Via electronic mail at rule-comments@sec.gov

January 27, 2014

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Crowdfunding; Proposed Rule [File No. S7-09-13], 78 FEDERAL REGISTER 66,428 (November 5, 2013) (the "Proposed Rules")

Dear Ms. Murphy:

Propellr LLC[1] ("Propellr") welcomes the opportunity to submit its comments on the proposed rules (the "Proposed Rules")[2] to implement the exemption from Securities Act of 1933 (the "Securities Act") registration for "crowdfunding" securities offerings as set forth in the Jumpstart Our Business Startups Act (the "JOBS Act"). Title III of the JOBS Act adds Section 4(a)(6) and Section 4A to the Securities Act to establish this exemption.

Propellr very much appreciates the hard work of the Securities and Exchange Commission (the "Commission") and its staff in formulating the Proposed Rules. We believe that crowdfunding will play an important role in the US economy by creating new opportunities for small businesses, start-ups and entrepreneurs to access capital, and for investors of all sizes to have access to a greater array of investments. In the Proposed Rules, the Commission sought to strike a reasonable balance between creating this increased access to capital and protecting the broader pool of investors eligible to invest under Title III of the JOBS Act. Propellr believes that the Commission reached a worthy result overall. We hope that our comments below, and in any other comment letters that we may submit, will result in certain changes that account for some of the nuance associated with different types of issuers and offerings to make crowdfunding both safe and accessible.

This letter in particular focuses on the ability of crowdfunding intermediaries to invest in the issuer(s) whose securities they offer. In the final rules, we respectfully request that the Commission clarify that the following types of investments by an intermediary will be permissible:

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1 Propellr is an alternative asset management marketplace providing accredited investors direct access to institutional quality investments. Propellr strives for the alignment of interests between individual investors and issuers through structure, professional due diligence and asset management resulting in superior risk adjusted returns.

2 *See* Crowdfunding; Proposed Rule, 78 Fed. Reg. 66,428, 66,460, *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-11-05/pdf/2013-25355.pdf.

(i) In response to Request for Comment 124, an intermediary should be permitted to invest alongside the other investors in the crowdfunding offering, on the same terms;

(ii) An intermediary should be allowed to make secondary market purchases and sales of securities issued in a crowdfunding offering; and

(iii) An intermediary should be allowed to purchase securities of the issuer in subsequent offerings, whether or not those securities have the same features as those issued in the crowdfunding offering.

Propellr believes that allowing an intermediary to co-invest in an issuer utilizing its platform at the same time or after other investors makes for a better alignment of interests, and encourages the intermediary to take more seriously its assigned role. Moreover, Propellr does not see any prohibition of these activities in Title III of the JOBS Act.

Our comments are structured as follows. First, we provide specific comments in response to the Commission's Request for Comment 124 in support of the ability of intermediaries to co-invest in a Title III offering by an issuer on its platform on the same terms as other investors. Second, we request clarification on the issue of whether an intermediary may invest in a Title III issuer in both: (i) simultaneous or subsequent offerings; and (ii) secondary-market transactions in the Title III securities.

I. Request for Comment Item 124: The Commission Should Permit Intermediaries to Co-Invest in Offerings

The Commission requested comment on whether intermediaries should be permitted to co-invest in an issuer under the same terms as other investors participating in an offering made in reliance on Section 4(a)(6) and Section 4A, and, if such an arrangement is permitted, what disclosures should be made in connection with such a co-investment. Section 4A(a)(11) of the Securities Act requires an intermediary to prohibit its directors, officers or partners (or any person occupying a similar status or performing a similar function) from having any financial interest in an issuer using its services for a Title III offering. The Proposed Rules implement the prohibition by importing the language of the statute and broadening it to prohibit the intermediary itself from having any financial interest in the issuer.[3] The Proposed Rules further note that an intermediary would specifically be prohibited from receiving a financial interest in an issuer as compensation for services provided to, or for the benefit of, the issuer, in connection with the offer and sale of its securities. The Proposed Rules would interpret "any financial interest in an issuer," to mean a direct or indirect ownership of, or economic interest in, any class of the issuer's securities.[4]

