

**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 the National Crowdfunding Association

**DATE:** May 14, 2012

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On May 14, 2012, Commission staff met with representatives from the National Crowdfunding Association to discuss issues regarding the implementation of Title III of the Jumpstart Our Business Startups Act.

The following Commission representatives were present: David Blass, Joseph Furey, Joanne Rutkowski, Ignacio Sandoval, Leila Bham, Timothy White, and Shaheen Haji from the Division of Trading and Markets; Lona Nallengara and Tamara Brightwell from the Division of Corporation Finance; and Christine Sibille from the Office of Compliance Inspections and Examinations.

The following representatives from the National Crowdfunding Association were present: Sara Hanks of CrowdCheck, Inc.; David Marlett of National Crowdfunding Association; Kiran Lingam of 1billionangel.com; Renee Caputi, Stephen J. Temes and Maurice R. Lopes of Earlyshares; and Douglas Ellenoff and Sarah Williams of Ellenoff, Grossman & Schole LLP.

The National Crowdfunding Association meeting agenda is attached.

Attachment

**Attachment**

**MEMORANDUM**

**To:** Securities and Exchange Commission

**From:** National Crowdfunding Association

**Date:** May 11, 2012

**Re:** Issues and Comments Regarding Implementation of Title III of the JOBS Act

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We wish to thank you for the opportunity to meet with the Staff of the Securities and Exchange Commission (“SEC”) on May 14, 2012 to discuss the implementation of Title III of the Jumpstart Our Business Startups Act (the “Act”). In anticipation of our meeting, we respectfully submit the following issues and comments for your consideration. Please note that the comments and issues we are submitting do not necessarily reflect the individual views of each member of our organization.

**Investor Protection**

1. **Investment Limitations.** The Act limits the aggregate amount that may be sold by an issuer to all investors reliant on the Section 4(6) exemption to \$1 million per twelve-month period. Further, under Section 4A(a)(8) of the Act, intermediaries must make efforts to ensure that no “investor” in a twelve-month period has purchased crowdfund securities that, in aggregate, from all issuers, exceed the 4(6) investment limits. The Act does not define the term “investor” and is therefore ambiguous. The Staff has historically differentiated between retail, institutional and accredited investors. Institutional investors and accredited investors are sophisticated and have the resources to better manage risk. As with similar exemptions, institutional and accredited investors should be excluded from the aforementioned investment limitations, both as to individual offerings and in the aggregate, and should not be limited in the number of transactions in which they invest. *We request that the Staff clarify that the definition of “investor” in connection with investment limitations does not include accredited investors and institutional investors.*

2. **Rights of Rescission.** The Act provides that an investor who purchased securities sold pursuant to the crowdfunding exemption has the right to rescind a commitment to purchase such

securities. It is unclear when an investor's commitment becomes binding. To maintain an orderly market and prevent fraud, we believe the right to rescind a commitment should be limited to 48 hours from the time of the initial commitment, a change in investment terms or materially adverse disclosure. This will prevent commitments being made initially just to attract attention to a project then being withdrawn after new investors join. *We request that the Staff clarify the time period in which an investor may rescind a commitment to purchase securities offered under Section 4(6) of the Act.*

### **Compensation & Fees**

3. **Compensation.** The Act prohibits an intermediary's directors, officers or partners from having any financial interest in an issuer using its services. It is unclear whether this provision prohibits an intermediary from accepting equity, in whole or in part, as compensation for its services. We believe that the proper interpretation of this provision is that the intermediary must not have an equity interest or similar financial interest in an issuer at the time of the initial offering. *We request that the Staff provide further clarification on what constitutes a "financial interest" and whether this restriction is only applicable at the time of the initial offering.*

4. **Fees.** It is also unclear the extent to which an intermediary may request as compensation for its services such as an initial service fee, closing fees, management services fees. It is further unclear whether an issuer can require investors to pay transfer agent fees associated with a crowdfunding offering. We believe that it is important to allow flexibility on how certain fees and expenses are allocated to facilitate smaller offerings. The Act does not provide any limitations on permissible fee structures. This is important as it allows intermediaries to both develop flexible fee structures and promotes free market competition. *We request that the Staff clarify whether there are any limitations regarding the allocation of fees and expenses.*

