Via email to: rule_comments@sec.gov

May 28, 2014

Kevin M. O'Neill
Deputy Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. S7-09-13
Release Nos. 33-9470; 34-70741
Regulation Crowdfunding

Dear Mr. O'Neill:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "Committee" or "we") of the Business Law Section (the "Section") of the American Bar Association (the "ABA"), in response to the request for comments made by the U.S. Securities and Exchange Commission (the "Commission") in the above-referenced release proposing new Regulation Crowdfunding (the "Proposing Release")[1] under the Securities Act of 1933, as amended (the "Securities Act"), and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), to implement Title III of the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"). This letter has been prepared by the Committee with the participation of, and in conjunction with, the Middle Market and Small Business Committee (along with the Committee, the "Committees") of the Section. The comments made in this letter represent the views of the Committees only, and have not been approved by the ABA's House of Delegates or Board of Governors. Accordingly, our comments do not represent the official position of either the ABA or the Section.

I. Overview and Summary of the Committees' Comments and Recommendations

The Committees generally support the Commission's approach to implementation of the JOBS Act crowdfunding provisions, as reflected in proposed Regulation Crowdfunding. Our comments and recommendations therefore focus on those areas in which we believe we can offer constructive suggestions for improvement or refinement of the Commission's proposals. We also indicate specific aspects of the Commission's proposals that we support, and respond to specific Commission requests for comment.

At the outset, we appreciate the Commission's recognition that the JOBS Act as a whole reflects a Congressional intent that start-ups and small businesses should have access to a wider array of cost-effective capital-raising alternatives in both the public and private securities markets. During their initial stages of development and growth, small

[1] 78 Fed. Reg. 66428 (Nov. 5, 2013).

issuers now will be able to choose from among various exempt public (proposed Regulation A Tier 2 or crowdfunding provisions) or private (Regulation D Rule 506(b) or Rule 506(c)) offering models without triggering the full array of Exchange Act reporting requirements. And when these issuers are prepared to shoulder the burdens of full Exchange Act reporting, Title I of the JOBS Act will facilitate their entry into the public markets via a registered equity initial public offering.[2]

Because private companies now have a broader range of Securities Act exemptions from which to choose in seeking to raise capital, we believe it is important that the Commission make Regulation Crowdfunding as "user-friendly" as possible for those small private issuers that wish to engage in crowdfunding. Such issuers, in our experience, are less likely to attract institutional capital (e.g., funding from venture capital or private equity firms), and to have access to sophisticated legal and accounting expertise. Given the likelihood that principally early-stage issuers lacking in such resources will be interested in conducting an exempt crowdfunding offering, we recommend that the Commission fashion offering-related and ongoing disclosure requirements that are as simple and clear as possible to the extent consistent with the statute. In this regard, management of such issuers should be able themselves to read and understand the regulatory requirements, and become familiar with the liability consequences of noncompliance, without having to devote a significant portion of the proceeds of a crowdfunding offering to the payment of legal, accounting and financial advisory fees. The intended benefits of crowdfunding could be undermined, in our view, if the costs and burdens of compliance are inconsistent with the fundamental purpose of the legislation – to promote small business capital formation as a means of generating jobs. Moreover, considering the liabilities to which persons engaged in the unregistered offer and sale of securities may be subject as a result of noncompliance with Securities Act exemptive provisions, the final rule should not become a trap for unsophisticated small business persons attempting to raise relatively small amounts of capital via crowdfunding.

We also understand and acknowledge the importance of protecting investors, another key objective of the framers of Title III of the JOBS Act. Especially because of the high failure rate of small businesses and the risk of fraud, we are concerned that many small investors may be at risk of losing their entire investment in crowdfunding transactions. We also realize, however, that in enacting the crowdfunding provisions, Congress sought to strike a balance that affords investors certain protections without overburdening issuers. This balance is generally reflected appropriately, in our view, in the Commission's Regulation Crowdfunding proposal. Our comments are presented in the context of that legislative backdrop.

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[2] The JOBS Act also raised the threshold for triggering of mandatory registration of a class of equity securities under Section 12(g) of the Exchange Act.

II. Discussion

A. Crowdfunding Exemption

1. Limitation on the Amount of Capital Raised

In our view, the Commission's general approach to implementing, by rule, the limitation on the amount of capital that an issuer may raise pursuant to the Section 4(a)(6) exemption is reasonable and consistent with the directive set forth in the statute. Issuers may well be dissuaded from relying on Regulation Crowdfunding if the statutory $1 million cap were effectively to be decreased through the aggregation, with crowdfunding proceeds, of amounts raised in non-crowdfunding transactions conducted in reliance upon other Securities Act exemptions. Accordingly, we support the Commission's determination that amounts raised in exempt offerings conducted under Section 4(a)(6) and the implementing regulations should not be aggregated with amounts raised in other exempt offerings by the same or affiliated issuers during the preceding twelve-month period. So long as each offering complies with the requirements of the particular exemption that is being relied upon for the particular offering – whether that exemption is Section 4(a)(6), Section 4(a)(2) and/or Rule 506(b), Rule 506(c), Regulation A, and/or any other available exemption or exemptive safe harbor under the Securities Act – we agree that there is no sound policy reason to count the amounts raised under different exemptive provisions against Section 4(a)(6)'s $1 million cap within a given twelve-month period. We believe this approach is consistent with the regulatory treatment of other Securities Act exemptions where similar statutory amount limitations have been imposed.[3]

For the same reasons, we share the Commission's view that the doctrine of integration should not be applied automatically to integrate Section 4(a)(6) offerings with other exempt offerings by the same issuer (or affiliated issuers) that are conducted either concurrently or consecutively. The flexible interpretive approach the Commission has proposed[4] advances the legislative purpose underpinning Section 4(a)(6) – "to provide an additional mechanism for capital raising by startup and small businesses….," by enabling "[a]n issuer … [to] complete an offering that is made in reliance on Section 4(a)(6) that occurs simultaneously with, or is preceded or followed by, another exempt offering."[5] In short, we strongly support the Commission's determination that "offerings made in reliance on Section 4(a)(6) should not necessarily be integrated with other exempt offerings if the conditions to the applicable exemptions are met."[6] The example set forth in footnote 33 of the Proposing Release is particularly helpful in this regard, noting at least one way an issuer conducting concurrent crowdfunding and Rule 506(b)-exempt offerings may satisfy itself that a prospective investor in the Rule 506(b) private offering did not become interested in a private investment as a result of the "public" exempt offering made in reliance upon Section 4(a)(6). The ability of small issuers to rely on other Securities Act exemptions, especially those facilitating private offerings, will

[3] See, for example, Regulation A.

[4] This approach is entirely consistent with the interpretive guidance outlined by the Commission in a 2007 proposing release, regarding concurrent registered and private exempt offerings. See Revisions of Limited Offering Exemptions of Regulation D, SEC Rel. No. 33-8828 (Aug. 3, 2007), [72 FR 45116], at Section II.C.

[5] Proposing Release at 66432.

[6] Id. at 66433.

enable fundraising from more sophisticated investors whose financial acumen and diligence efforts can serve to enhance the protections of crowdfunding investors.

That said, we are concerned that it may be difficult for small, development-stage issuers to identify and analyze some of the more complex questions posed in the Commission's requests for comment without additional guidance from Commission or the Staff. To illustrate, it is not clear whether (and when) general solicitation/general advertising activities undertaken in connection with a Rule 506(c)-exempt offering will be regarded by the Commission or its Staff as having been conducted "in a manner that is intended, or could reasonably be expected to, condition the market for a [concurrent or subsequent] Section 4(a)(6) offering or generate referrals to a crowdfunding intermediary." (Request for Comment No. 3). Nor is it clear whether the limited advertising permitted in Section 4(a)(6) offerings pursuant to an intermediary's electronic platform might be treated as general solicitation or advertising that might taint a simultaneous exempt offering under Section 4(a)(2) and/or Rule 506(b) thereunder.