Propellr supports rules that would permit either type of crowdfunding intermediary (a registered broker-dealer or a funding portal), to purchase a financial interest in issuers using its services, so long as the interest takes the form of the intermediary co-investing in the offering, on the same terms as other investors. At the same time, Propellr recognizes the Commission's concerns regarding potential conflicts of interest from such a financial stake and appreciates the need for investor protection. In the proposing release, the Commission notes that the Proposed Rules would prohibit intermediaries from having a financial interest in the issuer prior to the offering in order to avoid improper incentives to promote an offering.[5] The Commission next explained that the Proposed Rules would prohibit receipt of a financial interest in an issuer as compensation for services, because the promise of a financial stake in the outcome of the offering would create a perverse incentive for the intermediary to ensure the success of its own investment at the expense of investors and other issuers using the intermediary's

[3] Proposed Rule 300(b).

[4] Crowdfunding; Proposed Rule, 78 Fed. Reg. at 66,460.

[5] *Id.* at 66,461.

platforms, "particularly if the financial interest is provided to the intermediary on different terms than to other investors."[6]

Propellr acknowledges that the Commission raises real concerns. Nevertheless, Propellr strongly supports allowing intermediaries to purchase securities in the offering itself on the same terms as other investors, together with certain additional safeguards. Propellr firmly believes that this structure aligns the interests of the intermediary and investor to a much greater degree than placing them in conflict.

By incurring the monetary risk of investing in the issuer at the same time and on the same terms as other investors, the intermediary has a vested interest in the outcome. The intermediary is more likely to hold the issuer to more rigorous standards and more diligently conduct the offering so as not to jeopardize the investment it intends to make. Furthermore, having "skin in the game" creates an incentive for the intermediary to more carefully scrutinize and screen potentially fraudulent or "bad actor" issuers, or those issuers who simply are not ready to conduct an offering. Intermediaries will also have greater incentive to structure the offering in ways that are fair to both investors and issuers. By protecting its own investment, which is on the same terms as that of other investors, the intermediary provides a benefit to all purchasers in the offering.

We note that co-investment is normally permissible in connection with most types of private offerings, and is in some cases demanded by regulation or the marketplace. For example, the recently reproposed risk retention rules, which implement the requirements of Dodd Frank Act section 941, mandate that sponsors of various types of securitizations retain at least a five (5%) percent interest in the offering or the underlying assets.[7] Similarly, hedge fund and private equity fund managers and their employees long have been co-investors in the funds they sponsor and manage in response to market demands. In both situations, the alignment of interests alleviates some of the concerns presented by such investments.[8] And these concerns arise notwithstanding that the investors in securitizations and private funds typically are at least accredited investors, if not qualified purchasers or institutional accounts. It seems an odd result that affluent and institutional investors often receive the benefits of such an alignment of interests, but Title III investors may under no circumstances receive the same advantages.

Perhaps the most salient analogy comes from the AngelList and FundersClub no-action letters issued in March 2013 by the staff of the Division of Trading and Markets.[9] Each involved offerings performed through a technology platform where the intermediary co-invested in the issuer alongside accredited investors. In both letters, the staff granted no-action relief from registration as a broker to investment advisers who sponsored and managed single purpose entity investment funds. The investment advisers sought such relief because they functioned as intermediaries in establishing and marketing their funds. The sole distinction between the circumstances in those no-action letters and the proposal advocated by Propellr herein is the presence of accredited investors. If sophisticated investors insist on co-investment and the Division of Trading and Markets recognizes it as a legitimate practice in other types of private offerings, we urge the Commission to permit it in Title III offerings.

The existing safeguards already in the Proposed Rule and the federal securities laws more generally should mitigate concerns over conflicts of interest. Propellr appreciates and takes seriously the paramount concern of investor protection, and accordingly suggests the Commission mandate that intermediaries can only co-invest on the same terms as the rest of the "crowd." These terms include a

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6 *Id.*

7 Credit Risk Retention, 78 Fed. Reg. 57928 (Sept. 20, 2013; originally released Aug. 28, 2013).

8 *E.g., id.* at 19-20.

