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SECURITIES AND EXCHANGE COMMISSION

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Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

MARY JO WHITE, CHAIR

LUIS A. AGUILAR, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

KARA M. STEIN, COMMISSIONER

MICHAEL S. PIWOWAR, COMMISSIONER

(70 Documents)

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70222 / August 16, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-13847

IN THE MATTER OF **MORGAN ASSET MANAGEMENT, INC, MORGAN KEEGAN & COMPANY, INC., JAMES C. KELSOE, JR, AND JOSEPH THOMPSON WELLER, CPA** **RESPONDENTS.**	**ORDER APPROVING MODIFIED PLAN AND SETTING FUND ADMINISTRATOR BOND AMOUNT**

I.

On June 22, 2011, the Commission issued a Corrected Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940, and Imposing Suspension Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e)(1)(iii) of the Commission's Rules of Practice ("Order") against Morgan Asset Management, Inc., Morgan Keegan & Company, Inc., James C. Kelsoe, Jr., and Joseph Thompson Weller, CPA ("Respondents") (Exchange Act Rel. No. 64720 (June 22, 2011)). Pursuant to the Order, Respondents paid a combined total of $100,300,000 in disgorgement, prejudgment interest, and civil money penalties (the "Fair Fund"). The Order created the Fair Fund for a distribution to harmed investors pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended. Pursuant to the Order, Morgan Keegan and Company, Inc. will pay all reasonable costs and expenses of the distribution.

On August 30, 2011, the Commission issued an order appointing A.B. Data, Ltd. ("A.B. Data") as the fund administrator to administer the distribution of the Fair Fund (Exchange Act Rel. No.65227 (Aug. 30, 2011)). On April 3, 2013, pursuant to Rule 1103, 17 C.F.R. § 201.1103, the Commission issued a Notice of Proposed Plan of Distribution and Opportunity for Comment (the "Notice") for the distribution of monies placed into the Fair Fund (Exchange Act Rel. No. 69288 (April 3, 2013)). The Notice provided all interested parties thirty (30) days to submit a comment on the proposed Plan of Distribution (the "Plan"). The Notice advised interested parties that they could obtain a copy of the Plan by printing a copy from the Commission's public website or by submitting a written request to Anik A. Shah, United States Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5631. All persons who desired to comment on the Distribution Plan could submit their comments, in writing, no later than May 3, 2013. Six comments were submitted, three within the thirty (30) day comment period and three after.

After careful consideration, the Commission has concluded that the Plan should be approved in accordance with the changes described below in Section II.B. The Commission has further determined that the bond amount required under Rule 1105(c) will be set at $100,300,000 as provided in the Plan.

II.

A. Public Comments on the Plan

1. The John N. Bolus Letter

John N. Bolus wrote a letter on behalf of Regions Investment Management, Inc., f/k/a Morgan Asset Management, Inc., and Morgan Keegan and Company, Inc. In his letter dated May 3, 2013, Mr. Bolus requested that the Commission reconsider its decision not to waive the requirement that the fund administrator, A.B. Data, obtain a bond pursuant to Rule 1105(c), 17 C.F.R. § 201.1105(c).[1] In support of his reconsideration request, Mr. Bolus argued that "there exist several layers of protection for the Fair Fund," and cited five (5) factors he believes the Commission should consider.[2] Mr. Bolus argued that with the protections in place, the approximate $200,000 annual cost of the bond that Morgan Keegan and Company, Inc. will have to bear is "unnecessary" and "burdensome."

The Commission has considered the five factors cited by Mr. Bolus and, for the reasons below, good cause to waive the bond requirement has not been shown. Although we recognize that "positive pay" controls will be in place when the funds are held at Huntington to protect against payment on unauthorized checks, A.B. Data will have control over the distribution of those checks, including but not limited to, their amounts and the identification of payees. Protection of the full amount of the Fair Fund is an important consideration.

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[1] Rule 1105(c) states that "the administrator shall be required to obtain a bond in the manner prescribed in 11 U.S.C. 322, in an amount to be approved by the Commission. The cost of the bond may be paid for as a cost of administration. The Commission may waive posting of a bond for good cause shown."

[2] The five factors cited by Mr. Bolus are: 1) A.B. Data will have "no custody, and only limited control, of the Fair Fund"; 2) the Fair Fund will be held by the U.S. Treasury Department's Bureau of the Public Debt ("BPD") until immediately prior to the distribution; 3) after transfer from BPD, the Fair Fund will be held at The Huntington National Bank ("Huntington"), separate from Huntington's assets; 4) checks and electronic transfers will be subject to "positive pay" controls; and 5) Huntington and A.B. Data will maintain insurance and/or a financial institution bond that covers errors and omissions, malfeasance and fraud.

The errors and omissions insurance and/or other insurance coverage that Mr. Bolus cites does not provide the same level of protection to investors that would be provided by a fund administrator bond. First, the bond amount can be set to cover the entire amount of the Fair Fund, thereby providing the most extensive protection against losses. A.B. Data's insurance coverage totals $50 million, which is less than half the amount of the Fair Fund and is subject to claims from other parties to which A.B. Data provides services. Second, the fund administrator bond provides protections to investors for errors resulting from negligence rather than the "gross negligence" standard of most insurance. Third, a fund administrator bond provides the most direct recovery for the Fair Fund. For instance, with bond coverage, the SEC makes a claim directly against the bond, and the bond provider would directly reimburse the Fair Fund for any losses covered by the bond. The bond provider would then pursue a separate claim against the fund administrator for reimbursement for payments made to the Fair Fund. In contrast, if the Commission were to waive the bond requirement, a claim would have to be asserted against the fund administrator, which could, in turn, file a claim against its errors and omissions coverage for a reimbursement to the Fair Fund. The errors and omissions provider could deny the claim based on the myriad of policy exclusions, potentially resulting in litigation over whether the policy covers the Fair Fund's loss. Such a legal dispute would affect the timing and/or amount of a recovery by the Fair Fund, thereby delaying or limiting distributions to harmed investors. Finally, A.B. Data has obtained a commitment for a bond for this Fair Fund distribution at a cost of approximately $200,000 annually. The relative cost of the bond as compared to the coverage afforded (the full $100,300,000 Fair Fund) is not prohibitive and is a reasonable expense and cost associated with the distribution. Pursuant to the Order, Morgan Keegan and Company, Inc. will bear the cost of the bond. Therefore, the bond requirement will not reduce the amount of money available to distribute to investors from the Fair Fund and will provide investors with the fullest protection available. Because good cause has not been shown, the fund administrator bond requirement is not waived.

2. Comments from the Office of the Secretary of the State of Mississippi

The Office of the Secretary of the State of Mississippi ("State Secretary") submitted three comments on the Plan. The first comment proposed that paragraph thirty-five (35) of the Plan be revised to require A.B. Data to submit to the states' securities regulators involved in the states' action against Morgan Asset Management, Inc. and Morgan Keegan & Company, Inc. (together, "Morgan") the same information regarding undelivered mailings that A.B. Data will submit to Commission staff under the Plan. The State Secretary's second comment requests that paragraph thirty-six (36) of the Plan be revised to state that, since investors will not receive acknowledgement of receipt of their claim, A.B. Data "highly recommends" that investors send claims by certified mail, return receipt requested, or by some other method by which delivery can be confirmed, and that investors keep a file copy of the claim form. The Commission has considered these comments, and in response, paragraphs thirty-five (35) and thirty-six (36) of the Plan have been modified as suggested.