### **Liability**

5. **Liability.** The Act states that an investor in a crowdfunding offering may institute legal proceedings against the issuer to recover damages for material misstatements and omissions by the issuer. Although it is Congress' intent that the issuer and its executives be legally responsible for material misstatements and omissions in the offering documents, we request clarification on whether an intermediary will be required to confirm any information presented by the issuer during the course of the offering or will be subject to liability for any violations by the issuer of its Section 4(6) obligations. *The Staff should clarify whether intermediaries will be permitted to request issuers to provide greater disclosure of information to the public than required by the Act and whether this enhanced disclosure will result in any imputed liability on the intermediary in the event of fraud or negligent misrepresentation by the issuer.*

6. Personal Liability of Directors & Officers. The Act is ambiguous to the extent directors and officers of issuers raising capital through crowdfunding offerings may be held liable in connection with shareholder actions. It is anticipated that the large shareholder base created from such offerings may result in increased derivative actions. *We request that the Staff provide greater clarification on the liability of directors and officers of issuers raising capital through crowdfunding.*

### **Capital Formation**

7. Securities. The Act permits issuers to raise capital through a registered intermediary by selling its equity securities, debt securities, and debt securities convertible or exchangeable to equity interests. The Act does not expressly restrict an issuer from offering any classes of such securities. We believe that issuers should be permitted to offer classes of securities that further define shareholder rights. Therefore, an issuer may elect to offer dividend preferred stock, non-voting preferred or a class of convertible debenture. *We request that the Staff confirm that the Act permits issuers to offer classes of the aforementioned classes of securities.*

8. Integration. The Act permits offerings under the crowdfunding exemption up to an aggregate of \$1 million in a twelve-month period. It is unclear whether the Staff will apply the “integration doctrine” under Rule 502(a) and aggregate a crowdfunding offering and any private placement offering. We believe that the \$1 million limitation pertains only to offerings under Section 4(6) of the Act and does not limit an issuer from raising additional capital reliant on an alternative exemption. *We request that the Staff clarify whether such offerings are mutually exclusive and an issuer raising capital through crowdfunding is not foreclosed from other exemptions provided by securities law.*

9. Held of Record. The Act restricts the transfer of securities purchased under Section 4(6) for a period of one year, subject to certain limited exceptions. The securities sold in a crowdfunding offering are not counted towards the held of record threshold whereby an issuer is required to register its securities. However, once such securities are transferred, the new shareholder will be included in such calculation. We believe that this may result in an issuer being required to register with the SEC its securities on the anniversary of an offering. The time and expense associated with such a registration for a small or new venture will limit the issuer’s working capital and affect its business operations. We believe that the exception from the held of record calculations should attach to the security and to not the holder. *We request that the Staff provide further clarification regarding this exemption.*

### **Crowdfunding Regulations**

10. Advertisements. The Act prohibits an issuer from advertising the terms of a crowdfunding offering, except for notices which direct investors to the intermediary. The Act is ambiguous as to the form and content that would constitute either an advertisement or notice. We believe that an issuer should be permitted to place a notice consisting of the basic terms of the offering on the issuer's website, at the issuer's place of business or to include in correspondence to its customers or mailing list subscribers. It is further unclear whether the Staff will permit notices to state the offering period, that investors may contact the issuer's management to discuss the offering or if it may include names of accredited investors participating in the offering. It is important for issuers to be able to inform their friends, family, customers and community of an offering without violating these provisions. The broad interpretation of the term notice will facilitate capital formation by allowing issuers to inform its social and business network of the offering. We believe that this will not compromise the framework for investor protection because investors will only be allowed to purchase such securities on an intermediary's website. *We respectfully request the Staff provide guidance on the conduct that would constitute either an advertisement or notice.*