We would not favor prohibiting or restricting an issuer from offering securities under Section 4(a)(6) within a specified period before, after or contemporaneously with another exempt offering, or to impose any restrictions or conditions to reliance upon a non-crowdfunding exemption that would not otherwise apply in the absence of a concurrent or consecutive crowdfunding transaction undertaken pursuant to Section 4(a)(6). Instead, we recommend that the Commission or its Staff articulate a simple, principles-based analytical framework that would help smaller issuers identify and address integration questions on a case-by-case basis.

In response to the Commission's specific request for comment on this point (Request for Comment No. 3), we believe that an issuer that begins an offering under Section 4(a)(6) should be permitted to convert that offering to a Rule 506(c) offering. We see no sound policy basis for treating an offer under Section 4(a)(6) as preclusive of an offer made by means of general solicitation/advertising in reliance upon Rule 506(c) shortly thereafter, provided of course that all purchasers in the Rule 506(c)-exempt offering are accredited investors and the required "reasonable steps to verify" have been undertaken where necessary or appropriate.

2. Individual Investment Limitation

We support the Commission's reasonable construction of Section 4(a)(6)(B) to allow for proposed rules that would impose an overall investment ceiling of $100,000 and, within that ceiling, to provide for a "greater of" limitation based on an investor's annual income or net worth. A more restrictive reading of the admittedly ambiguous statutory language, in our view, would unduly hinder small issuer capital formation without significantly enhancing investors' interests.

Under this two-pronged approach, a prospective investor with more limited resources would not be permitted to invest more than the *greater of* $2,000 or 5 percent of annual income or net worth, if *both* his or her annual income and net worth are *less than* $100,000. But if that prospective investor's annual income *or* net worth *exceeds* $100,000, his or her investment would be capped at the *greater of* 10% of annual income or net worth (whichever measure of financial means exceeds $100,000) *or* $100,000. This seems to us to fulfill Congressional intent to minimize any single investor's exposure to risk in a crowdfunding transaction, while allowing the issuer maximum flexibility. In this connection, as the Commission notes, the issuer is free to solicit larger investments from prospective investors meeting the "accredited investor" eligibility criteria of Regulation D (and even some who do not) pursuant to a concurrent unregistered offering, provided that the conditions to a different Securities Act exemption for that concurrent offering can be satisfied.[7]

B. Issuer Disclosure Requirements Applicable to Crowdfunding Transactions – Form C

1. Non-Financial Disclosure Requirements

We generally support the Commission's proposed Form C disclosure requirements relating to the issuer and the crowdfunding offering, but suggest a few refinements and modifications below.

a. Proposed Rule 201(d): Description of Business and Business Plan

If adopted, proposed Rule 201(d) of Regulation Crowdfunding would require issuers to provide their anticipated business plan, in addition to a description of the issuer's business. In the Proposing Release, the Commission indicated that it does not expect issuers to provide either "a document prepared by management for internal use only," or "a marketing document used to solicit investors[,]"[8] both of which have been described by commenters as a "business plan." But that raises the question of what the Commission does expect.

Although a discussion of an issuer's business and its business plan share common elements, we believe a business plan is more evolutionary and subject to ongoing updating and refinement. Because most issuers we expect to rely on Regulation Crowdfunding are likely to be in the early stages of development, it is unclear how specific their business plans will be at the time they most need to raise capital. Moreover, to the extent that such early-stage issuers have formulated business plans, these plans are likely to change over time, in some cases multiple times. In addition, the business plan disclosure requirement appears to overlap to some degree with the proposed requirement (in proposed Rule 201(i)) calling for a description of the purpose and intended use of the offering proceeds. We therefore recommend that the Commission eliminate the proposed requirement to disclose a business plan and, instead, simply require crowdfunding issuers to describe their business or proposed business, and disclose the purpose and intended use of proceeds. To assist issuers in crafting the requisite disclosure, it would be helpful if the Commission were to provide a non-exhaustive list of informational items that may be material to investors, including (but not necessarily limited to) the types of information regarding their plan of operations specified in Item 101(a)(2) of Regulation S-K.

In our view, the absence of a "specific idea or business plan" should not automatically disqualify an issuer from using the Section 4(a)(6) exemption as implemented by Regulation Crowdfunding. (Request for Comment No. 20). While we agree with the Commission that an issuer that has identified its sole business plan as engaging in a merger or acquisition involving

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[7] Id. at 66434.
[8] Id. at 66440 (footnotes omitted).

an unidentified company or companies should not be eligible to use the crowdfunding mechanism, we are concerned that a particular business idea or proposition disclosed by a crowdfunding issuer might be deemed after-the-fact (by the Commission or a disappointed investor) to be too non-specific to have permitted reliance on Section 4(a)(6), thus exposing that issuer to the potentially draconian consequences of a Section 5 violation.

b. Additional Non-Financial Disclosure Requirements

Certain aspects of the proposed disclosure requirements go beyond what is required by Section 4A(b) of the Securities Act and, in so doing, may impose burdens on smaller issuers that could outweigh any informational benefits to investors. Thus, while we understand that "Section 4A(b)(1)(I) specifies that the Commission may require additional disclosures for the protection of investors and in the public interest," we urge the Commission to give careful consideration to whether such disclosures are necessary or appropriate to protect investors given the other mandatory investor safeguards that will apply (including but not limited to the statutorily-prescribed disclosures, the intermediation and investor education requirements, and the proposed disqualification provisions). In our view, the foregoing safeguards, along with the antifraud provisions and attendant obligation to provide such additional information as may be necessary for investors' understanding of the risks of investment, are sufficient to ensure investor protection.

Set forth below are two examples of situations in which we see the proposed disclosures not mandated by Congress, if adopted, potentially could impose disproportionate burdens on smaller issuers without yielding significant investor protection benefits. In our view, compelling such disclosures could have the unintended consequence of discouraging issuers from relying on Regulation Crowdfunding to raise capital.

Example 1. Proposed Rule 201(b)

If adopted, proposed Rule 201(b) of Regulation Crowdfunding would require issuers to disclose the business experience of each director and officer for the preceding three years. Although this three-year period is less than the five-year period applicable to issuers conducting exempt offerings under current Regulation A, we note that this regulation has a $5 million/12-month ceiling, in contrast to the $1 million/12-month cap that is proposed for a Regulation Crowdfunding offering.

In our view, the statutory disclosures (i.e., names of each officer, director and greater than 20% holder), along with the proposed disqualification provisions and other safeguards imposed by statute, would afford investors sufficient protection. For this reason, we urge the Commission to limit the business experience disclosure requirement to one year, at most.

Example 2. Proposed Rule 201(f)

Proposed Rule 201(f), if adopted, would require issuers to discuss the material factors that make investment in a particular issuer speculative or risky. Item 2 to General Instruction II of proposed Form C also would require inclusion of the following legend: "A crowdfunding investment involves a risk. You should not invest any funds in this offering unless you can afford to lose your entire investment." However, all that is required by Section 4A(b) is a discussion of "the risks to purchasers of the securities relating to minority ownership in the issuer, the risks associated with corporate actions, including additional issuances of shares, a sale of the issuer or of assets of the issuer, or transactions with related parties." We believe that a discussion of the risks enumerated in the statute, along with the proposed legend, is all that should be required of issuers seeking to rely on the proposed crowdfunding exemption.

