

Comments to the SEC's Proposed Crowdfunding Rules

After reviewing the Security Exchange Commission (SEC or the Commission) proposed rules for crowdfunding, we would like to provide our comments for the Commission to consider. Our comments are organized according to the questions shown in the document of the Commission's proposed rules.

Q6: Regarding annual income and/or net worth.

Comment: We support to set up investment limitations for investors who have different levels of income/net worth. Our concern relates to “net worth” in the proposed investment limitation. For some investors, they may be asset-rich but income-poor. If the net worth is counted and/or included, they may be qualified at a higher level of investment limitation. However, because they may have the limited income, their investment should really be restricted to a lower level, say, \$2,000 or 5 percent of their income. We would like to suggest to taking “net worth” out of the consideration. Additionally, non-U.S. investors may have interpretations for net worth that are different from what we have been using in the United States.

Q12: The proposed rule would prohibit an issuer from conducting an offering or concurrent offerings in reliance on Section 4(a)(6) using more than one intermediary. Is this proposed approach appropriate?

Comment: We would like to suggest the Commission to re-consider this proposed approach. Although we understand the Commission's concerns, the proposed rule may hurt the competitiveness of the crowdfunding market. For example, after an issuer selected a funding portal for offering securities, he might soon discover that the funding portal was not a good match for his company. Although he hoped to attract a good crowd, it has not happened yet after awhile. With additional research, he identified another portal that might offer a good opportunity. Based on the proposed rule, he can only make the offering on one portal. By then, he would face a dilemma such as whether to close the account on the first portal and move to the second portal, or continue to stay with the first portal. He might conclude that he would face a “lose-lose” situation because he might lose potential crowd on the first portal if he left. However, if he stayed with the first portal and could not build up a crowd for one reason or another, he would lose a chance to build crowd on the second portal.

From the regulatory point of view, the difficulties for monitoring an issuer using several funding portals concurrently may be related how to ensure that the rule for the limitation on capital to be raised by the issuer will be followed. We would like to suggest that the Commission requires all funding portals to provide a warning message on their websites and inform issuers to follow the rule when raising capital.

Q25: Should the requirement to disclose the business experience of officers and directors include a specific requirement to disclose whether the issuer's directors and officers have any prior work or business experience in the same type of business as the issuer?

Comment: We understand the reasons that the Commission wants issuers to disclose officers' and directors' work and business experience. However, we are concerned that the proposed rules may turn some startups away from the crowdfunding market. We would like to illustrate our concerns by discussing two scenarios.

In the first scenario, a potential business owner has a new idea that may or may not relate to his prior work and business experience and he hopes to get financial support to launch the business. Whether to launch his own business almost entirely depends on the availability of investment funds. He may

choose not to provide his past experience because he believes that it may be counter-effective for his offering.

In the second scenario, a potential business owner is still working for his current employer. The disclosure of his current or past employers may endanger his current job and would have negative effects on his income. As a result, the potential business owner would skip using crowdfunding.

For issuers that have been in business for awhile, the requirement for disclosure would be reasonable. But, for new issuers that have not started a business yet, the requirement for this disclosure may become an issue that will cause new startup owners to think twice whether to use crowdfunding.

Q42: Should we require disclosure of certain related-party transactions, as proposed?

Comment: If possible, we would like to suggest the Commission to change “related-party transactions” to “any other investments” received in past 12 months and/or to be received. We have two reasons for this suggestion. First, the term of “related-party” may be difficult to understand for small businesses that have not had any experience in stock related offering. Second, a relatively broader definition for the “related-party” may be needed. For example, suppose that an issuer wants to open a new business. He would receive a certain level of financial support from potential investors outside of the crowdfunding market and also outside of definition for the “related-party,” but the financial support is contingent on the conditions if he can raise amount of cash from sources like the crowdfunding market. Because the potential investment has not been materialized, he would not need to disclose such potential investment based on the proposed rules, but the potential investment may be important for attracting investors.

Q38: Are these proposed disclosure requirements appropriate?

Comment: We would like to point out potential confusions in disclosing the number of employees. We agree that it is important to collect this data from each issuer. However, if new startups have not entered operation, the number of employees would be an estimate rather than a real number. Additionally, if it is not required to report full-time equivalent employees, issuers may count everyone who may be involved full-time, part-time, or voluntarily. As a result, the quality of employment data may become questionable.

Q50: The proposed rules would require all issuers to provide a complete set of financial statements prepared in accordance with U.S. GAAP. Should we define financial statements differently than under U.S. GAAP?

Comment: We would like to suggest the Commission to re-consider this proposed rule. For small businesses no matter which stage they are in, they would face a steep up-hill learning curve to gain knowledge and follow U.S. GAAP accounting rules because most of them may not have in-house accountant(s) and/or have limited fund for hiring an outside accountant. The principal executive officers, however, would want to focus more on developing business. As a result, this requirement may turn some, if not most, small businesses away from the crowdfunding market.

Alternatively, what small businesses may already have and is readily for being used would be information from their tax return data. For issuers that have an operational history, the tax return should be readily available. If they are instructed to disclose selected key and relevant data items, such as gross revenue, gross cost, total assets, total liability, total cash, total debt, and other data items from the

tax return, we believe that they would feel a big relief from the requirement of financial statement as indicated in the proposed rules. Asking small businesses for specific financial data items that are readily available, instead of asking them to learn and follow certain accounting rules, would encourage them to participate the crowdfunding market.