9 *See*, *e.g.*, AngelList LLC, SEC No-Action Letter (Mar. 28, 2013), *available at* http://www.sec.gov/divisions/marketreg/mr-noaction/2013/angellist-15a1.pdf; FundersClub Inc. and FundersClub Management LLC, SEC No-Action Letter (Mar. 26, 2013), *available at* http://www.sec.gov/divisions/marketreg/mr-noaction/2013/funders-club-032613-15a1.pdf ("FundersClub").

one-year restriction on sales to other than sophisticated investors, which adequately addresses the risk of a "false start" or "pump and dump" schemes. The limits on the amounts of investments, advertising and customer solicitation also provide practical curbs on abusive practices. Moreover, existing antifraud rules provide an overarching means to punish wrongdoers.

As stated previously, the Commission further warns that an intermediary receiving a financial stake in an issuer could create an incentive for the intermediary to market that particular issuer at the expense of other issuers. This incentive, according to the Commission, could result in an uneven playing field among issuers, because such inequality (i) undermines the very spirit and purpose – to afford smaller start-ups and companies equal footing and opportunities they cannot find in existing funding frameworks like venture capital – of crowdfunding, and (ii) hurts investors by not showcasing for them the full-range of investment options. Propellr believes, however, that the existing safeguards already built in to the Proposed Rules address these issues as well.

First, there is little incentive to market one issuer over another under the type of co-investment Propellr suggests above. The intermediary is simply choosing whether or not to invest alongside the other investors in the offering. Indeed, the intermediary may not have made that decision at the time the offering commences. With the disclosure requirements of the Proposed Rules, the antifraud and anti-manipulation requirements of the federal securities laws, and the ability of the crowd to discuss transparently all aspects of the offering, the intermediary stands on the same footing as other potential investors. Even if the intermediary does decide to invest before the offering commences (or well before it will close), the offering may still fail, the intermediary may be only one of a few investors, or countless other permutations may occur leaving the intermediary at risk.

Second, the rules should require disclosures concerning the intermediary's involvement so that investors are aware of the financial interest. Among other things, the intermediary should be required to commit with enough time to allow other potential investors to discuss this factor on the required communication channel, and to withdraw, if they like. Once the intermediary has decided to invest, it should not be permitted to withdraw its commitment, unless the offering fails by its terms. The final rules can be crafted in such a manner as to prohibit the intermediary from forcing the issuer to terminate the transaction if the intermediary becomes dissatisfied with its commitment.

Third, any concern that a funding portal's financial interest in a particular issuer constitutes implied "investment advice" or a "recommendation," is unwarranted.[10] Foremost among the factors that militate against such a concern is that the fact of being an intermediary for an issuer and its offering already carries an implicit endorsement. We urge the Commission to consider the implied recommendation that comes with the intermediary's due diligence obligations and requirements to reasonably ensure that the issuer and the offering are appropriate for investors. Intermediaries also must seek to weed out bad actor issuers. These facts combined make for a strong endorsement.

Moreover, we strongly believe that the alignment of interests created by an intermediary co-investing outweighs any concerns of an "endorsement." In addition to the benefits of common interest discussed above, issuers will want to shop for an intermediary willing to co-invest alongside the other investors. If an issuer is unable to find an intermediary willing to co-invest, that acts as a further deterrent against issuers who simply are not ready for broader investorship for any of a number of reasons.

[10] The Proposed Rules' prohibition on "investment advice and recommendation" is limited in scope to funding portals and not registered broker-dealers. Therefore, the concern that an intermediary's financial stake constitutes implicit investment advice is relevant only to funding portals. Propellr strongly believes that such a stake would not constitute investment advice, as outlined in the arguments above and, consequently, both funding portals and registered broker-dealers should be permitted to co-invest in crowdfunding issuers. However, if the Commission deems that such a co-investment would in fact be an implied recommendation, then Propellr strongly argues that at least registered broker-dealers be permitted to co-invest in crowdfunding issuers.