Finally, the State Secretary proposed that paragraph fifty-four (54) be revised to require the Commission staff to obtain authorization to disburse the Fair Fund from the Commission within twenty (20) days of receiving and reviewing the payee list, and the Commission staff cause the transfer of funds to the escrow account within twenty (20) days of the Commission's authorization to disburse the Fair Fund. The time deadlines proposed are logistically impracticable. The plan provides that all efforts will be coordinated to keep the time between the receipt of the funds and the transmittal process to a minimum. As a result, the Commission has not modified paragraph fifty-four (54).

3. Comments Regarding the Plan Methodology

The Commission received comments regarding the Plan's methodology from four individuals. Dr. W. W. Mayer and Johnny Bowen each submitted a comment asking that the Commission not adopt the methodology used by the States to distribute funds to injured investors, a methodology referred to as "rising tide." Since the Plan does not propose to use the rising tide methodology for the Commission's Fair Fund distribution, these comments are already resolved, and do not need to be addressed further.

Steven Green, Ph.D., Senior Professor, University of Miami, Coral Gables, Florida, states in his comment: "If I correctly understand this phrase within the proposed settlement '(without regard to the cost basis for those shares)', the claims paid under the Fair Fund will not reflect actual investor losses in that two people who purchased the same number of shares at two very different prices and therefore had the same holdings on 1 January 2007 would receive the same settlement even if their losses differed considerably. Such a method of calculation is manifestly unfair and only actual losses should be the basis for payment from the Fund."

It is the practice of the Commission to compensate investors for harm caused by the underlying securities law violations during the period of the violations. Under the circumstances here, where it would be impractical to calculate precise investor losses due in part to a lack of data about the funds' actual net asset values during the period of violations, the Commission selected the value of shareholders' holdings as of January 1, 2007, as a reasonable proxy for calculating investor harm. Accordingly, the Commission is not making any changes to the Plan based on this comment.

Finally, William S. Little asked: "why is the computation of the distribution amount not the same as the states fund?" In actuality, the Plan's methodology is similar to the States' distribution methodology; however, the States' plan differs in three principal respects. First, the States' plan covers a longer time period, from January 2007 through March 2008. This longer period corresponds to the broader allegations of the States' cases, which in addition to valuation, also include allegations of misconduct concerning suitability, advertising, and marketing. Second, the States' plan implements a "bottom up"/"rising tide" approach that compensates investors for 100% of their losses up to a certain threshold ($1,000 for the States' plan) and then on a *pro rata* basis for the remainder of losses. As a result, some investor loss computations under the States' plan will not be the same as the compensation calculations under the Plan. Previously, the Commission concluded that *pro rata* compensation *without* the "bottom up"/"rising tide" component is in the best interests of all harmed investors. Therefore, the Plan did not include the "bottom up"/ "rising tide" component. Lastly, the Plan provides that distributions made to any investor will be reduced by the amount of any distribution the investor received from the States' fund. For these reasons, the Commission will not make any changes to the Plan based on this comment.

B. <u>Modifications to the Plan</u>

The following modifications have been made to the Plan:

- Paragraph thirty-five (35) of the Plan has been revised to require the fund administrator to submit to the states' securities regulators involved in the states' action against Morgan the same information regarding undelivered mailings that the fund administrator will submit to Commission staff under the Plan.

- Paragraph thirty-six (36) of the Plan has been revised to state that each notice sent by the fund administrator will include language advising claimants to send claims by certified mail, return receipt requested, or by some other method by which delivery can be confirmed, since confirmation of receipt will not be sent by the fund administrator.

C. **The Bond Requirements of Rule 1105(c)**

Rule 1105(c) provides:

> *Administrator to Post Bond.* If the administrator is not a Commission employee, the administrator shall be required to obtain a bond in the manner prescribed in 11 U.S.C 322, in an amount to be approved by the Commission. The cost of the bond may be paid for as a cost of administration. The Commission may waive posting a bond for good cause shown.

17 C.F.R. §201.1105(c). Based on the facts described above, good cause has not been shown for waiving the bond. The amount of the bond will be set at $100,300,000, which is the amount of the Fair Fund.

III.

Accordingly, IT IS HEREBY ORDERED that:

A. Pursuant to Rule 1104, 17 C.F.R. § 201.1104, the Plan is modified as described above, and approved with such modification; and

B. The fund administrator, A.B. Data, shall obtain a bond in the manner prescribed in Rule 1105(c) in the approved amount of $100,300,000.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3684 / October 1, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15547

In the Matter of BREWER INVESTMENT ADVISORS, LLC Respondent.	CORRECTED ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(e) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act") against Brewer Investment Advisors, LLC ("BIA" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(e) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. From June 2009 through October 2010, BIA was engaged in the business of advising others as to the advisability of investing in and purchasing securities, including promissory notes. During that time, BIA was registered with the Commission as a registered investment adviser.

2. On June 11, 2013, a judgment was entered by consent against BIA, permanently enjoining it from future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1) and 206(2) of the Advisers Act, in the civil action entitled *Securities and Exchange Commission v. Steven Brewer, et al.*, Civil Action Number 10-cv-6932-BMM-AK, in the United States District Court for the Northern District of Illinois.

3. The Commission's complaint alleged that, from June 2009 through at least the end of September 2010, BIA and Steven Brewer ("Brewer"), Adam Erickson ("Erickson"), Brewer Investment Group, LLC ("BIG"), and Brewer Financial Services, LLC ("BFS"), a registered broker-dealer, participated in fraudulent, unregistered offerings of promissory notes issued by FPA Limited ("FPA"), an Isle of Man company, in the aggregate amount of $5.6 million to at least 74 investors. Through the fraudulent offerings, BIG and Brewer funneled cash to BIG and one of its subsidiaries when the entities were under significant financial distress. The offering materials that Defendants used for the offerings of FPA promissory notes ("FPA Notes") failed to disclose that over 90% of the proceeds would be disbursed at Brewer's direction to BIG and then to its wholly-owned subsidiaries. In addition, the offering materials misrepresented the risk of the investment and failed to disclose the precarious financial condition of BIG and its subsidiaries. The complaint further alleged that through the offering materials for the FPA Notes, Defendants also implicitly and explicitly represented to investors that the proceeds of the offerings would be used to procure collateral which would be used to secure the notes. Instead, over 90% of the proceeds were disbursed at Brewer's direction to BIG and then spent, including making payments to one of BIG's subsidiaries, and the promised collateral was never obtained. As a result, representations in the offering materials concerning the use of proceeds and representations concerning the risk of the investment were materially false and misleading. The complaint also alleged that in the offering materials, Defendants did not disclose that BIG was failing to make the required interest payments on the FPA Notes being sold to investors. Nor did Defendants disclose that material information to prospective investors in other communications. These material omissions rendered statements in the offering documents materially misleading. The complaint alleged that BIA advised its clients to invest in and purchase the fraudulent offering of the FPA Notes. BIA knew that the representations in the offering documents concerning the use of proceeds and risk were materially false and misleading. It also knew that material information about the precarious financial condition of BIG and BIG's failure to make required interest payments on the notes was not being disclosed to prospective investors. Nonetheless, BIA continued to advise investors to invest in and purchase the notes and caused others to advise investors to invest in and purchase the notes.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(e) of the Advisers Act, the registration of Respondent BIA be, and hereby is, revoked; and

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission,

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3684 / October 1, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15547

In the Matter of **BREWER INVESTMENT ADVISOR, LLC** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(e) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act") against Brewer Investment Advisor, LLC ("BIA" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. From June 2009 through October 2010, BIA was engaged in the business of advising others as to the advisability of investing in and purchasing securities, including promissory notes. During that time, BIA was registered with the Commission as a registered investment adviser.