2. Financial Disclosure Requirements

The Commission has proposed to implement Section 4A(b)(1)(D) of the Securities Act by requiring the issuer to include the following in its Section 4(a)(6) offering materials: (a) a narrative discussion of its financial condition similar to the management's discussion and analysis of financial condition and results of operations ("MD&A") disclosure required of companies engaged in a registered offering; and (b) tiered financial statement disclosure requirements that increase in complexity and detail as the aggregate amount raised in crowdfunding transactions over the past twelve months exceeds certain monetary thresholds. For the reasons outlined below, we support the Commission's proposed financial disclosures, and offer a few suggestions for refinement that, in our view, would reduce small issuer costs without undermining investor protection.

a. Financial Condition Discussion

We support the Commission's flexible, principles-based approach to disclosure of financial condition that is predicated on materiality. However, we recommend against imposing a public company style "MD&A" disclosure obligation on small non-reporting companies as envisioned by the Instruction to proposed Rule 201(s). There is little Commission or judicial precedent that would serve to guide the management of a private company in assessing how a "reasonable investor" would view the total informational mix in a crowdfunding context. At a minimum, we urge the Commission to make clear that the following language in the Instruction does not establish a duty to disclose "known events, trends and uncertainties" as is required of public companies in the MD&A, because such a requirement would be difficult for start-up companies with little visibility into the future to apply: "For issuers with no prior operating history, the description should include, to the extent reasonably known, a discussion of financial milestones and operational, liquidity and other challenges."[9]

Without detracting from the flexibility the Commission is proposing to allow under Rule 201(s), we believe that it would be helpful to include in an instruction an illustrative, non-prescriptive list of Questions and Answers that management could consider in drafting the financial condition discussion. In this regard, Questions 47 through 50 of Form 1-A (Model A), used in current Regulation A offerings, may provide a useful template, although we would encourage the Commission to apply them only to companies that have an operating history.

In response to the Commission's Request for Comment No. 47, we believe that the proposed requirements for a discussion of the financial condition of the issuer are appropriate, even as to those issuers with no operating history (Request for Comment No. 48). Investors will

[9] Proposing Release at 66553 (regulatory text of proposed Rule 201(s)).

need some insight into a start-up's financial condition before committing their capital. We suggest, however, that the regulatory text of the final Rule or accompanying Instruction repeat the assurances in the Proposing Release that: (1) the Commission does not intend to prescribe content or format for the required information, but rather to set forth principles of disclosure that must be applied to the particular facts and circumstances of each issuer; and (2) to the extent that the disclosure items listed in the Instruction overlap with the issuer's description of its business, duplicative disclosure under Rule 201(s) is not mandated.

With respect to Request for Comment No. 49, we believe that the disclosure of prior exempt offerings spanning a three-year period under proposed Rule 201(q) is sufficient. Instead of mandating a discussion of these offerings under Rule 201(s), we suggest that the Commission leave the materiality determination up to each issuer in light of all relevant facts and circumstances while providing some illustrative examples to guide that determination. To illustrate, if the issuer's only source of working capital in the past three years has been the proceeds from exempt offerings, this information would be highly relevant to the issuer's discussion of its financial condition. Regarding possible disclosure of an issuer's failure to reach the target amount in a prior crowdfunding transaction, whether called for by proposed Rule 201(q) or proposed Rule 201(s), we believe that the Commission should allow issuers to conduct a case-by-case analysis with a focus on the materiality to current investors of the reason(s) the target amount was not reached (e.g., the issuer may have decided to halt a previous offering because of the need to consider an attractive acquisition proposal it was not prepared to disclose to investors in an earlier crowdfunding offering, but need more capital once the acquisition proposal fell through).

b. Tiered Financial Disclosures

New Securities Act Section 4A(b)(1)(D) establishes the following three tiers of financial statement disclosures tied to aggregate target offering amounts within the preceding twelve-month period (which as discussed may not exceed $1 million within that period), with the level of complexity of the prescribed disclosure increasing at specified dollar thresholds:

(1) $100,000 or less (Section 4A(b)(1)(D)(i)) -- income tax returns filed by the issuer for the most recently completed fiscal year (if any), and financial statements certified by the principal executive officer to be true and complete in all material respects;

(2) more than $100,000 but less than $500,000 (Section 4A(b)(1)(D)(ii)) – financial statements "reviewed" by an independent public accountant, "using professional standards and procedures for such review or standards and procedures established by the Commission, by rule, for such purpose;" and

(3) more than $500,000 or "such other amount as the Commission may establish, by rule, …, audited financial statements…." (Section 4A(b)(1)(D)(iii)).

Although the Commission's proposed rules mirror the statute's tiered approach based on aggregate offering amounts within a twelve-month period, these proposals go beyond the plain statutory language to prescribe that the issuer financial statements required for offerings in all three categories (as outlined immediately above) be prepared in accordance with U.S. Generally

Accepted Accounting Principles ("GAAP"), and cover the shorter of the two most recently completed fiscal years or the period of the issuer's existence. A complete set of financial statements presented in accordance with GAAP would be required for all three offering levels -- a balance sheet, income statement, statement of cash flows and statement of changes in owners' equity – with no exceptions for newly formed issuers without an operating history, and regardless of the amount raised.

Under the proposed rules, an issuer could conduct an offering in reliance on Section 4(a)(6) using financial statements for the fiscal year prior to the most recently completed fiscal year, provided that not more than 120 days have passed since the end of that issuer's most recently completed fiscal year, the issuer is not otherwise required to update the financial statements, and updated financial statements are not otherwise available. By the same token, issuers must include a discussion of material changes in their financial condition since the period covered by the financial statements (e.g., material changes in revenue or net income). Depending on the aggregate offering amount involved, a public accounting firm that satisfies the independence standards set forth in Rule 2-01 of Regulation S-X either must review (offerings of more than $100,000 but less than $500,000) or audit (offerings of more than $500,000) the required financial statements.

We generally support the approach to financial disclosure reflected in proposed Rule 201(t) and the instructions thereto, recognizing as we do the highly prescriptive language of the statute, but offer a few suggestions for modification that we believe would constitute (whether viewed alone or in the aggregate) a permissible exercise of Commission discretion under Section 4A(b)(1)(D). In particular, we think the Commission has the latitude to strike a more effective balance between issuer costs and investor protection benefits in crafting the financial statement requirements at all three offering levels fixed by the statute, by allowing issuers in appropriate circumstances to provide financial statements presented on a comprehensive basis of accounting other than GAAP. We also recommend that the Commission increase the audit threshold from $500,000 to $750,000, thus exercising the authority Congress has conferred in this area. Our reasoning, and suggested modifications, are explained below.

i. Offerings of $100,000 or Less Within a Twelve-Month Period

We agree with the Commission that strong privacy policy considerations warrant the omission of "personally identifiable information," including but not limited to Social Security numbers, from the issuer tax returns for the most recent fiscal year that must be filed with the Commission, and provided to investors and the relevant intermediary, in connection with offerings of $100,000 or less. That said, we recommend that the Commission include – in the text of Instruction 2 to proposed Rule 201(t) -- a non-exhaustive list of the specific types of information that may be redacted.

With respect to the financial statement requirements, we agree with the Commission that, because GAAP are "generally self-scaling to the size and complexity of the issuer," the burden of preparing financial statements may be reduced for some smaller issuers. We are concerned, however, that start-ups without an operating history and/or revenues will be unable to make use of the Section 4(a)(6) exemption because they lack the resources to hire employees with the financial or accounting expertise necessary to prepare GAAP-compliant financial statements. Moreover, there may be some risk that crowdfunding issuers incurring an ongoing reporting obligation under proposed Rule 202 – like issuers tapping Tier 2 of Regulation A, if adopted as proposed by the Commission – may be viewed by the Financial Accounting Standards Board ("FASB") as "public business entities" that may not qualify for less burdensome private company alternatives available under GAAP.[10]

While comparability among issuers normally is an appropriate goal for financial disclosures, we do not believe that this and any other benefits associated with GAAP-compliant financial statements outweigh the burdens that mandatory application of GAAP would impose on many newly formed or development-stage issuers with a promising business idea that desperately need seed capital, but are unable for whatever reason to attract the interest of venture capital firms or even angel investors. As the Commission itself observed, "many issuers … [in such situations] might not have any financial history, and potential investors might make investment decisions without a track record of issuer performance, relying largely on the belief that an issuer can succeed based on the concept and other factors."[11] To compel these issuers to produce up to two years' worth of the full array of financial statements GAAP prescribes would, as a practical matter, eliminate a Section 4(a)(6)-exempt offering as a viable capital-raising alternative for these issuers. We acknowledge that current Regulation A, as well as proposed Regulation A Tier 1 (up to $5 million/12 months) and Tier 2 (up to $50 million/12 months), call for financial statements presented in accordance with GAAP. Nevertheless, the cost-benefit calculus of a small issuer with no revenues and/or minimal assets that seeks a maximum of $100,000 within a twelve-month period from the "crowd," through an intermediary that must be paid for its services, is far different than that of a small issuer seeking as much as $5 million from investors on a disintermediated basis over the same period.