11. Issuer Solicitation. The Act does not prohibit compensation to portal employees or agents to solicit issuers as opposed to investors. We believe that intermediaries should be permitted to attract quality issuers. *We request that the Staff clarify whether intermediaries will be permitted to compensate employees and agents to solicit issuers by commission, referral fee, or otherwise.*

12. Intermediary Services. While the Act prohibits intermediaries from handling securities of the issuer, we believe that the intermediary should be permitted to perform services similar to that of a transfer agent for the period of one year after a crowdfund offering. This will facilitate the crowdfunding process by providing an efficient and cost effective process of maintaining an accurate database of shareholder information. The crowdfunding intermediaries will have the technology that will permit the intermediary site to provide issuers with efficient and cost effective services for managing their shareholders. In addition, the requirement that an issuer retain a separate transfer agent may be cost prohibitive for smaller offerings. *We ask that the Staff clarify whether such services will be permitted.*

13. Investment Advice. The Act specifically prohibits an intermediary from offering investment advice or recommendations. However, the Act does not provide a definition of what constitutes investment advice or a recommendation. *We request that the Staff clarify whether the following actions would constitute either investment advice or a recommendation: (i) removing an offering after a period of time for lack of investor sufficient investor commitments; (ii) preventing an issuer from offering its securities on the intermediary's website because of failure to provide documents responsive to a the portal due diligence/disclosure standard; (iii) assuming an intermediary allows investors to comments or submit questions to an issuer on the intermediary's website, if the intermediary is moderating the comments to remove spam or prevent fraud; (iv) the positioning of issuer disclosures of offerings within the layout of the intermediary's website; (v) providing market and news updates; and (vi) declining to post an offering due to the offering not fitting into the 'type' or 'market characteristics' of the offerings that the intermediary seeks to limit itself to offering (i.e. film production securities, women owned businesses' offerings, etc.)*

14. Disclosures. The Act requires intermediaries to provide certain disclosures regarding the investment in unregistered securities and to provide investors with certain education materials. It is ambiguous in form and substance of the materials that must be provided. For example, it is unclear whether the risk disclosures may be provided by electronic communication or be available on the intermediaries website. *We ask that the Staff provide further clarification in the form of a draft model text that could be made be delivered to investors through the internet.*

15. Investor Education Information. The Act requires intermediaries to provide investors with investor-education information and to confirm that investors understand the risks of loss associated with crowdfunding. It is unclear what information and disclosures are required to meet this requirement. We believe that this requirement may be met by providing investors with disclosures regarding risks and requesting that each investor affirms its understanding of such risks. *We ask that the Staff provide further guidance on the extent of information that an intermediary must provide investors and its obligation to confirm an investor's understanding of such risks.*

16. Background Checks. The Act requires an intermediary to implement measures to reduce fraud, including completing enforcement regulatory history check on each officer, director, and person holding more than twenty percent with respect to the outstanding equity of an issuer. It is not clear whether the Staff will expect each intermediary to merely report the findings of these checks and allow the “crowd” of investors to determine the legitimacy of any issuer or individual and whether to take the risk, or whether the Staff will expect intermediaries to pass judgment on the issuer and/or its principals and thus possibly deny the offering on some basis arising from said assessment. *We ask that the Staff provide additional guidance on the extent of background checks that must be completed and the responsibilities of the arising from said assessment.*

17. Annual Financial Disclosure. The Act requires an issuer that has completed a crowdfunding offering to file the results of its operations and financial statements annually and also to provide investors with such filing. This requirement is ambiguous and requires further clarification. In the event that a company has not completed a full year's operations and thus cannot produce complete financial statements, it is unclear the extent to which such information should be made available and if such a filing will satisfy this obligation. It is further unclear whether the issuer can provide investors its filing by posting such filings on its website or sending via email to investors of either a notice of such a website posting the actual filing itself. Furthermore, it is unclear whether the issuer's submission will only require the financial status of the issuer or if any qualitative disclosures are also required. *We ask that the Staff clarify the extent of the disclosure required to meet this requirement.*