2. On June 11, 2013, a judgment was entered by consent against BIA, permanently enjoining it from future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1) and 206(2) of the Advisers Act, in the civil action entitled *Securities and Exchange Commission v. Steven Brewer, et al.*, Civil Action Number 10-cv-6932-BMM-AK, in the United States District Court for the Northern District of Illinois.

3. The Commission's complaint alleged that, from June 2009 through at least the end of September 2010, BIA and Steven Brewer ("Brewer"), Adam Erickson ("Erickson"), Brewer Investment Group, LLC ("BIG"), and Brewer Financial Services, LLC ("BFS"), a registered broker-dealer, participated in fraudulent, unregistered offerings of promissory notes issued by FPA Limited ("FPA"), an Isle of Man company, in the aggregate amount of $5.6 million to at least 74 investors. Through the fraudulent offerings, BIG and Brewer funneled cash to BIG and one of its subsidiaries when the entities were under significant financial distress. The offering materials that Defendants used for the offerings of FPA promissory notes ("FPA Notes") failed to disclose that over 90% of the proceeds would be disbursed at Brewer's direction to BIG and then to its wholly-owned subsidiaries. In addition, the offering materials misrepresented the risk of the investment and failed to disclose the precarious financial condition of BIG and its subsidiaries. The complaint further alleged that through the offering materials for the FPA Notes, Defendants also implicitly and explicitly represented to investors that the proceeds of the offerings would be used to procure collateral which would be used to secure the notes. Instead, over 90% of the proceeds were disbursed at Brewer's direction to BIG and then spent, including making payments to one of BIG's subsidiaries, and the promised collateral was never obtained. As a result, representations in the offering materials concerning the use of proceeds and representations concerning the risk of the investment were materially false and misleading. The complaint also alleged that in the offering materials, Defendants did not disclose that BIG was failing to make the required interest payments on the FPA Notes being sold to investors. Nor did Defendants disclose that material information to prospective investors in other communications. These material omissions rendered statements in the offering documents materially misleading. The complaint alleged that BIA advised its clients to invest in and purchase the fraudulent offering of the FPA Notes. BIA knew that the representations in the offering documents concerning the use of proceeds and risk were materially false and misleading. It also knew that material information about the precarious financial condition of BIG and BIG's failure to make required interest payments on the notes was not being disclosed to prospective investors. Nonetheless, BIA continued to advise investors to invest in and purchase the notes and caused others to advise investors to invest in and purchase the notes.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(e) of the Advisers Act, the registration of Respondent BIA be, and hereby is, revoked; and

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission,

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70592 / October 1, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3685 / October 1, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15548

In the Matter of PHILIP MARK CAIN, Respondent.	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Philip Mark Cain ("Respondent" or "Cain").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. From August 2006 through August 2010, Respondent was a registered representative with Commonwealth Financial Network, a dually registered investment adviser and broker-dealer. From September 2010 to March 2011, Respondent was also a registered representative associated with H. Beck, Inc., a dually registered investment adviser and broker-dealer. Respondent, 50 years old, is a resident of Tucson, Arizona.

B. ENTRY OF RESPONDENT'S CRIMINAL CONVICTION

2. On December 14, 2011, Cain pleaded guilty to one count each of mail fraud in violation of 18 U.S.C. Section 1341, engaging in an illegal monetary transaction greater than

$10,000 in violation of 18 U.S.C. Section 1957, and structuring transactions to evade currency reporting requirements in violation of 31 U.S.C. Sections 5324(a)(3) and (d)(2) before the United States District Court for the District of Arizona. *U.S. v. Philip Mark Cain*, 4:11-CR-1105-JGZ. On March 15, 2012, a Judgment in a Criminal Case was entered against Cain. He was sentenced to 51 months in prison followed by five years of supervised release and ordered to pay $1,272,943.89 in restitution.

3. The counts of the indictment to which Cain pleaded guilty alleged, among other things, that between June 2008 and February 2011, Cain participated in a scheme and artifice to obtain money or property by means of materially false or fraudulent pretenses, representations or promises. More specifically, the indictment alleged that Cain defrauded seven investors out of approximately $1.4 million by purporting to purchase structured notes on their behalf. Cain did not at any time invest any of the investors' funds in structured notes and instead used their funds to purchase and repair classic cars.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act and Section 203(f) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70603 / October 2, 2013

Admin. Proc. File Nos. 3-14872, 3-15116

In the Matter of the Application of BDO CHINA DAHUA CPA CO., LTD., ERNST & YOUNG HUA MING LLP, KPMG HUAZHEN (SPECIAL GENERAL PARTNERSHIP), DELOITTE TOUCHE TOHMATSU CERTIFIED PUBLIC ACCOUNTANTS LTD., and PRICEWATERHOUSECOOPERS ZHONG TIAN CPAs LIMITED	ORDER GRANTING SECOND EXTENSION

I.

Chief Administrative Law Judge Brenda P. Murray has moved, pursuant to Commission Rule of Practice 360(a)(3),[1] for an extension of one hundred days to issue the initial decision in this consolidated proceeding. For the reasons set forth below, we grant her motion.

On May 9, 2012, we issued an Order Instituting Administrative Proceedings Pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice and Notice of Hearing ("OIP") against Deloitte Touche Tohmatsu Certified Public Accountants Ltd. ("D&T Shanghai"), a public accounting firm registered with the Public Company Accounting Oversight Board.[2] The OIP alleges that D&T Shanghai willfully failed to provide audit workpapers in response to a Commission request, despite its legal obligations as a registered accounting firm to do so under Section 106 of the Sarbanes-Oxley Act of 2002.[3]

1 17 C.F.R. § 201.360(a)(3).

2 *Deloitte Touche Tohmatsu Certified Public Accountants Ltd.*, Exchange Act Release No. 66948, 2012 SEC LEXIS 1457 (May 9, 2012). We subsequently issued a Second Corrected OIP, which corrected typographical errors in certain dates in the original OIP. That OIP is available at http:// www.sec.gov/litigation/admin/2012/34-66948.pdf.

3 15 U.S.C. § 7216.

On December 3, 2012, we issued an additional OIP against D&T Shanghai and four other respondents.[4] The OIP in this second proceeding alleges that the respondents willfully refused to provide the Commission with audit workpapers and other materials prepared in connection with audit work or interim reviews in contravention of their legal obligations under Sarbanes-Oxley Section 106 as foreign public accounting firms. The first proceeding, in which D&T Shanghai was the sole respondent, was subsequently consolidated with this second proceeding.