For all these reasons, we urge the Commission to re-evaluate its proposal and consider providing conditional relief from, if not an complete exception to, GAAP compliance for small issuers seeking no more than $100,000 via Section 4(a)(6) within a given twelve-month period. So long as they file the requisite tax return, for example, newly formed issuers or issuers with no operating history and/or revenues should be permitted to prepare financial statements covering whatever period they have been in existence using a comprehensive basis of accounting other than GAAP (e.g., income tax basis, cash basis, modified cash basis). As a condition to such relief, the Commission could require the issuer's certifying principal executive officer to represent that the issuer is unable to prepare financial statements in accordance with GAAP without unreasonable effort or expense (see, in this regard, the Commission's Request for Comment No. 66) because it has not yet generated revenue and otherwise has no access to funding, other than the crowdfunding transaction itself, with which to hire and compensate an employee with the requisite accounting expertise. Of course, an issuer could be required to provide GAAP-compliant financial statements if available.[12]

[10] See ASU 2013-12, *Definition of a Public Business Entity*, Criterion (a) (the term "public business entity" includes an entity "required by the U.S. Securities and Exchange Commission … to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing)."

[11] Proposing Release at 66523.

[12] See Regulation A; see also Section 16.20(a) of the Model Business Corporation Act.

ii. Offerings of More Than $100,000 But Not More Than $500,000 Within a Twelve-Month Period

As discussed above, we have recommended that some smaller issuers raising no more than $100,000 within a twelve-month period be given complete or conditional relief from the obligation to prepare, file and deliver GAAP-compliant financial statements under cover of Form C. Similar relief would be appropriate, in our view, for some issuers that conduct offerings that fall into the middle statutory tier -- for offerings of more than $100,000 up to and including $500,000 within a given twelve-month period. We note in this regard that the Commission has appropriately exercised its authority under the statute to enable crowdfunding issuers to provide financial statements reviewed by an independent public accountant in accordance with the Statements on Standards for Accounting and Review Services ("SSARS") promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants ("AICPA"). Under the SSARS, an independent auditor may conduct an audit or review of financial statements prepared in conformity with a comprehensive basis of accounting other than GAAP or International Financial Reporting Standards ("IFRS").[13]

Section 4A(b)(1)(D)(ii) not only enables the Commission to designate the AICPA's SSARS as the appropriate review framework in lieu of creating a new set of review standards by rule, but also permits the Commission to determine that GAAP-compliant financial statements may not be necessary or appropriate for all offerings by all crowdfunding issuers whose Section 4(a)(6)-exempt offerings bring them within this middle statutory tier. Accordingly, we believe the Commission should consider allowing small issuers raising up to $500,000 (within a twelve-month time span) to provide financial statements that have been prepared on an acceptable basis other than GAAP – referred to by the AICPA as Other Comprehensive Basis of Accounting or "OCBOA" – and reviewed by an independent public accounting firm pursuant to SSARS. An issuer's ability to provide such financial statements could be limited to situations in which the issuer has no operating history and/or revenues, and/or a minimal amount of assets as measured in terms of dollar value (e.g., assets worth less than $500,000), and has not prepared GAAP-compliant financial statements for any other purpose. As we suggested for the first offering tier, the Commission could require the issuer's principal executive officer to certify that financial statements could not be presented in accordance with GAAP without unreasonable expense and other burdens.

With respect to the appropriate independence standard applicable to the review engagement, we support the Commission's determination to apply the independence standards set forth in Rule 2-01 of Regulation S-X. While application of these standards, as the Commission observed in the Proposing Release, "may impose higher costs than other independence standards, such as the AICPA standards,"[14] the Commission could consider mitigation of these costs for certain smaller issuers that lack the resources to prepare financial statements in accordance with GAAP, as discussed above.

[13] See AU Section 623, *Special Reports* (audit engagements); SSARS 19 and AR Section 90 (review engagements); AR Section 60 (review and compilation engagements).
[14] Proposing Release at 66524.

iii. Offerings of More Than $500,000 (But No More than $1Million) Within a Twelve-Month Period

Pursuant to Request for Comment No. 64, the Commission asks whether it should increase the offering amount for which audited financial statements would be required; for example, from $500,000 to $600,000 or $750,000. Given what we believe will be the substantial costs for many start-ups of obtaining an audit by an accounting firm that passes muster under Rule 2-01 of Regulation S-X,[15] even if the audit itself may be performed in accordance with AICPA rather than PCAOB auditing standards if the issuer so chooses, we urge the Commission to exercise the authority Congress conferred in Section 4A(b)(1)(D)(iii) to raise the $500,000 threshold to $750,000.

We agree with the Commission's statement that "audited financial statements would benefit investors in offerings by issuers with substantive prior business activity by providing them with greater confidence in the quality of the financial statements of issuers seeking to raise larger amounts of capital."[16] The real question, which Congress left entirely to the Commission, is whether the perceived investor benefits of an audit are outweighed by the costs to smaller non-reporting issuers in situations where the amount of capital sought within a twelve-month period exceeds $500,000. We believe that it is likely that more developed private issuers with operating track records will eschew crowdfunding in favor of using Rule 506(b) or (c), for which no audited financial statements are prescribed (and no offering amount ceiling is imposed), so long as all sales are made to the type of "accredited investor" that these issuers would be better able to attract. By contrast, those "newly formed" issuers, "with little or no operations" – clearly among the intended beneficiaries of Title III – are more likely to conclude, as the Commission points out, that "the benefit of the audit may not justify the cost of the audit," and therefore decide against seeking more than $500,000 in much-needed capital under Section 4(a)(6).[17] A review of the required financial statements in accordance with AICPA standards by an independent accounting firm qualified under S-X Rule 2-01 is sufficient, in our view, to protect investors without unduly discouraging those smaller, startup issuers that are not yet profitable from utilizing the new crowdfunding exemption in the manner Congress contemplated.

Moreover, we recommend that the Commission evaluate the necessity of going beyond the text of Section 4A(b)(1)(D)(iii) to require that all issuer financial statements for offerings covered by this statutory tier be prepared in accordance with GAAP. Newly formed, family-owned businesses whose management have no intention of ever "going public" in the traditional sense might wish to use crowdfunding as a seed capital mechanism, but would be deterred by the significant costs and other burdens attendant to GAAP compliance (whether these costs are analyzed alone or in conjunction with the costs of obtaining an audit). In addition to lacking an operating and/or financial track record, such businesses might have little or no cash flow and minimal assets. Both for these small issuers, and for those prospective "friends-and-family" investors who want to support a promising new business concept via direct investment, the costs of producing GAAP-compliant financial statements may far outweigh any perceived benefits.

[15] See id.
[16] Id. at 66523.
[17] Id.

