRACTICES

Portal Participation in Offerings

The Act specifically bars the principals of a funding Portal from establishing a financial interest in the success of the issuance, but the Act does not address the possibility of the Portal itself investing in the campaign.

SEC.302(b)/SEC4A.(a)(11) – INTERMEDIARY’S FINANCIAL INTEREST IN ISSUER

(11) prohibit its directors, officers, or partners (or any person occupying a similar status or performing a similar function) from having any financial interest in issuer using its services...

The issue of Portal participation in offerings becomes complex because the Portal’s action of investing in a particular offering could be viewed as an endorsement constituting investment advice. Additionally, this raises a possible abuse by the Portal, where it would not invest unless the issuer provides specific deal terms or favored treatment for the Portal.

This practice also risks accelerating commitment of investor capital, by advancing offerings to the 100% mark without true market commitment by crowdfunding investors, if the Portal is investing in the crowdfunded offering instead of pursuant to another exemption. This creates an artificial acceleration of the money supply on the Portal system at the expense of investor protection, by short-circuiting the investor protection provided by a large number of investors having adequate time to discuss the investment opportunity. In the situation of crowd-funded debt-based products, which RocketHub believes to be one of the riskiest forms of capital available, Portals would in effect be turned into banks that are padding their own capital expenditures with outside investor capital by leveraging the JOBS Act regulation framework. This behavior should not be permitted.

If the Commission permits Portals to participate in offerings, this participation should only be allowed after the campaign reaches 100% of its funding target. The Portal may only participate by investing between the funding target, and the funding cap. Thereby the campaign will have achieved success by crowd action, without the influence of the Portal.

The Portal could also take equity in the issuer as part of its commission. While this scenario avoids the “acceleration” risk, it may raise disclosure risks if the Portal’s equity is not issued on the same terms as crowdfunding investors. The Portal should disclose whether its fees will be paid with equity, the dilutive impact of such payment on investors and any special rights the Portal will receive, before investors make an investment

decision. The Commission should clarify that the receipt of equity as payment of a Portal's commission is not "investment advice," while also requiring disclosure of any transaction between the Portal and the issuer.

Selective Offerings

Crowdfunding is community based. Entrepreneurs reach out to members of their family and their web-based connections to crowdfund projects. It is this pre-existing connection to an entrepreneur or project that RocketHub believes will drive most participation in crowdfunding. One issue that may arise is where an entrepreneur does not want to offer interests to people outside of a select group (such as family members, neighbors or participants in an on-line community). RocketHub believes that Portals can provide this service in compliance with applicable laws. Portals should be able to offer entrepreneurs the ability to "hide" their offering from the public. Only invitees from the issuer would have the opportunity to invest. This would allow an entrepreneur to use the Portal's mechanisms and compliance, while retaining control over their offering. These offerings would have a more difficult time reaching their goals, as their promotion would, of necessity, be more limited. A Portal's decision whether or not to offer this service, should be in the Portal's discretion.

Conversely, a Portal should not distinguish between investors in any offering openly promoted on the Portal's website. This type of practice could enmesh a Portal in discriminatory behavior and cause the Portal to be viewed as partial with respect to certain offerings.

Additionally, crowdfunding issuers should be able to insert a "call" right in their constituent documents, which would allow the issuer to repurchase all, or a portion, of shares issued. This mechanism may be a needed safety valve for issuers who find that they cannot work with certain of their new investors. Any such right would need to be appropriately disclosed to investors.

Credit Card Payment vs. Secure Funding Method

Credit cards are debt vehicles. Payments via credit card are effectively high interest, short-term loans. While payment via credit card may be convenient, it exposes the investor, issuer, and Portal to unnecessary risks and the possibility of substantial complications. Credit cards are notoriously vulnerable to fraudulent transactions, and additional complications could include:

1. Investor default on credit card debt; and
2. Investor chargebacks

If an investor were to purchase securities with a credit card, then default on the debt, ownership of the securities may potentially be transferred to the credit card company. Furthermore, credit card companies allow cardholders to dispute charges (i.e. issue chargebacks) up to six months after a transaction is completed, with as little justification

as the charge is “not recognized” by the cardholder. This would allow for an investor to rescind payment for securities well after the securities had been issued. Banks often issue credit card chargebacks without truly investigating the merits behind the claim. These factors expose the investor, the issuer and the Portal to unnecessary risk.

Many other payment systems exist that are more suitable than credit cards to the requirements of crowdfunding Portals. ACH is an example of one of them. The Automated Clearing House network (ACH) provides a secure payment method. ACH provides a transaction system with real liquid capital, from actual bank accounts, owned by bank verified individuals. Furthermore, ACH rules and regulations prevent any financial institution from issuing an ACH transaction towards an account without prior authorization from the account holder, and ACH already has an established electronic authorization system in place. ACH’s chargeback policy still protect consumers from debits that occur without permission, but it also protects businesses from “buyer’s remorse” as long as the business can provide proper documentation of the debit authorization.

If the Commission permits Portals and issuers to accept credit card payments, the Commission should provide clear guidance on how Portals and issuers should handle disallowed or fraudulent charges.

Portal Sponsored Grants/Contests

The Act specifically prohibits Portals from offering investment advice. As such Portals should clearly refrain from issuing reports or performing analyses concerning securities. Portals that hold contests providing prizes or proclaiming winners are in effect performing an analysis. If the Portal compensates any of the judges, we believe the Portal is providing prohibited investment advice. Therefore, a Portal should not be allowed to host the crowdfunding campaign of any business that has participated in a contest/competition organized by, or associated with, that Portal.