II.

The OIPs direct the presiding law judge to issue an initial decision no later than 300 days from the date of service of the OIP. On March 8, 2013, we granted Chief Judge Murray's motion requesting an extension of time to file the initial decision in the first proceeding until October 11, 2013 because the first proceeding "was postponed for approximately five months pending the Commission's negotiations with the China Securities Regulatory Commission and has since been consolidated with [the second proceeding], which was instituted approximately seven months after the first proceeding."[5] The initial decision in the second proceeding is also due on October 11, 2013.[6] Chief Judge Murray has now filed a second motion requesting an extension for this consolidated proceeding pursuant to Rule of Practice 360(a)(3).

We adopted Rules of Practice 360(a)(2) and 360(a)(3) to enhance the timely and efficient adjudication and disposition of Commission administrative proceedings by setting deadlines for issuance of an initial decision.[7] The rules further provide for deadline extensions under certain circumstances if supported by a motion from the Chief Administrative Law Judge and we determine that "additional time is necessary or appropriate in the public interest."[8]

In her motion, Chief Judge Murray asserts that "[i]t will not be possible to issue an Initial Decision within the time specified due to the size and complexity of the Consolidated Proceeding and [her] Office's very heavy workload." She notes that there have been twelve days of hearings in the consolidated proceeding which have produced over 2,700 pages of transcript, that the parties presented testimony from twenty lay witnesses and seven expert witnesses, and that approximately 1,000 exhibits were admitted into evidence. She also notes that the "expert witness reports are hundreds of pages long and the parties' opening post-hearing briefs have a combined total of nearly 250 pages." Moreover, the presiding law judge "has three other Initial Decisions due in early October following hearings in those proceedings and is scheduled to preside at a hearing beginning on September 23, 2013, which is expected to last a week." Under the circumstances, it is appropriate in the public interest to grant the Chief Administrative Law

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4 *BDO China Dahua CPA Co.*, Exchange Act Release No. 68335, 2012 SEC LEXIS 3704 (Dec. 3, 2012).

5 *BDO China Dahua CPA Co.*, Exchange Act Release No. 69094, 2013 SEC LEXIS 974, at *4-5 (Mar. 8, 2013) (internal quotations omitted).

6 *BDO China Dahua CPA Co.*, Administrative Proceedings Rulings Release No. 763, 2013 SEC LEXIS 1298, at *17 (Apr. 30, 2013).

7 *See Adopting Release*, Securities Act Release No. 8240, 2003 SEC LEXIS 1404, at *2-3 (June 11, 2003).

8 17 C.F.R. § 201.360(a)(3).

Judge's request and to extend the deadline for issuance of a decision in this consolidated proceeding.

Accordingly, IT IS ORDERED that the deadline for filing the initial decision in this consolidated proceeding is extended to January 20, 2014.

By the Commission.

Elizabeth M. Murphy
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

Commissioner Gallagher not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9462 / October 2, 2013

SECURITIES EXCHANGE ACT OF 1934
Release No. 70595 / October 2, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3686 / October 2, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30740 / October 2, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15549

In the Matter of **MANARIN INVESTMENT COUNSEL, LTD.,** **MANARIN SECURITIES CORP.,** **and** **ROLAND R. MANARIN,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), 203(f), AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Manarin Investment Counsel, Ltd., Manarin Securities Corp., and Roland R. Manarin (collectively, "Respondents").

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II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Section 15(b) of the Securities Exchange Act of 1934, Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds[1] that:

Summary

1. These proceedings arise from the Respondents' misconduct in their management of three pooled investment vehicles referred to herein as "the Funds." First, from at least June 2000 through mid-2010, Manarin and his firm, Manarin Investment Counsel, Ltd. ("MIC"), breached their fiduciary duties as investment advisers by causing the Funds to buy the Class A shares of underlying mutual funds ("Investment Funds") even when the Funds were eligible to own lower-cost "institutional" shares of the very same Investment Funds. As a result, the Funds paid avoidable, and ongoing, 12b-1 fees on their Investment Fund holdings, which were passed through to MIC's affiliated broker-dealer, Manarin Securities Corp. ("MSC"). This practice was inconsistent not only with MIC's and Manarin's duty to seek best execution for the Funds, but also with multiple disclosures by the Respondents. Second, between at least October 2008 and December 2011, MSC charged its affiliated mutual fund commissions that exceeded the usual and customary broker's commission on transactions effected on a securities exchange. As a result of the foregoing conduct, Respondents violated the federal securities laws as set forth below.

Respondents

2. Manarin Investment Counsel, Ltd. ("MIC"), a Nebraska corporation headquartered in Omaha, Nebraska, has been registered as an investment adviser with the Commission since 1983.

[1] The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

According to its most recent Form ADV, MIC serves as the investment adviser to the Funds and roughly 1,300 separately managed accounts, with combined assets under management of approximately $549 million as of May 24, 2013.

3. Manarin Securities Corp. ("MSC"), a Nebraska corporation headquartered in Omaha, Nebraska, has been registered as a broker-dealer with the Commission since 1995 and is affiliated with MIC through common ownership. Throughout the relevant period, MSC acted as broker-dealer for MIC's clients, including the Funds described below. Prior to February 2012, MSC also acted as the distributor for Lifetime Achievement Fund, a mutual fund managed by MIC, and, as such, was responsible for marketing and selling fund shares.

4. Roland R. Manarin, age 69, is a resident of Omaha, Nebraska. He is the founder, owner, and President of MIC and MSC. As such, Manarin exercised control over the management and policies of both entities throughout the relevant period. Prior to February 2012, Manarin also was the President and Chairman of the Board of Lifetime Achievement Fund.

The Funds

5. Lifetime Achievement Fund ("LAF") is a mutual fund that invests principally in shares of other mutual funds. Launched by Manarin in July 2000, LAF originally was organized as a Maryland corporation and registered as an investment company with the Commission. Since April 2012, LAF has been organized as a series of Northern Lights Fund Trust III, which registered as an investment company in December 2011.

6. Pyramid I Limited Partnership ("Pyramid I") and Pyramid II Limited Partnership ("Pyramid II") are private partnerships organized under Delaware law and created by Manarin in 1989 and 1995, respectively. Like LAF, Pyramid I and Pyramid II (collectively, the "Pyramid Funds") mainly invest in shares of various mutual funds. Since December 2006, MIC has been the general partner of the Pyramid Funds. Prior to December 2006, Manarin was the general partner.

Facts

A. *Breach of Fiduciary Duty in Selection of Investment Fund Share Classes*

7. Throughout the relevant period, MIC acted as investment adviser to LAF, Pyramid I, and Pyramid II (collectively, the "Funds") and received management fees from the Funds for its services. MIC sought to achieve the Funds' capital appreciation objectives mainly by investing in a variety of equity mutual funds ("Investment Funds") and had its affiliated company, MSC, execute purchases and sales of shares of these Investment Funds.