By not prescribing GAAP-compliant financial statements for any of the statutory offering tiers, including the top tier, the framers of Section 4A(b)(1)(D) arguably intended to give these issuers a shot at beating the odds via crowdfunding regardless of the amounts they are trying to raise (subject to the $1 million/12-month limitation). Thus, while we understand that Congress has deferred to the Commission's judgment in this area, we ask the Commission to consider allowing some issuers seeking more than $500,000 within twelve months – for example, those start-ups with no operating history or revenue, and minimal assets – to provide financial statements presented on a comprehensive basis other than GAAP if the principal executive officer can certify that the issuer is unable to prepare financial statements in accordance with GAAP without undue cost and other burden, and that the OCBOA methodology selected is acceptable under AICPA audit standards.[18]

C. Ongoing Issuer Reporting Requirements; Termination of Reporting

Section 4A(b)(4) directs the Commission to determine, by rule, how crowdfunding issuers should meet the basic statutory mandate to file with the Commission and provide to investors, "not less than annually[,] … reports of the results of operations and financial statements of the issuer, … subject to such exceptions and termination dates as the Commission may establish by rule." Although this provision would appear to give the Commission significant flexibility in deciding what periodic disclosures would be "appropriate," we are concerned that the Commission's proposed approach to annual reporting, and to the ability of an issuer to terminate such reporting, would be unduly burdensome for those issuers most likely to engage in crowdfunding transactions. As noted earlier, we expect that crowdfunding issuers will be smaller companies, with minimal or no operations, that will lack access to legal and financial personnel whose services may be necessary to comply with the annual reporting obligation as proposed by the Commission. Accordingly, we urge the Commission to exercise the substantial discretion conferred by Section 4A(b)(4) to modify proposed Rule 202 as follows.

First, consistent with the arguments outlined above with respect to financial disclosures prescribed for crowdfunding offerings, we believe that the requisite financial statements (both content and outside review/audit elements) for annual reporting purposes should be proportionate to the aggregate amount actually raised within a twelve-month period in reliance upon Section 4(a)(6). For this reason, we believe that GAAP-compliant financials should not be required on an ongoing basis for certain issuers that raise $500,000 or less under Section 4(a)(6) within that period. And there are some limited circumstances, as discussed above, in which an issuer that has raised more than $500,000 in exempt crowdfunding transactions over a twelve-month period should be permitted to file both offering-related and annual financial statements that have been prepared on a comprehensive basis of accounting other than GAAP.

In addition, as previously discussed, an audit of an issuer's financial statements should not be required unless an issuer has raised more than $750,000 in proceeds under Section 4(a)(6) within a twelve-month period. The same rationale applies to the issuer's choice of accounting frameworks for its ensuing annual financial statements. As recommended in our pre-rulemaking comment letter on Title III ("Pre-Proposal Comment Letter"),[19] we further suggest that a

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[18] We are not suggesting dispensation from GAAP in situations where the issuer chooses a PCAOB-compliant audit.
[19] Our prior comment letter is available at http://www.sec.gov/comments/jobs-title-iii/jobstitleiii-227.pdf.

minimum asset test be established as a trigger for review or audit of annual financial statements filed by issuers that have engaged in crowdfunding offerings: (a) review (total assets as of the end of the most recently completed fiscal year exceeded $300,000); and (b) audit (total assets as of the end of the most recently completed fiscal year exceeded $750,000).[20] We agree with the Commission that no reporting obligations should be incurred in connection with amounts sought, but not realized, in unsuccessful Section 4(a)(6) offerings within any given twelve-month period.

Second, we suggest that information that has already been included in a Form C (or C-A or C-U) or Form C-AR need not be repeated in every Form C-AR that a crowdfunding issuer subsequently files with the Commission, unless there has been a material change in the previously disclosed information.[21] Rather than being compelled to repeat information that has been previously disclosed, a crowdfunding issuer should be able simply to indicate that there has been no material change from the previously disclosed information in response to a particular Form C-AR item. For example, if an issuer's officers, directors and 20% beneficial owners remain the same as reflected in the previous filing, whether it be a Form C, C-A, C-U or C-AR, investors can be referred to the prior filing for this information. Our proposal would apply to all provisions of Form C-AR except the financial statements – here, we agree with the Commission that information facilitating year-to-year comparisons of an issuer's financial performance would be useful to investors.

Third, we believe that it should not be more difficult for a crowdfunding issuer to terminate its annual reporting obligations than it is for an issuer that has become subject to the reporting requirements of Section 15(d) of the Exchange Act, by virtue of having made a registered public offering. Accordingly, we suggest adding a new subsection (b)(4) to proposed Rule 202(b) stating that: "(4) The issuer has, as to any fiscal year other than the fiscal year in which a crowdfunding offering has been made in reliance upon Section 4(a)(6) of the Securities Act … if, at the beginning of such fiscal year, the securities of each class of securities previously offered and sold pursuant to Section 4(a)(6) of the Securities Act are held of record by fewer than 300 persons."[22]

Finally, in response to the Commission's specific requests for comment:

- We do not support an interim (i.e., quarterly) reporting requirement, but do believe that material events should be reported more frequently than on an annual basis. Should the Commission require more frequent reporting than annually, we recommend that the Commission limit such reporting to those events in an issuer's life cycle that clearly qualify as material from an investor's perspective, such as a change in control, bankruptcy, or material acquisition or disposition of assets (Requests for Comment Nos. 80, 91). We recommend that issuers be given 15 calendar days after the event in question in which to amend their last Form C-AR to disclose such information.

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[20] Proposing Release at note 218 and accompanying text, citing the ABA Pre-Proposal Comment Letter.
[21] See, e.g., id. at note 213 and accompanying text (defining "material").
[22] We recognize that the provision we have suggested is likely to be useful only if crowdfunding securities are eligible for deposit with The Depositary Trust Company ("DTC"), or record holdings otherwise are substantially limited to intermediaries.

- The Commission has asked whether the "proposed exclusion [from reliance on the Section 4(a)(6) exemption] of issuers who fail to comply with certain ongoing annual reporting requirements [is] too broad …."[23] In our view, such a disqualification provision may be perceived by start-up and/or development-stage issuers as unduly harsh, at least without a "cure" mechanism. If the Commission decides to adopt such an eligibility provision, we suggest that the Commission allow a reasonable "cure" period and limit the "look-back" period to one year.

- In response to Request for Comment No. 82, we believe that an issuer's posting of its Form C-AR on its website, in a location that would be readily accessible to investors, at the time of filing via EDGAR is sufficient to satisfy the statutory requirement that the annual report be provided to investors. As the Commission pointed out,[24] crowdfunding is a financing technique that originated on the Internet and has attracted technologically-savvy investors. For such investors, access to a crowdfunding issuer's filings on the websites of the Commission (EDGAR) and the issuer is more than enough to constitute delivery.[25] We do not believe that there should be any need for posting the annual report on a crowdfunding intermediary's website, as the issuer may have no further relationship with a particular intermediary after completing a single crowdfunding offering, and in any event should not be required to bear the additional cost that an intermediary may impose with respect to posting the annual report (or other ongoing disclosures prescribed by Commission rule).

- Request for Comment No. 91 asks whether the Commission should consider excepting certain issuers from ongoing reporting. In our view, issuers that raise $100,000 or less under Section 4(a)(6) should be excepted from future ongoing filing obligations after filing one annual report on Form C-AR.

D. Prohibition on Issuer Advertising

We support the Commission's proposed implementation of Section 4A(b)(2)'s prohibition against an issuer's advertising of the terms of a Section 4(a)(6)-exempt offering via proposed Rule 204 of Regulation Crowdfunding. However, we recommend that the Commission specify in Rule 204, in the form of a Securities Act safe harbor (e.g., by adding a new subsection (d) to Rule 204), a provision expressly allowing issuers engaged in a crowdfunding offering to continue to publish regularly released factual business information – whether on an issuer's Internet website or otherwise -- so long as such communications do not refer to the terms of the

[23] Proposing Release at 66437 (Request for Comment No. 18).

[24] Id. at 66435, text accompanying note 56 ("We believe that an 'online-only' requirement enables the public to access offering information and share information in a way that will allow members of the crowd to decide whether or not to participate in the offering and fund the business or idea.").

