The Surety & Fidelity Association of America

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Via Federal *e*Rulemaking Portal

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F. Street NE
Washington, DC 20549

**Re: Proposed rules
Crowdfunding
S7-09-13**

Dear Ms. Murphy:

The Surety & Fidelity Association of America ("SFAA") is a trade association of approximately 450 insurance companies licensed to provide surety and fidelity bonds. SFAA member companies collectively provide the vast majority of surety bonds and fidelity bonds in accordance with various regulatory requirements. The referenced proposed rules establish various requirements for the registration of a funding portal that acts as an intermediary of crowdfunding transactions under the exemption provided by § 4(a)(6) of the Securities Act. We support the requirement that the funding portal obtain a fidelity bond as a condition of registration. 78 Fed. Reg. 66428, 66481 (November 5, 2013). However, we provide guidance regarding the difference between a surety bond and a fidelity bond so that the Commission requires the appropriate insurance product.

A fidelity bond is a form of two-party insurance that protects the insured against loss caused by theft or embezzlement by its employees. Under a fidelity bond, the insured, and not other third parties, may make a claim under the bond for losses that it has incurred. Most regulators of financial institutions require the regulated entity to have a fidelity bond to provide indirect protection to the institution's customers and to the public. As stated in the proposed rules, FINRA Rule 4360 requires regulated brokers to obtain a fidelity bond. [1] This protection is "indirect" because the customers or the public do not themselves make claims on the bond, and losses suffered by the customers or the public are not necessarily covered by the bond. The

[1] For other, *see* 12 C.F.R. §7.2013 ("All officers and employees of a national bank must have adequate fidelity coverage."); 12 C.F.R. §1 examples 63.190 ("Each Federal savings association shall maintain fidelity bond coverage."); 12 C.F.R. §390.356 ("Each State savings association shall maintain fidelity bond coverage."); 12 C.F.R. §563.190 ("Each savings association shall maintain fidelity bond coverage.")

customers and the public are protected because the regulated financial institution is protected. The bank or insurance company or stock broker can recover its loss and, therefore, will be able to meet its obligations to its customers. The underwriting and pricing of fidelity coverage contemplate that the fidelity bond will provide coverage when the dishonest employee overcomes the internal controls that the insured has established. Thus, the insurer will evaluate the internal controls of the insured in determining whether to provide the coverage and under what terms.

We presume that the Commission is contemplating this type of protection. However, some comments by the Commission suggested that broader coverage than that provided by a fidelity bond is intended – an exposure that is not considered in the underwriting and pricing of a fidelity bond. For example, the Commission states that the bond "would help insure against the loss of investor funds that might occur if, for example, a funding portal were to violate the prohibition set forth in Section 304(b) of the JOBS Act on holding, managing, possessing or otherwise handling investor funds or securities." 78 Fed. Reg. at 66481. As noted above, a fidelity bond would insure the funding portal against loss caused by the dishonesty of its employees. Violation of prohibitions set forth in statute is not a covered loss under a fidelity bond, and a fidelity bond would not provide direct protection to investors for losses.

The exposure noted above could be addressed by a surety bond. A surety bond is a three party agreement by which the surety secures the obligation owed by one party (bond principal) to another (obligee). Such bonds would obligate the surety to answer for the default of the portal to conduct its activities in accord with Section 304(b) of the JOBS Act. Investors that were harmed as a result of the violative conduct could make a claim under the bond. The investor would still have to show that the portal had in fact breached its obligation, but if so there would be a deep-pocket, regulated insurer obligated to pay for the breach. However, the amount of the required surety bond directly affects how widely available the bond would be. Unlike other forms of insurance, in the event the surety must pay a loss, it has the right to seek indemnity from the principal. Therefore, part of the surety's underwriting involves a financial assessment of the principal. The surety will require a certain threshold of financial strength relative to the bond amount – the higher the bond amount, the higher the threshold. In the case of a $100,000 surety bond, sureties would expect that the principal exhibit financial strength relative to $100,000.

We are not providing recommendations regarding whether the Commission should require a fidelity bond or a surety bond. We simply are providing guidance regarding the nature of coverage offered by either bond, so that the product that best meets the Commission's objectives is required.

Thank you for your consideration.

Sincerely,

Robert J. Duke
Corporate Counsel