8. Mutual funds usually offer multiple share classes with different fee structures, including, as relevant here, Class A shares and so-called "institutional" shares. Class A shares are typically available to all investors, but usually carry fees (typically 25 basis points) to cover fund distribution and/or shareholder service expenses pursuant to Section 12(b) of the Investment Company Act and Rule 12b-1 thereunder ("12b-1 fees"). Such 12b-1 fees are paid out of fund

assets, on an ongoing basis, to the fund's distributor, who passes them through to broker-dealers whose customers hold fund shares.[2]

9. By contrast, "institutional" shares are available only to investors who meet certain criteria (e.g., a minimum investment amount) and do not carry 12b-1 fees.[3] An investor who holds such shares of a given mutual fund therefore will pay lower fees over time – and keep more of his or her investment returns – than an investor who holds Class A shares of the same fund. Therefore, if a mutual fund offers institutional shares, and an investor is eligible to own them, it is generally in the investor's best interests to select the institutional share class.

10. Section 206 of the Advisers Act imposes on investment advisers a fiduciary duty to act for the benefit of their clients. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191 (1963). That duty includes, among other things, an obligation to seek best execution for client transactions – i.e., "to seek the most favorable terms reasonably available under the circumstances." *In the Matter of Fidelity Management Research Company*, Investment Advisers Act Rel. No. 2713 (March 5, 2008).

11. Throughout the relevant period, many Investment Funds in which the Funds held shares offered both Class A shares, which carried 12b-1 fees, and institutional shares, which did not. Although the Funds often met the eligibility criteria for institutional shares (which were set forth in Investment Fund prospectuses), MIC and Manarin consistently caused the Funds to invest instead in Class A shares with higher fees. As a result, the Funds paid approximately $3.3 million in 12b-1 fees between June 2000 and mid-2010. These fees were deducted from the Funds' assets and passed through the Investment Funds' distributors to MSC.

B. *Misleading Disclosures*

LAF

12. Throughout the relevant period, LAF issued shares pursuant to a registration statement filed with the Commission and signed by Manarin as President of the fund. MSC acted as the fund's distributor and, as such, was responsible for marketing and selling fund shares.

13. Between LAF's inception and April 2006, its registration statement represented that MIC, "in effecting portfolio transactions" for the fund, "seeks to obtain the best net results for the Fund." Beginning in April 2006, the registration statement assured investors that MIC sought "best execution and net results" in effecting portfolio transactions for LAF.

14. Prior to April 2007, LAF's registration statement did not mention MSC's receipt of 12b-1 fees from Investment Funds. Beginning in April 2007, the registration statement disclosed

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[2] Although Class A shares often carry up-front sales charges for certain investors, such charges are not at issue here, as the Funds did not pay sales charges on their purchases.

[3] "Institutional" shares go by a variety of names in the mutual fund industry. As used in this Order, the term refers to share classes that carry neither up-front sales charges nor 12b-1 fees.

that, "with respect to Investment Funds that charge distribution and/or shareholder servicing (12b-1) fees, to the extent [MSC] effects the Fund's purchase of shares in such Investment Funds, [MSC] will be entitled to receive from the Investment Fund its share of any such fee." At no time, however, did LAF's registration statement disclose that MIC would cause the fund to purchase Investment Fund shares that carried 12b-1 fees even when it was eligible to own lower-cost institutional shares of the same Investment Fund.

The Pyramid Funds

15. As general partners of the Pyramid Funds, Manarin and, later, MIC offered interests in the Pyramid Funds pursuant to private placement memoranda (PPMs). Similar to LAF's registration statement, the PPMs disclosed that, in managing the Pyramid Funds' assets, "MIC uses its best efforts to obtain the most favorable price and execution available." While the PPMs also disclosed that MSC could receive 12b-1 fees in connection with the Pyramid Funds' mutual fund investments, they did not disclose that MIC would cause the Pyramid Funds to buy shares that carried such fees even when they were eligible to own lower-cost institutional shares of the same Investment Fund.

MIC's Form ADV

16. As investment adviser to LAF, MIC transmitted its Form ADV to the fund's board of directors each year in connection with the board's annual review of MIC's advisory contract. From at least March 2007, MIC's Form ADV Part II stated that MIC "directs securities transactions for [its fund clients] to MSC, "[s]ubject to any relevant legal or regulatory restrictions and obligations, including the assurance that [MIC] is obtaining best execution." Similar to LAF's registration statement and the Pyramid Funds' PPMs, the Form ADV disclosed that MSC representatives were "typically entitled to receive" a portion of 12b-1 fees passed through Investment Funds to MSC. It did not disclose, however, that MIC would select Investment Fund shares that carried 12b-1 fees even when its fund clients were eligible to own lower-cost institutional shares of the same Investment Fund.

C. *MSC Refunds 12b-1 Fees Paid by LAF but not by the Pyramid Funds*

17. In May 2010, following communications with staff in the Commission's Division of Investment Management about MSC's receipt of 12b-1 fees on LAF's investments, MIC converted LAF's holdings from Class A to institutional shares. On June 25, 2010, MSC refunded to LAF $1,878,680, representing all 12b-1 fees collected on LAF-held Investment Funds since LAF's inception. Although MIC subsequently converted the Pyramid Funds' holdings to institutional shares, MSC has not refunded 12b-1 fees previously collected on the Pyramid Funds' investments.

18. Between June 2000 and October 2010, the Pyramid Funds paid, and MSC received, approximately $1.4 million in 12b-1 fees on their Investment Fund holdings. Of that amount, approximately $685,000 was attributable to Investment Funds that offered institutional shares that the Pyramid Funds were eligible to own.

D. *MSC Commissions that Exceeded the Usual and Customary Broker's Commissions on ETF Transactions for LAF*

19. Although LAF primarily invested in other mutual funds during the relevant period, occasionally it also transacted in exchange-traded funds ("ETFs"). As with mutual fund transactions, MIC directed such ETF transactions to MSC.

20. Unlike mutual fund shares, ETF shares are bought and sold on securities exchanges. As an "affiliated person" of the investment adviser to LAF, MSC was prohibited from receiving, on such transactions, commissions that exceeded the "usual and customary broker's commission" for such transactions.

21. From LAF's inception through December 2011, MSC charged LAF a flat commission of 25 basis points (.25%) on every transaction effected on an exchange. In many instances, this practice resulted in commissions exceeding $.10 per share.

22. In recent years, standard commission rates for transactions effected on securities exchanges have declined substantially across the brokerage industry. By no later than October 2008, the commissions charged by MSC to LAF for such transactions substantially exceeded the usual and customary commissions charged by other broker-dealers.

23. LAF's procedures for board review and approval of affiliated brokerage transactions purported to require that MSC's commissions be "reasonable and fair" compared to commissions charged by other broker-dealers. Those procedures were not reasonably designed to achieve that result, however, as they did not require any investigation into the commissions actually charged by other broker-dealers for similar transactions. The safe harbor provided by Investment Company Act Rule 17e-1 therefore does not apply.

24. On October 31, 2012, at the request of LAF's board, MSC refunded to LAF $37,965.15, representing commissions in excess of $.03 per share on LAF's ETF transactions between October 2008 and December 2011.

Violations

25. By failing to seek best execution for the Funds when selecting among available Investment Fund share classes, MIC and Manarin willfully[4] violated Section 206(2) of the Advisers Act, which it makes it unlawful for an adviser to engage in any transaction, practice, or course of business that operates as a fraud or deceit upon any client. MIC also willfully violated Section 206(2) by representing to LAF, through its board of directors, that MIC sought best execution on transactions for its fund clients, including LAF.