[25] In this connection, our comment is intended to express support for an "access = delivery" model with respect to the annual or any other "ongoing" disclosures by the issuer, made via EDGAR filings, that are triggered by successful completion of a Section 4(a)(6)-exempt offering. That said, we agree with the Commission that investor access to a crowdfunding issuer's offering-related materials via posting of such materials on the intermediary's electronic platform is sufficient to constitute delivery thereof in the context of such an offering. See id. at 66465 ("[T]he intermediary would only need to post the [issuer's offering-related] information on its platform in a manner complying with proposed Rule 303(a) and would not be required to send any electronic messages with regard to its posting.").

offering. As the Commission aptly observed, "permitting [crowdfunding] issuers to continue to engage in communications that do not refer to the terms of the offering during the pendency of [an] offering made in reliance on Section 4(a)(6) would increase the likelihood of the success of an issuer's business because the issuer could continue to advertise its products or services, so long as it does so without discussing the terms of the offering."[26]

In addition, we recommend that the Commission provide guidance to issuers on responding to unsolicited inquiries regarding an impending or ongoing crowdfunding offering, whether from potential investors or other third parties. It would be helpful, for example, if the Commission made clear that an issuer may respond to such inquiries by providing the information contained in the Notice, which as proposed would direct the person or entity making the inquiry to the intermediary's platform.

E. Intermediary Requirements

1. Measures to Reduce Risk of Fraud

Securities Act Section 4A(a)(5) requires an intermediary to "take such measures to reduce the risk of fraud with respect to [transactions made in reliance on Section 4(a)(6) of the Securities Act], as established by the Commission, by rule, including obtaining a background and 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." The proposed rules would implement this statutory provision by requiring an intermediary, *inter alia*, to have a reasonable basis for believing that the issuer (a) is in compliance with relevant regulations, and (b) has established means to keep accurate records of holders of the securities it offers.

The Proposing Release goes into some detail with respect to the intermediary's obligations in this regard, and it is clear from the discussion that the intermediary may not simply rely on an issuer representation made to it with respect to establishing that the issuer is in compliance with Regulation Crowdfunding or has established means to keep accurate records of securities. However, the text of proposed Rule 301 is, in our view, at odds with the Commission's discussion in the Proposing Release of the intermediary's obligation, and the various provisions of the proposed rules are also internally inconsistent.

Proposed Rule 301 provides:

> An intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) must:
>
> (a) Have a reasonable basis for believing that an issuer seeking to offer and sell securities in reliance on Section 4(a)(6) … through the intermediary's platform complies with the requirements in Section 4A(b) of the Act … and the related requirements in this part. In satisfying this requirement, an intermediary may rely on the representations of the issuer concerning compliance with these

[26] Id. at 66455.

> requirements unless the intermediary has reason to question the reliability of those representations;
>
> (b) Have a reasonable basis for believing that the issuer has established means to keep accurate records of the holders of the securities it would offer and sell through the intermediary's platform. In satisfying this requirement, an intermediary may rely on the representations of the issuer concerning compliance with this requirement unless the intermediary has reason to question the reliability of those representations.

Having established in both cases (under Subsections (a) and (b) of proposed Rule 301, quoted above), that the intermediary must have a "reasonable basis" for its belief as to an issuer's compliance, the rule then states that the intermediary's obligations may be satisfied by relying on representations by the issuer. Permitting such reliance is inconsistent, in our view, with the need to establish a reasonable belief, absent a specific basis for establishing a reasonable belief as to as to compliance.

In particular, we believe this result is inconsistent with the discussion in the Proposing Release as to the methods by which an intermediary could establish a reasonable belief as to compliance. Indeed, in contrast, the text of the proposed rule provides a direct incentive for the intermediary *not* to take any steps to check up on the issuer's compliance. Having no reason to question a representation is not the same thing as reasonably relying on that representation.

We are concerned that the proposed rule would permit intermediaries to establish a belief simply by having issuers or prospective issuers click a button stating "I agree" to the terms of engagement set forth in an online application, without any assurance that a particular issuer has actually read the terms to which it is agreeing by clicking through (which many web users do when presented with so-called "click-through" agreements on the website of a service provider). If an intermediary were to include in those terms representations as to an issuer's compliance with the regulation and establishment of a record-keeping system, an issuer conceivably could click the "I agree" button without ever reading the terms and the intermediary would not be required to take further diligence-related steps. To the contrary, the intermediary would be incentivized *not* to make any further investigation so as to avoid uncovering facts that would lead it to question the issuer's compliance. In sum, the rule as drafted could permit – if not encourage -- this undesirable form of "click-through compliance."

This presumably is not what the Commission intended. We believe that requiring an intermediary to take reasonable measures to determine whether an issuer has complied with the conditions of the exemption, including the implementation of appropriate recordkeeping, is important to investor protection. In this connection, the Commission may wish to consider the flexibility and the safe harbor provisions associated with offerings conducted under Rule 506(c).

2. *Safe Harbor for Certain Intermediary Activities*

Section 3(h)(1) of the Exchange Act directs the Commission to exempt, conditionally or unconditionally, a registered funding portal from the requirement to register as a broker or dealer, recognizing that even the limited activities with which funding portals are charged under Securities Act Section 4A(a) would bring them within the definition of "broker" under Exchange Act Section 3(a)(4). This is because a funding portal acting as an intermediary in a Section 4(a)(6)-exempt transaction would be "'effecting transactions in securities for the account of others' by, among other things, ensuring that investors comply with the conditions of Securities Act Section 4A(a)(4) and (8), making the securities available for purchase through the funding portal, and ensuring the proper transfer of funds and securities as required by Securities Act Section 4A(a)(7)."[27] A funding portal's receipt of compensation tied to the successful completion of a crowdfunding offering also would be indicative of acting as a broker.

In defining the term "funding portal," Congress imposed some restrictions on the scope of services that a funding portal could provide without registering as a broker or dealer under Section 15(a)(1) of the Exchange Act. New Exchange Act Section 3(a)(80) defines a funding portal as a person that does *not* "(A) offer investment advice or recommendations; (B) solicit purchases, sales or offers to buy the securities offered or displayed on its website or portal; (C) compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal; (D) hold, manage, possess, or otherwise handle investor funds or securities; or (E) engage in such other activities as the Commission, by rule, determines appropriate." In so defining the term, Congress presented the Commission with something of a challenge, since merely making the securities available for purchase through the portal could be deemed to involve a solicitation. We agree with the flexible approach that the Commission has taken in proposing a non-exclusive safe harbor set forth in proposed Rule 402, which reiterates Section 3(a)(80)'s prohibitions (in proposed Rule 402(a)) then goes on (in proposed Rule 402(b)) to define a range of permissible portal activities (including certain activities that otherwise might be prohibited by Section 3(a)(80)).

We generally support the proposed safe harbor, with a few suggested modifications intended to clarify its scope and thus facilitate portal compliance. In particular, we recommend that the Commission revise proposed Rule 402(b) to extend safe harbor coverage to a key portal function: deciding whether to deny an issuer access to the portal not only because it does not meet the portal's "objective" eligibility criteria (proposed Rule 402(b)(1)), but also because the portal believes "that the issuer or the offering presents the potential for fraud or otherwise raises concerns regarding investor protection" for purposes of proposed Rule 301(c). Absent such protection, a portal may be vulnerable to claims that, in making such "curatorial" determinations, it may have performed an investment advisory function.

In response to the Commission's Request for Comment No. 219, we believe that the proposed safe harbor should allow a portal to limit the offerings made on its platform so long as the requisite "objective criteria" being applied are disclosed prominently on the portal's website. We note in this regard, that the Commission is not proposing to define the term "investment advice" for purposes of Regulation Crowdfunding. To be meaningful, the safe harbor should be supplemented by explicit Commission guidance – preferably in the regulatory text -- that a portal engaging in activities covered by proposed Rule 402(b) will not trigger the application of the Investment Advisers Act of 1940. In addition, we recommend that the Commission include examples of acceptable "objective criteria" in an instruction to Rule 402(b).