RocketHub believes that contests hosted by Portals will lead to:

1. Confusion by investors;
2. Interpretation of the company’s status as “winner”, “finalist”, “entrant” or “non-winner”, as investment advice; and
3. Abusive practices by Portals and issuers that deceive investors into believing that the endorsed campaign is less risky or an appropriate investment.

When the investment advice has been organized and solicited by the platform, a clear conflict of interest arises. On the other hand, third-party advertisers should be permitted to sponsor contests on the Portal. These third-party advertisers are not “Portals” under the JOBS Act and should not be regulated as such. We do not believe the same risks of confusion of the Portal’s role are present in contests sponsored by unaffiliated third-parties.

The Commissioners should keep the spirit of the legislation in mind when clarifying this topic, and consider what crowdfunding is today when crafting these regulations. RocketHub believes that in order for crowdfunding to flourish, funding Portals must be allowed to:

- Feature trending campaigns, as all currently existing crowdfunding platforms do on their homepages, blogs, newsletters and other promotional material;
- Present a list of all, or a subsection of, campaigns; and
- Order that list of campaigns based on specific objective metrics, including
 1. Percentage funded;
 2. Total dollars raised;
 3. Time remaining;
 4. Date launched; and
 5. Activity.

A disclaimer stating that a campaign’s status as “featured” should not be construed as investment advice, or any indication as to the likelihood of future investment performance, should allow for both automated, and discretionary featured placement.

White Label Equity-Based Crowdfunding Platforms

Some entrepreneurs have indicated that they intend to operate a “parent” funding Portal, which allows other sites to operate under its umbrella, (leveraging the parent’s systems, architecture, design, infrastructure, etc.). If subordinate Portals are allowed to operate under the umbrella of a registered Portal, either the management team of the parent Portal must be liable for the operations of the subsidiary Portals, or those subordinate Portals must fully register with the SEC and FINRA as independent Portals. The logic applies also to the licensing of any “turn-key” Portal solution. The Commission must make it clear that the operators of each funding Portal must comply with all pertinent SEC and FINRA regulations.

Investment Target and Investment Cap

As SEC.302(b)/SEC4A.(a)(7) specifically allows for issuers to raise funds “greater than a target offering amount,” the issuer must also establish an offering cap at campaign inception. This will protect the issuer by limiting over subscription. RocketHub does not believe there should be a limit on the spread between a cap and a target offering amount. While this would allow for a campaign where an issuer has a target offering amount of \$1,000 and a cap of \$1,000,000, RocketHub sees no issue as long as there is a clear and transparent communication path for both investors and issuers to understand the risks associated with such a large spread between investment target and cap. Additionally, the issuer must abide by the disclosure requirements mandated by the investment cap.

SEC.302(B)/SEC4A.(A)(7) – INVESTMENT TARGET AND INVESTMENT CAP

(7) 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 allow all investors to cancel their commitments to invest...

As part of its Portal, RocketHub plans to offer a new countdown mechanism. Once an offering reaches its cap amount, the “count down” to the offering deadline will be paused, awaiting the expiration of the last investor’s rescission period. During the pause, RocketHub will continue accepting “investment pledges” and placing those who invest during the pause on a “wait list.” If during the pause, a pending investor exercises his/her right to cancel his/her investment, investors will be added from the wait list, until the cap is reached again, and the pause will continue. If the entire wait list is exhausted, without reaching the cap the “count down” will resume. Due to the retail nature of the investors, RocketHub believes it is not necessary to follow the practice of counting only working days; RocketHub believes that if terms are set at the beginning of the offering, the rescission period should last no longer than 24 hours.

Substantial Compliance

The SEC should implement “substantial compliance” rules that protect issuers and Portals, even if the issuer failed to comply with the exemption in certain insignificant ways. The Regulation D exemption includes several provisions that protect the issuer if it reasonably believed the requirements of the rule were met, even if they actually were not. If this language is not included, a small infraction, or an infraction that has no true effect on the quality of the offering could invalidate the entire offering.

The SEC should include language to protect the issuer and the issuance from involuntary, innocent and immaterial violations.

Pilot Program

RocketHub recognizes that the Commission is responsible for regulating an emerging market. As such, there is limited information available to generate effective regulatory policies. While RocketHub has made its data freely available to the Commission’s economist department, it believes there are further steps that can be taken to test the infrastructure, security, and cost of full compliance through the proposed framework.

A pilot program would initiate equity crowdfunding, including the data collection and filing process, on a small scale to get feedback on whether the regulation is likely to work as expected in a “real world” situation. RocketHub believes that by administering crowd-funded offerings by a small group of issuers to the retail-investor public the Commission will effectively simulate the offering process including security registration, offering logistics, and identity verification. This will give the Commission an

opportunity to make revisions to their regulatory framework to ensure that the right data will be collected and the data collection methods will work, the securities registrations procedures work, and investors and issuers are protected. Furthermore, the pilot program would also provide the SRO with necessary data for their own regulatory programs. RocketHub believes that by neglecting pilot testing the regulatory framework, the Commission runs the risk of writing out an inefficient and potentially ineffective regulatory framework. A pilot program will allow both the Commission and SRO to identify topics that require additional regulation before the floodgates are opened to numerous Portals many of whom are first-time entrants into the crowdfunding space.

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Thank you for your attention. If you have any questions regarding the contents of this paper, or would like to contact us, you may do so at:

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