26. By making materially misleading statements regarding MIC's practice of seeking best execution in the Pyramid Funds' offering documents, MIC and Manarin willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8(a)(1) thereunder, which make it unlawful for

[4] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

any adviser to a pooled investment vehicle to make any false or misleading statement of material fact to any investor or prospective investor in the pooled investment vehicle. Manarin also willfully violated Section 206(4) and Rule 206(4)-8(a)(1) by making misleading statements regarding MIC's best execution practices in LAF's registration statement, which he signed as President of the fund.

27. By making materially misleading statements regarding MIC's best execution practices in LAF's registration statement, Manarin, as President of LAF, willfully violated Section 34(b) of the Investment Company Act, which, among other things, makes it unlawful for any person to make any untrue or misleading statement of material fact in any registration statement, application, report, account, record, or other document filed with the Commission under the Investment Company Act.

28. By offering and selling interests in the Funds through the use of materially misleading offering documents, Respondents willfully violated Section 17(a)(2) of the Securities Act, which makes it unlawful, in the offer or sale of securities, to obtain money or property by means of any false or misleading statements of material fact.

29. By receiving, on transactions for LAF effected on a securities exchange, commissions that exceeded the usual and customary broker's commission for such transactions, MSC willfully violated Section 17(e)(2)(A) of the Investment Company Act, which prohibits any affiliated person of a registered investment company, or any affiliated person of such person, from receiving, in connection with transactions effected on an exchange for such registered investment company, any commission, fee, or other remuneration that exceeds the usual and customary broker's commission for such transactions.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Section 8A of the Securities Act, Section 15(b) of the Exchange Act, Sections 203(e), 203(f), and 203(k) of the Advisers Act, and Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent MIC cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder and Section 17(a) of the Securities Act.

B. Respondent MSC cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Section 17(e) of the Investment Company Act.

C. Respondent Manarin cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, Section 34(b) of the Investment Company Act, and Section 17(a) of the Securities Act.

D. Respondents are hereby censured.

E. Manarin and MSC, jointly and severally, shall pay disgorgement and prejudgment interest as follows:

(1) Manarin and/or MSC shall pay disgorgement totaling $685,006.90 and prejudgment interest totaling $267,741.72. Within ten (10) days of the entry of this Order, Manarin and/or MSC shall deposit the full amount of the disgorgement and prejudgment interest (together, the "Disgorgement Fund") into an escrow account acceptable to the Commission staff and provide the Commission staff with evidence of the deposit in a form acceptable to the Commission staff. If timely deposit of the Disgorgement Fund is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.

(2) Within twenty (20) days of entry of this Order, Manarin and/or MSC shall cause the following payments to be made from the Disgorgement Fund:

(a) Disgorgement of $331,910.51 and prejudgment interest of $135,774.46 (for a total of $467,684.97) to Pyramid I;

(b) Disgorgement of $353,096.39 and prejudgment interest of $127,105.65 (for a total of $480,202.04) to Pyramid II;

(c) Prejudgment interest of $4,861.61 to LAF. MSC's prior voluntary payment of $37,965.15 to LAF on October 31, 2012 is deemed to satisfy its disgorgement obligations with respect to MSC's receipt of excessive commissions on exchange transactions for LAF in violation of Section 17(e)(2)(A) of the Investment Company Act.

(3) Within thirty (30) days of entry of this Order, Manarin and/or MSC shall certify to the Commission staff, in a form acceptable to the Commission staff, that the Disgorgement Fund has been distributed as set forth in subparagraph E.(2) above and shall submit documentation evidencing each distribution to the Commission staff. Such certification and documentation shall be delivered under cover letter, which identifies Manarin and MSC as respondents in these proceedings and the file number of these proceedings, addressed to Kurt L. Gottschall, Assistant Director, Asset Management Unit, Denver Regional Office, 1801 California St., Suite 1500, Denver, Colorado 80202.

(4) If, for any reason, any portion of the Disgorgement Fund is not distributed, Manarin and/or MSC shall cause such undistributed funds to be paid to the Commission, for transmittal to the United States Treasury, in the manner set forth in paragraph F below.

(5) If any deadline set forth in this Subsection E falls on a weekend or a federal holiday, the deadline shall move to the next business day. The Commission staff may extend any of the deadlines set forth in this Subsection E for good cause shown.

(6) Manarin and/or MSC shall be responsible for any and all tax compliance responsibilities associated with the Disgorgement Fund and may retain any professional services necessary. They may not, however, pay for such services out of the Disgorgement Fund.

F. Manarin shall, within 20 days of the entry of this Order, pay a civil money penalty in the amount of $100,000.00 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

(1) Manarin may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(2) Manarin may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Manarin as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Kurt L. Gottschall, Assistant Director, Asset Management Unit, Denver Regional Office, 1801 California St., Suite 1500, Denver, Colorado 80202.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70602 / October 2, 2013

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3505 / October 2, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15550

In the Matter of **Jing Xie,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Jing Xie ("Respondent" or "Xie") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings

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[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

herein, except as to the Commission's jurisdiction over himself and the subject matter of these proceedings, and the findings contained in Section **III.3.** below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Xie, age 32, represents that he is and has been a member of the Association of Credited Chartered Accountants. He served as Chief Financial Officer of Universal Travel Group ("UTG") from February 13, 2009 to August 17, 2009, as interim Chief Financial Officer of UTG from August 17, 2010 to February 9, 2013, and as director and Secretary of UTG from December 29, 2006 to February 9, 2013.

2. UTG was, at all relevant times, a Nevada corporation with its headquarters in Shenzhen, People's Republic of China ("PRC"). UTG claimed to be engaged in the business of selling travel services. At all relevant times, UTG's common stock was registered with the Commission pursuant to Section 12(g) or Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act"). On October 27, 2009, UTG common stock was listed and traded on the New York Stock Exchange ("NYSE"). Previous to that, on May 29, 2009, UTG common stock was listed and traded on the NYSE AMEX. Previous to that, UTG common stock was traded on the Over The Counter Bulletin Board. On April 26, 2012, UTG voluntarily delisted its stock from the NYSE.

3. On September 30, 2013, a final judgment was entered against Xie by consent, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 and Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13a-14 and 13b2-1 thereunder, and from aiding and abetting future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder, in the civil action entitled Securities and Exchange Commission v. Universal Travel Group et al., Civil Action Number 13 CV-1492, in the United States District Court for the District of Columbia. Xie was also ordered to pay a $60,000 civil money penalty and was barred for five years from serving as an officer or director of a company with securities registered with the Commission pursuant to Section 12 of the Exchange Act.

4. The Commission's complaint alleged, among other things, that Xie violated the antifraud provisions of the securities laws by making materially false and misleading statements and omissions concerning, *inter alia*, UTG's risky transfer of $41 million in U.S. stock offering proceeds to numerous unaffiliated third parties in Hong Kong and the PRC, UTG's intended use of public offering proceeds, UTG's risky uses of cash and cash controls, UTG's corporate organization, and UTG's revenues and profits during the first three quarters of 2010. The Complaint alleged that Xie aided and abetted UTG's reporting violations, UTG's failure to devise and implement proper internal accounting controls, and UTG's failure to create proper

records of cash transactions. In addition, the complaint alleged that Xie knowingly failed to implement a system of internal accounting controls, signed a false certification as to UTG's internal controls over financial reporting, and caused to be falsified certain UTG records.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Xies's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Xie is suspended from appearing or practicing before the Commission as an accountant.