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[27] Proposing Release at 66484 (footnote omitted).

Because the concept of "concerns regarding investor protection" (as set forth in proposed Rule 301(c)) is by its nature somewhat subjective, we recommend that the Commission provide specific guidance, again, preferably in the regulatory text, as to the types of investor protection concerns that would permit a portal to reject or remove an offering on these grounds, and to permit the portal to refer to such Commission guidance in general terms in disclosing the grounds upon which offerings may be rejected or removed. It may be appropriate to warn investors that the fact that a portal may reject or remove offerings on investor protection grounds does not amount to any assurance of investor protection on the part of either the portal or the Commission.

Permissible compensatory arrangements for portals are outlined in proposed Rules 402(b)(6) and (b)(7), along with proposed Rule 305. As we understand the intended operation of these provisions, a portal may not pay transaction-based compensation to third parties for investor or issuer referrals unless that third party is a registered broker-dealer. Nor may a portal receive transaction-based compensation for referring potential investors in exempt offerings other than Section 4(a)(6)-exempt transactions being effected by a registered broker-dealer.[28] Despite the Commission's extensive discussion of the topic in the Proposing Release, it is unclear to us whether and when compensation paid by a portal to a third party other than a registered broker-dealer will be deemed improperly to "be based, directly or indirectly, on the purchase or sale of a security offered in reliance on Section 4(a)(6) on or through the portal's platform."[29] Another unanswered question involves the extent to which the portal may pay initiating brokers, if at all, for referrals in the absence of a formal written agreement – does the fact that such arrangements do not appear to fall within proposed Rule 402(b)(7) mean that they are prohibited? Finally, we are unable to discern from the Proposing Release with respect to whether a funding portal may charge issuers fees that are tied to the magnitude or the success of a specific crowdfunding offering conducted on that portal's platform. Accordingly, we urge the Commission to provide clear guidance on these issues.

Proposed Rule 402(b)(9) would appear to allow an otherwise eligible funding portal to engage in limited advertising regarding its own services and to identify the issuer crowdfunding offerings available through its web-based platform. Such "advertisements" must be based on objective criteria (examples listed by the Commission include the type of securities offered, geographic location, industry or business segment of the issuer, the expressed interest of investors measured by number of investment commitments), and the portal is barred from receiving special or additional compensation that might bias its judgment. While the examples reflected in the proposed regulatory text and discussed in the Proposing Release[30] are helpful, we suggest that the Commission be more explicit in emphasizing the limitations of permitted advertising, and state either in the final rule or the adopting release that emails recommending or promoting investment in particular companies sent by a funding portal to potential investors who have signed up with that portal to receive crowdfunding information would be considered "advertising" subject to the limitations set out in the safe harbor. In this regard, we note the current practice of so-called "passive bulletin boards," which are not registered as broker-dealers,

[28] See id. at 66488.
[29] Id.
[30] Id. at 66485-66489.

of sending out soliciting emails recommending investment in particular companies. Such activities would not seem to comply with the conditions established in the line of Staff no-action letters that authorizes the bulletin board's operations without Exchange Act registration as a broker-dealer or a securities exchange.[31] In our view, it would be inappropriate for funding portals to follow this practice.

F. Restrictions on Resales

In our view, the provisions of proposed Rule 501 are sufficient to implement both the letter and the spirit of Section 4A(e)'s restrictions on resale of securities issued under Section 4(a)(6). No further restrictions are necessary or appropriate for resales that occur either within, or beyond, the one-year period following the issuer's initial sale of securities in an exempt crowdfunding transaction. It would be helpful if the Commission were to indicate (either in the final rule or the adopting release) that Rule 144A resales to qualified institutional buyers ("QIBs") could be made during this one-year period, inasmuch as the statute allows resales to "accredited investors" and the QIB eligibility criteria exceed those of an accredited investor as defined in Rule 501(a) of Regulation D. For similar reasons, bona fide offshore resales under Rule 904 of Regulation S also should be permissible during the one-year period.

We urge the Commission to provide specific guidance with respect to the availability of the Section 4(a)(1) exemption and/or the Rule 144 (or Rule 144A and/or Regulation S) exemptive safe harbor after the one-year period of limited transferability has run. We believe that once the Section 4A(e) one-year limitation on transfers has expired, securities originally issued in a Section 4(a)(6)-exempt offering may be resold pursuant to Section 4(a)(1) and/or the Rule 144, Rule 144A or Regulation S safe harbor – provided, of course, that the conditions to reliance on the particular exemption or exemptive safe harbor are met. The "current public information" requirement of Rule 144(c) and the "current information" requirement of Rule 144A(d)(4) should be deemed to be met if the crowdfunding issuer has complied with its ongoing reporting obligations.

G. Disqualifications and Waiver Requests

1. Disqualifications

We support the Commission's proposed disqualification standards. Since the Commission adopted the final rule regarding the disqualification of "bad actors" in connection with Rule 506 offerings, however, a number of interpretative questions have arisen that have led to some confusion. Thus, while the Commission's Staff has provided helpful guidance on several issues through three sets of Compliance and Disclosure Interpretations, some questions remain unanswered -- such as, for example, the intended meaning of the term "voting securities." We therefore recommend that the Commission provide that, for purposes of the disqualification provisions applicable to exempt offerings conducted under Regulation Crowdfunding, as well as Regulations A and D, the term "voting securities" has the meaning ascribed to it under Exchange Act Rule 12b-2 (namely, securities, the holders of which are entitled to vote for the election of directors, or the equivalent).

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[31] See, e.g., PerfectData Corp. (avail. Aug. 5, 1996); Real Goods Trading Corp. (avail. June 24, 1996).

2. Waiver Process

The Proposing Release notes that the Commission may waive disqualification under Proposed Rule 503, and provides a few examples of circumstances that might justify a waiver.[32] Although we support a waiver process, we are concerned that the costs associated with preparing and submitting a waiver request may deter some otherwise eligible smaller issuers from undertaking a waiver request, thus foreclosing access to the crowdfunding marketplace for future offerings. As such, the proposed disqualification and waiver provisions could impose an undue burden on crowdfunding. To mitigate these potential costs, we recommend that the Commission provide clear guidance regarding possible grounds for relief, the anticipated time to process a request, and other aspects of the waiver process.

H. Exemption from Section 12(g) of the Exchange Act

We agree with the proposed formulation of Rule 12g-6 to exclude from the definition of "held of record," for purposes of Section 12(g), those "securities issued pursuant to the offering exemption under Section 4(a)(6) of the Securities Act." As stated in our Pre-Proposal Comment Letter, the most logical and appropriate interpretation of Exchange Act Section 12(g)(6), which is consistent with the capital formation purposes of Securities Act Section 4(a)(6) and the inclusion of the Section 12(g) exemption in Title III rather than Title V, is to apply the Section 12(g) exemption to the *securities* issued in a Section 4(a)(6)-exempt crowdfunding offering, such that the Section 12(g) exemption continues to be available once the securities are sold or otherwise transferred by the initial purchaser of such securities. Unlike the Title V amendments focused on holders -- i.e., excluding only those holders who are "accredited investors" and "securities held by persons who received" the securities issued pursuant to an exempt offering by an employee compensation plan -- new Section 12(g)(6) references only the securities, and not a particular holder or class of holders. We think the most analogous provision is the definition of "restricted security" set forth in Securities Act Rule 144(a)(3), which encompasses "securities acquired" in a variety of exempt transactions and imposes resale restrictions and enables all subsequent holders to rely on its safe harbor, not just the person who initially acquired the securities in the initial exempt transaction.