Although we are proposing to use data from tax returns, we would like to suggest the Commission to re-consider the requirement for issuers to submit an income tax return when offering \$100,000 or less. To avoid revealing the tax return and privacy related information online, an issuer may decide to offer \$100,000+, even though he may only need \$50,000.

For new startups without an operational history, we would like to suggest the Commission to require issuers to report their personal related financial conditions, especially total debts. One of the risks investors may face is that issuers misuse the investment fund to pay down their personal debts.

Q78: ... Would it be appropriate to require disclosure of the final price but not require reconfirmation?

Comment: In theory, the reconfirmation of investment commitment makes sense. However, because the Internet operation is 24/7 and issuers and investors may get online (or ignore it) at any moment, the reconfirmation may create problems for everyone. The following example illustrates potential impacts to each party involved and also our concerns. In the example, we assume that each of the 100,000 investors committed \$10 for a \$1 million funding request, which would be closed in five days:

- **Investors:** Although a reconfirmation email was sent and received, investors may not respond because they have been traveling, felt disturbed by additional actions needed for a small investment, or simply were too busy to reconfirm. Or worse, some reconfirmation emails went into the “spam” email box. As a result, half of 100,000 investors did not respond on time and their investments have to be canceled.
- **Issuers:** Although they have felt excited for getting close to receive investment fund, it turns out that only \$500k were reconfirmed. Because the special needs of their business, the funding of \$1 million is a must. As a result of the reconfirmation, they have to extend the deadline and hope to receive new investment commitments.
- **Funding portal:** As required by the rules, the funding portal sent out 100,000 reconfirmation emails to investors. As a result that issuers extended the deadline, the funding request for this business has entered the second round. The funding portal operator is afraid that the reconfirmation may result a never-ending loop for each issuer's funding request.

Q131: The proposed rules would implement Section 4A(a)(5) by requiring the intermediary to conduct a background and securities enforcement regulatory history check aimed at determining whether an issuer or any of its officers, directors or 20 percent Beneficial Owners is subject to a disqualification, ... Is this approach appropriate?

Comment: Please clarify whether an intermediary should conduct a background check on an issuer and all its officers, directors and 20 percent Beneficial Owners; or only need to check the issuer or its officers, directors, or 20 percent Beneficial Owners. If the intermediary needs to conduct a background check for All of an issuer’s officers, directors, and major stock holders, the costs and efforts would become major considerations for issuers that are small businesses. As a result, some small businesses may decide to skip the crowdfunding market.

Q173: Are the proposed requirements for fund maintenance and transmission appropriate?

Comment: We would like to ask the Commission to clarify whether the following scenario would be permitted by the proposed rules for maintaining and transmitting investors' fund. Before accepting investors' investment commitments, whether a funding portal is permitted to direct investors to transmit fund to a designated bank account, which is opened exclusively for investors and issuers. If an investor does not have any money available in the bank account before making commitments, the funding portal is permitted not accepting the investment commitments. We would like to use an example below to illustrate why we have this concern.

Suppose that an issuer's offering has attracted investors' attention and received many investment commitments. On Day T, which also was the deadline set up by the issuer, about 100 investors made investment commitments that resulted the total investment committed exceeding the target fund. Although the funding portal handling the issuer's offering directed those 100 investors to transmit the fund to a bank account at the same day, it would take five days (or T+5 days) to complete the transactions because Day T was a Friday. On Day T+5, the funding portal only received money from 60 investors. Among other 40 investors, 20 of them did not have enough balance for transmitting and another 20 of them had some problems in their accounts or other issues. However, the investment committed by those 40 investors was more than 50 percent of the target fund or \$500,000.

Based on the proposed rules, the funding portal should send the money to the issuer promptly on Day T. But, the funding portal could only send the investment fund it had to the issuer. Until Day T+5, the funding portal learned and realized that the portal might involuntarily become an investor for the issuer because of the failure of receiving the money from those 40 investors. That became a real problem for the funding portal as it could not cancel the commitments made by those 40 investors, but the issuer might have to re-open the offering.

We are concerned that this problem will not be resolved even though the proposed rules would allow extra time such as T+x days for investors to transmit money. Perhaps, the only solution is that an investor can only make an investment commitment if he has a balance in the bank account opened by the funding portal for investors. Alternatively, a clarification for the "investment commitment" would be very helpful.

Q206: Should the Commission impose additional or different conditions for nonresident funding portals than those proposed?

Comment: We would like to suggest the Commission to consider imposing at least one additional condition on nonresident funding portals. If a nonresident funding portal operates in a foreign country and uses a foreign bank for processing money, the funds invested by U.S. investors would be transferred to the foreign bank with or without investors' acknowledgment. To protect U.S. investors' interests, the additional condition the Commission may impose is to ask the nonresident funding portal to clearly indicate on their websites that they are organized and operated outside the United States, and whether a U.S. or non-U.S. Bank will be used for processing investors' funds.

Q233: Are there any other requirements under the BSA and its implementing regulation that should be clarified, ...?

Comment: Because non-U.S. investors may participate crowdfunding and use the U.S.-based funding portals, please advise and provide suggestions how to prevent anti-money laundering.