B. After five years from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the respondent's or the firm's quality control system that would indicate that the respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his status as an accountant is current and he has resolved all other disciplinary issues with the applicable state or national boards of accountancy. However, if licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
October 4, 2013

In the Matter of **China Ritar Power Corp.,** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of China Ritar Power Corp. because China Ritar Power Corp. has not filed any periodic reports for any reporting period subsequent to the period ended September 30, 2010.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in securities of China Ritar Power Corp.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of China Ritar Power Corp. is suspended for the period from 9:30 a.m. EDT, October 4, 2013, through 11:59 p.m. EDT, on October 17, 2013.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70610 / October 4, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15551

In the Matter of China Ritar Power Corp., Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against China Ritar Power Corp.

II.

After an investigation, the Division of Enforcement alleges that:

1. Respondent China Ritar Power Corp. (CIK No. 0000786368) is a Nevada corporation located in Nanshan District, Shenzhen, China as reflected in its last periodic filing. It has a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). As of August 13, 2013, Respondent's common stock (symbol "CRTP") was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Group Inc. ("OTC Link"), had five market makers, and was no longer eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Respondent's most recent periodic filing was a Form 10-Q for the period ended September 30, 2010, filed on November 15, 2010.

3. The Division of Corporation Finance sent a delinquency letter to Respondent at its registered agent in the State of Nevada and to its business address in Shenzhen, China on June 25, 2012, requesting compliance with Respondent's periodic filing obligations.

4. Respondent has failed to respond to the delinquency letter sent to it by the Division of Corporation Finance, or to make any subsequent periodic filings.

5. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires issuers to file quarterly reports.

6. As a result of the foregoing, Respondent failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke, the registration of each class of securities of the Respondent registered pursuant to Section 12 of the Exchange Act, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondent personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9463 / October 7, 2013

SECURITIES EXCHANGE ACT OF 1934
Release No. 70621 / October 7, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3687 / October 7, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30741 / October 7, 2013

Admin. Proc. File No. 3-15015

In the Matter of MICHAEL BRESNER RALPH CALABRO JASON KONNER, and DIMITRIOS KOUTSOUBOS	ORDER GRANTING SECOND EXTENSION

Chief Administrative Law Judge Brenda P. Murray has moved, pursuant to Commission Rule of Practice 360(a)(3),[1] for an extension of thirty days to issue the initial decision in this proceeding. For the reasons set forth below, we grant her motion.

On September 10, 2012, we issued an Order Instituting Administrative and Cease-and-Desist Proceedings ("OIP") against Michael Bresner, an Executive Vice President and Head of Supervision at JP Turner & Company, LLC ("JP Turner"), a registered broker-dealer, and a person associated with JP Turner & Company Capital Management, LLC, a registered investment adviser; and Ralph Calabro, Jason Konner, and Dimitrios Koutsoubos, each a former registered representative of JP Turner.[2] The OIP alleges that, between January 1, 2008 and December 31, 2009, Calabro, Konner, and Koutsoubos churned the accounts of seven customers, without regard to the customers' conservative investment objectives and low or moderate risk

1 17 C.F.R. § 201.360(a)(3).

2 *Michael Bresner*, Exchange Act Release No. 67810, 2012 WL 3903387 (Sept. 10, 2012).

tolerances, in violation of the antifraud provisions.[3] The OIP further alleges that Bresner failed reasonably to supervise Konner and Koutsoubos with a view to preventing their antifraud violations.

The OIP directs the presiding law judge to issue an initial decision within 300 days of the date of service of the OIP. On July 5, 2013, we granted Chief Judge Murray's motion requesting an extension of time to file the initial decision until October 9, 2013 based on her assertion that "[i]t is certain that [the presiding law judge], who expects to begin a lengthy hearing on July 8, will need an additional ninety days to issue an Initial Decision in *Bresner*."[4] Chief Judge Murray supports her second extension request by noting that the seventeen-day hearing in this matter resulted in an extensive record that warrants additional time to review and that the staff member assigned to assist the law judge in this proceeding is simultaneously handling another proceeding with an extensive record.[5]

We adopted Rules of Practice 360(a)(2) and 360(a)(3) to enhance the timely and efficient adjudication and disposition of Commission administrative proceedings by setting deadlines for issuance of an initial decision.[6] The rules further provide for deadline extensions under certain circumstances if supported by a motion from the Chief Administrative Law Judge and it appears, as here, that "additional time is necessary or appropriate in the public interest."[7]

Accordingly, IT IS ORDERED that the deadline for filing the initial decision in this proceeding is extended to November 8, 2013.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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3 Section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a); Section 10(b) of the Securities Exchange Act of 1934, *id.* § 78j(b); and Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5.

4 *Michael Bresner*, Exchange Act Release No. 69940, 2013 WL 3477080, at *1 (July 5, 2013).

5 She notes that "progress has been made on the Initial Decision in this matter and [her] Office has hired two new law clerks starting on September 23, 2013."

6 *See Adopting Release*, Exchange Act Release No. 48018, 2003 WL 21354791, at *2 (June 11, 2003).

7 17 C.F.R. § 201.360(a)(3).

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Rel. No. 9464 / October 8, 2013

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 70631 / October 8, 2013

Admin. Proc. File No. 3-15020

In the Matter of

JILAINE H. BAUER, ESQ.

ORDER DISMISSING PROCEEDING

On September 12, 2012, we issued an order instituting administrative proceedings ("OIP") against Jilaine H. Bauer, Esq., pursuant to Rule 102(e)(3)(i)(B) of our Rules of Practice, which authorizes Commission action when an attorney or other professional or expert has been "[f]ound by any court of competent jurisdiction in an action brought by the Commission to which he or she is a party . . . to have violated (unless the violation was found not to have been willful) or aided and abetted the violation of any provision of the Federal securities laws or of the rules and regulations thereunder."[1] The OIP imposed on Bauer a temporary suspension from appearing or practicing before the Commission, as authorized by Rule 102(e)(3)(i)(B).

The OIP was based on a judgment entered on June 15, 2012 by the United States District Court for the Eastern District of Wisconsin finding that Bauer violated Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder.[2] Bauer appealed the district court's judgment to the United States Court of Appeals for the Seventh Circuit.

On April 16, 2013, an administrative law judge issued an initial decision (the "Initial Decision") in the administrative proceeding finding, based on the action in the Eastern District of Wisconsin, that Bauer "has been 'found by [a] court of competent jurisdiction in an action brought by the Commission to which . . . she is a party . . . to have violated [willfully] any provision of the

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1 17 CFR § 201.102(e)(3)(i)(B).

2 15 U.S.C. §§ 77q(a), 78j(b); 17 CFR § 240.10b-5.

Federal securities laws or of the rules and regulations thereunder' within the meaning of [Rule 102(e)(3)(i)(B)]."[3] The law judge found that the seven-month suspension Bauer had served by the time the Initial Decision was entered was an appropriate sanction on the facts of the case and therefore lifted the temporary suspension.[4] Both Bauer and the Office of the General Counsel petitioned for Commission review of the Initial Decision.