We also note that there exist appropriate safeguards within the Proposed Rules to ensure that the intermediary's platform is neutral and unbiased. For example, intermediaries may only highlight offerings on their platforms based on objective criteria.[11] Indeed, a funding platform's display of issuers and offerings "must be reasonably designed to highlight a broad selection of issuers, so as to not recommend or implicitly endorse one issuer or offering over another, and must be applied consistently to all potential issuers and offerings."[12] Furthermore, any selection criteria used by the intermediary must not be based on an assessment of the merits of a particular issuer and the criteria must be disclosed on the intermediary's platform. . . .[13] Propellr believes that the receipt of a financial interest in an issuer can and should be interpreted by the Commission as an "assessment of the merits of a particular issuer" and therefore such issuers would be prohibited from being highlighted by the Proposed Rules already in place.

The Proposed Rules also provide for a comprehensive and mandatory communication channel, which acts as an additional layer of investor protection to allay the Commission's concerns.[14] These communication channels are fully public and allow for very limited participation on the part of the intermediary. These mandatory channels, combined with the sharing and use of information based on the "wisdom of the crowd" to decide whether or not to fund a campaign, effectively establish an additional check on any potentially unequal treatment of issuers by the intermediary.[15] For instance, even if an intermediary were to devise some method to highlight an issuer in which it intends to co-invest at the expense of another issuer, we should trust that the collective "wisdom of the crowd" will appropriately filter this information, identify and generate "buzz" on a non-highlighted but investment-worthy issuers, and otherwise bring the right information to the fore.

As discussed above, Propellr strongly believes that permitting intermediaries to co-invest in the offering on the same terms as other investors furthers the goals of both Congress and the Commission in crowdfunding offerings. The alignment of interests is a powerful tool, as demonstrated in other situations, and the various limitations and restrictions in the Proposed Rules and the federal securities laws conquer any lingering conflicts of interest, resulting in high-quality offerings and better-protected investors.

II. The Commission Should Permit Intermediaries to Invest in Later Offerings by Issuers and to Purchase Issuer Securities in the Secondary Market

In the proposed release, the Commission does not specifically address whether an intermediary can: (i) purchase securities of the Title III issuer in simultaneous or subsequent offerings, such as private placements pursuant to Regulation D, or (ii) effect for its own account secondary-market transactions (both purchases and sales) in the securities from a crowdfunding offering that originated on its platform. Propellr respectfully requests that the Commission in the final rules make clear that both of these activities are permissible, so long as the transactions are otherwise in accordance with applicable laws and rules, including disclosure requirements. Propellr believes that these transactions would be permissible after other types of private and public offerings, again so long as they are otherwise effected in accordance with applicable laws and rules. Propellr is unaware of any reason that crowdfunding offerings should engender differing treatment of these post-offering transactions.

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[11] Such objective criteria may include, among other things, the type of securities being offered; the geographic location of the issuer; the number or amount of investment commitments made; and the progress in meeting the target amount or, if applicable, the maximum offering amount, and minimum or maximum investment amount.

[12] Crowdfunding; Proposed Rule, 78 Fed. Reg. at 66,486.

[13] *Id.*

[14] *See* Proposed Rule 303(c).

[15] Crowdfunding; Proposed Rule, 78 Fed. Reg. at 66,429.

III. Conclusion

Propellr recognizes and supports the efforts by the Commission in its proposed rulemaking to establish a crowdfunding regime. These types of offerings will make capital more accessible to the entrepreneurs, small businesses and start-ups that need it to thrive and create jobs. Just as importantly, it will further democratize investing. In developing this regime, we do urge the Commission to consider the ability for intermediaries to invest in issuers that access the capital markets through them.

Propellr appreciates the opportunity to submit comments on the Commission's proposed rules relating to crowdfunding offerings. If it would be helpful to discuss Propellr's specific comments or general views on this issue, please contact me at (212) 255-2277 or todd@propellr.com.

Respectfully submitted,

Todd Lippiatt, CEO
Propellr LLC

cc: The Hon. Mary Jo White, Chair
The Hon. Luis A. Aguilar, Commissioner
The Hon. Daniel M. Gallagher, Commissioner
The Hon. Michael S. Piwowar, Commissioner
The Hon. Kara Stein, Commissioner