Accordingly, we strongly support the Commission's proposal that the Section 12(g)(6) exemption should apply to the "securities issued" in a crowdfunding offering, and consequently, this exemption should remain in effect and flow with the securities upon their resale or transfer by either the initial purchaser or subsequent purchasers. We would expect that issuers will develop means to track record ownership of such securities to be able to confirm the continued availability of the exemption. Were the Section 12(g) exemption limited to the initial purchaser of crowdfunding securities and certain related parties of the initial purchasers, the issuer would forever be exposed to a "springing" Section 12(g) reporting obligation, which could be triggered if the initial purchasers were to resell their equity securities, which may occur without the issuer's knowledge or involvement. We therefore agree with the Commission's proposal *not* to limit the Section 12(g)(6) exemption available for securities issued under Section 4(a)(6) to those securities held of record by the original purchasers in the Section 4(a)(6)-exempt transaction, an

[32] See Proposing Release at 66505.

affiliate of the original purchaser, a member of the original purchaser's family or a trust for the benefit of the original purchaser or the original purchaser's family.

Our Pre-Proposal Comment Letter recommended that the Section 12(g)(6) exemption for securities issued in a 4(a)(6)-exempt crowdfunding transaction should survive and attach to different equity securities issued in a subsequent restructuring, recapitalization or similar transaction that is exempt from, or otherwise not subject to, the registration requirements of Section 5, if the parties to the transaction are affiliates of the original issuer. Although the Commission indicated it is not prepared to extend the proposed Rule 12g-6 exemption to all securities issued in a restructuring in exchange for securities issued in a Section 4(a)(6)-exempt transaction, we believe that the Commission should consider exempting securities issued in a statutory merger to change the domicile of the issuer, in reliance on Rule 145(a)(2) under the Securities Act. Absent such relief, crowdfunding issuers may be unable to avail themselves of the benefits of a reincorporation without risking the loss of the Rule 12g-6 exemption. Because such transactions are not deemed by Rule 145 to involve an offer and sale of securities, the issuer is not relying on an alternative exemption from Securities Act registration to issue the new securities that could be viewed as superseding reliance on the Section 4(a)(6) exemption. The new securities thus would retain the same character as those issued in the earlier crowdfunding transaction.

In our Pre-Proposal Comment Letter, we suggested that the Commission consider proposing that the Section 12(g)(6) exemption not apply to any issuer that had assets, at the last date of the fiscal year with respect to which the Section 12(g) compliance determination is made, in excess of $25 million. We recommended this limitation in order to avoid the inconsistency that certain companies with assets as low as $10 million, but which had grown by means other than crowdfunding, would be required to become publicly reporting companies, while companies that had grown to a much larger asset size, with hundreds or perhaps thousands of shareholders as a result of crowdfunding transactions, would be exempt from Section 12(g) registration. Although the suggested $25 million threshold could be viewed as an overly restrictive limitation on the Section 12(g)(6) exemption, we believe that at some level of assets, a company that no longer resembles the type of startup entity that Congress envisioned in passing Title III, should not be entitled to the benefits of the Exchange Act exemption. Section 12(g)(6) specifically contemplates that the Commission could subject the Section 12(g) exemption to certain conditions. Given the likelihood that an active over-the-counter market will develop for the equity securities of a company with assets exceeding those of many listed companies, we continue to recommend that at some level of assets (as measured in dollar value) – whether or not at the $25 million level – the exemption could be made unavailable without contravening the Congressional purpose underlying the Section 12(g)(6) exemption.

I. Scope of Statutory Liability for Portals

In the Proposing Release, the Commission did not propose any rules or solicit comments with respect to Section 4A(c) of the Securities Act, which provides for issuer liability to a purchaser in a Section 4(a)(6) offering if the issuer, in the offer or sale of the securities, makes an untrue statement of a material fact or omits to state a material fact required to be stated or necessary in order to make the statements, in light of the circumstances under which they were made, not misleading, and that the purchaser did not know of the untruth or omission. An issuer will be subject to such liability if it does not sustain the burden of proof that the issuer did not know, and in the exercise of reasonable care could not have known, of the untruth or omission. The Proposing Release does, however, express the Commission's view that because Section 4A(c)(3) defines "issuer" to include "any person who offers or sells the security in such offering," "it appears likely that intermediaries, including funding portals, would be considered issuers for purposes of this liability provision." In addition, the Commission noted in a footnote to its discussion that "[t]he anti-fraud and civil liability provisions of the Securities Act, such as Sections 12(a)(2) and 17, apply to exempted transactions, including those transactions that will be conducted in reliance on Section 4(a)(6)."

It does not appear to us that a funding portal necessarily would fall within the definition of "issuer" for purposes of Section 4A(c) liability. Among other things, funding portals are prohibited from "solicit[ing] purchases, sales, or offers to buy the securities offered or displayed on its website or portal" or "compensat[ing] employees, agents, or other persons for such solicitation." It is clear from the statute that by merely listing a security on its website (or by identifying a broad selection of issuers in its advertising), a funding portal would not be engaged in a solicitation of purchases or offers to buy securities. Congress did not intend that funding portals serve as selling agents, but rather simply as "neutral marketplaces."[33]

We also believe the applicability of Section 12(a)(2) to a funding portal is far from settled.[34] In Pinter v. Dahl, 486 U.S. 622, 642-648 (1988), the Supreme Court held that a person who is not passing title to the securities can be deemed to be a seller for purposes of liability under Section 12(a)(2) only to the extent the person solicits purchases or offers to buy the securities. While we agree that any person that actively engages in soliciting purchases of securities in Section 4(a)(6) offerings are sellers subject to potential liability under Section 4A(c), we are concerned that firms that are considering whether to become a funding portal without any intent to actively solicit purchases will be deterred by the Commission's statements regarding potential liability, including a funding portal's obligation to perform due diligence beyond the regulatory "reasonable basis" obligation imposed by Section 4A(a)(5) and proposed Rule 301. If funding portals cannot receive compensation for soliciting activities, the Commission should not assume they are subject to the same private liability as persons who are so compensated. For the above reasons, we urge the Commission to clarify the potential liability

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33 Although the Senate amendments that became the crowdfunding provisions of the JOBS Act clearly intended to subject issuers and their officers and directors to a due diligence obligation, the same intent does not appear to extend to firms merely acting as portals. See, e.g., Cong. Rec. S1884 (daily ed. Mar. 21, 2012)("What the Senate bill says is, in order for this capital market to work well one has to stand behind the accuracy of their information. It has basic liability accountability; that is, as a director or officer of this organization, they are standing behind the accuracy of what they put out. It has a due diligence protection so this is very balanced.")(Statement of Sen. Merkley). It was suggested by Senator Bennet, however, that portals could perform due diligence services for issuers. Cong. Rec. Page S2229 (Mar. 29, 2012).

34 We do not express a view whether, under the Supreme Court's opinion in *Gustafson v. Alloyd Co*., 513 U.S. 561 (1995), Section 12(a)(2) would apply to exempt public offerings, such as a crowdfunding transaction under Section 4(a)(6). We note that the JOBS Act expressly provides that persons offering or selling securities pursuant to Section 3(b)(2) of the Securities Act are subject to Section 12(a)(2) liability, but only applied the loss causation and statute of limitations defenses of Sections 12 and 13 of the Securities Act to Section 4A(c) private actions. The specific language is: "An action brought under this paragraph shall be subject to the provisions of section 77l(b) of this title and section 77m of this title, *as if* the liability were created under section 77l(a)(2) of this title" (emphasis supplied). It is therefore an "as if" formulation.

of portals in connection with a Section 4(a)(6)-exempt crowdfunding transaction by providing a safe harbor from status as an "issuer" or a "seller," for purposes of Section 4A(c) and/or Section 12(a)(2), for portals that merely list crowdfunding offerings on their website and do not solicit purchasers.

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We appreciate the opportunity to comment on the Proposing Release and respectfully request that the Commission consider our recommendations and suggestions. We are available to meet and discuss these matters with the Commission and its staff, and to respond to any questions.

Very truly yours,

/s/ Catherine T. Dixon
Chair of the Federal Regulation of Securities Committee

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