18. Audit Requirements. The Act requires any offering under Section 4(6) of the Act greater than \$500,000 to provide investors with audited financial statements. The Act is ambiguous as to the type and extent of audit that is required to satisfy this obligation, particularly for new ventures and growth companies. Further the Act is unclear as to whether a crowdfunding offering will be considered, for the purposes of the audit provisions, to be “public,” and thus the Generally Accepted Auditing Standards for such an audit will be under the jurisdiction of the PCAOB (Public Company Accounting Oversight Board), or “private” and under the jurisdiction of the AICPA's ASB (Audit Standards Board). We believe that due to the relative size and nature of crowdfunding offerings,

that the financial statements should be under the jurisdiction of the ASB, not the PCAOB. To that end, the National Crowdfunding Association wishes to work with the ASB to propose a set of audit standards for crowdfund offerings that will protect investors while managing audit costs so that such costs do not hinder the offerings the Act was intended to facilitate. *We request that the Staff clarify which audit standards authority will have jurisdiction over the audit of offerings under Section 4(6) of the Act, and that such authority be permitted to develop audit standards which will not be cost-prohibitive to crowdfund transactions.*

19. **Record Keeping.** The Act requires intermediaries to provide investors with certain information about the risks of crowdfunding and to “ensure” their understanding. We believe this requirement may be satisfied through an online questionnaire. This will promote efficiency by avoiding the time and costs associated with mailing transaction documents associated with an offering to investors and will also be environmentally friendly. *We request that the Staff confirm the extent to which questionnaires and agreements may be completed electronically through the portal.*

20. **Record Keeping of Aggregate Investments.** Under Section 4A(a)(8) of the Act, intermediaries must make such efforts as the SEC determines appropriate, to ensure that no investor in a twelve-month period has purchased crowdfund securities that, in aggregate, from all issuers, exceed the Section 4(6) investment limits. It is unclear how an intermediary will be able to verify whether an investor had exceeded the aforementioned investment limitation considering its limited access to information. *We seek clarification from the SEC whether an intermediary is entitled to rely upon the representation of an investor as to its prior investments in such securities to satisfy this obligation.*

## **Registration & Compliance**

21. **Registration.** Transactions pursuant to Section 4(6) may only be executed through an intermediary registered as either a broker-dealer or funding portal. The Act requires the Staff to provide additional regulation on the registration process for funding portals. We believe that the Staff should provide guidance on the registration process before the final rules are adopted and permit funding portals to register. It would be inequitable to permit registered broker-dealers to act as intermediaries without affording funding portals the opportunity to timely register. *We request the Staff clarify whether funding portals will be permitted to complete the registration process prior to the expiration of the 270 day rulemaking period.*

22. The registration requirements are also ambiguous to the extent an intermediary uses a third-party service providers for certain services and pays that service provider a percentage of the sums raised by the intermediary whether the third-party service provider is subject to any registration, disclosure or other requirements. *We request that the Staff provide additional clarification whether in such a situation the third-party would be subject to registration.*

23. Self-Regulatory Organization. The Act requires an intermediary to be registered with the SEC and any applicable self-regulatory organization. *We request that the Staff clarify as soon as possible whether the Financial Industry Regulatory Authority will serve as the crowdfunding industry's self-regulatory organization.*

24. Funding Portal. The Act defines a funding portal in accordance with the definition provided in Section 3(a) (80) of the Securities Exchange Act of 1934. It is unclear whether a funding portal by this definition must be a single entity with a single internet site. Since the Act defines a funding portal with reference to its conduct and not its form, we interpret the Act as permitting a duly registered funding portal to be able to have multiple intermediary websites under a single registration application. This will permit a registered portal to offer issuers the opportunity to offer their securities on a funding portal website that is specific as to such parameters including industry, geography, community and affinity group. This will result in a better organized market for both issuers and investors. *We seek clarification from the Staff of the exact definition of a funding portal and the extent the foregoing structure will be permissible.*