On July 22, 2013, while this administrative appeal was pending, the Seventh Circuit reversed and remanded the district court's judgment.[5] Bauer has filed a motion to dismiss the administrative proceeding.[6]

In seeking to have the proceeding dismissed, Bauer argues that the district court judgment was the sole basis for the proceeding, and that as a result of the Seventh Circuit's ruling, the predicate for this proceeding no longer exists. OGC initially opposed Bauer's motion as premature, because the time for filing post-judgment motions had not expired and the court's mandate had not issued, and the July 22 decision was thus not effective and could be changed. However, the mandate has now issued.[7]

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[3] *Jilaine H. Bauer, Esq.*, Initial Decision Rel. No. 483, 2013 SEC LEXIS 1125, at *8-9 (Apr. 16, 2013).

[4] *Id.*, 2013 SEC LEXIS 1125, at *10.

[5] *SEC v. Bauer*, 2013 U.S. App. LEXIS 14767 (7th Cir. July 22, 2013).

[6] Bauer's motion asks us to vacate the initial decision. However, the initial decision has not become final. *See* Rule of Practice 360(3)(d)(1), 17 CFR § 201.360(3)(d)(1) (providing that "[i]f a party . . . timely files a petition for review . . . the initial decision shall not become final as to that party"). We therefore construe Bauer's petition as seeking dismissal of the administrative proceeding. *See, e.g., Richard L. Goble*, Securities Exchange Act Release No. 68651, 2013 SEC LEXIS 129 (Jan. 14, 2013) (dismissing follow-on administrative proceeding after court of appeals, while petition for review was pending before Commission, vacated injunction that served as basis for OIP); *Evelyn Litwok*, Investment Advisers Act Release. No. 3438, 2012 SEC LEXIS 2328, at *3-4 (July 25, 2012) (dismissing follow-on proceeding after court of appeals, while petition for review was pending before Commission, reversed certain convictions and vacated and remanded other convictions, all of which served as basis for proceeding). *But cf. Kenneth E. Mahaffy, Jr.*, Exchange Act Rel. No. 68462, 2012 SEC LEXIS 4020 (Dec. 18, 2012), (vacating bar issued in follow-on administrative proceeding where court of appeals vacated criminal conviction that provided basis for proceeding after Commission had issued bar order).

Bauer included in her motion a request that we discontinue the federal action and not proceed with remand proceedings in the district court. We decline to take the requested action, which is outside the scope of this administrative proceeding.

[7] We take official notice that neither reconsideration nor review was sought, and that the mandate has issued. *See* 17 CFR § 201.323 (rule of practice pertaining to official notice).

Because the Seventh Circuit reversed the district court judgment that was the predicate for this proceeding, we conclude that it is appropriate to dismiss the proceeding.[8]

Accordingly, IT IS ORDERED that this proceeding be, and it hereby is, dismissed.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Lynn M. Powalski
Deputy Secretary

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8 *See, e.g.*, *Jimmy Dale Swink, Jr.*, Exchange Act Rel. No. 36042, 1995 SEC LEXIS 2033 (Aug. 1, 1995) (vacating findings and administrative bar order when appellate court reversed criminal conviction that was basis for proceeding).

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3688 / October 8, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15552

In the Matter of **RICHARD LEE,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Richard Lee ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Lee, age 34, resides in Chicago, Illinois. From April 2009 to June 2011, and then again from September 2012 through March 2013, Lee was employed as a portfolio manager at S.A.C. Capital Advisors, L.P. ("S.A.C."), an investment adviser based in Stamford, Connecticut that registered with the Commission in 2012.

2. On July 25, 2013, the Commission filed a civil action against Lee in SEC v. Richard Lee, Civil Action No. 13-CV-5185 (S.D.N.Y.). On September 12, 2013, the Court entered an order permanently enjoining Lee, by consent, from future violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder.

3. The Commission's complaint alleged that, in connection with the purchase or sale of certain securities, Lee knew, recklessly disregarded, or should have known, that material non-public information he received came from inside sources and was disclosed or misappropriated in breach of a fiduciary duty, or similar relationship of trust and confidence, and Lee is liable for illegal trades that he placed in his own personal brokerage account and on behalf of S.A.C. because he directly or indirectly caused S.A.C. to place such trades.

4. On July 23, 2013, Lee pleaded guilty to one count of securities fraud and one count of conspiracy to commit securities fraud and in violation of 15 U.S.C. §§ 78j(b) and 78ff and 18 U.S.C. § 371 before the United States District Court for the Southern District of New York, in United States v. Richard Lee, 13-CR-539-PGG.

5. The counts of the criminal indictment to which Lee pleaded guilty alleged, inter alia, that Lee, and others, participated in a scheme to defraud by executing securities trades based on material nonpublic information that had been disclosed or misappropriated in violation of duties of trust and confidence, and that he unlawfully, willfully and knowingly did so, directly and indirectly, by use of the means and instrumentalities of interstate commerce, and of the mails, and of the facilities of national securities exchanges, in connection with the purchase and sale of securities.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Lee's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Lee be, and hereby is: barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70632 / October 8, 2013

Admin. Proc. File No. 3-13678

In the Matter of the Application of JOHN M.E. SAAD For Review of Disciplinary Action Taken by FINRA	ORDER REMANDING PROCEEDING TO REGISTERED SECURITIES ASSOCIATION

On May 26, 2010, we issued an opinion finding that John M.E. Saad, formerly a registered representative associated with Homer, Townsend & Kent ("HTK"), a FINRA member firm, had violated NASD Rule 2110 by accepting reimbursement based on Saad's submission of false expense reimbursement requests and receipts. We also sustained FINRA's imposition of sanctions, which were a bar in all capacities and an assessment of costs.[1]

Saad appealed our decision to the United States Court of Appeals for the District of Columbia Circuit. Saad did not contest that he had violated Rule 2110, but instead asserted only that the Commission had abused its discretion in upholding the bar. In particular, Saad argued that the Commission had ignored two mitigating factors: (1) that HTK had terminated Saad's employment before FINRA detected his misconduct, and (2) Saad's claim that he was under personal and professional stress at the time of his misconduct.

The D.C. Circuit agreed with Saad's contention that the Commission had failed to consider his two claims of mitigation and remanded the proceeding to the Commission for further consideration of those issues.[2] In doing so, the court found that the Commission had acknowledged Saad's claim that his firm had fired him before FINRA detected his misconduct, but that neither FINRA nor the Commission had fully addressed that claim. The court concluded

[1] *John M.E. Saad*, Securities Exchange Act Release No. 62178, 2010 SEC LEXIS 1761 (May 26, 2010).

[2] *Saad v. SEC*, 718 F.3d 904, 912–14 (D.C. Cir. 2013). Although the court remanded for further consideration of Saad's claims of mitigation, the court affirmed the Commission's finding that FINRA had appropriately used the FINRA Sanction Guideline regarding the conversion or improper use of funds or securities when considering whether a bar was an appropriate sanction. The court also found that the Commission had correctly noted that a bar was a possible sanction regardless of whether FINRA had used the guideline for conversion/improper use or, as Saad argued was more appropriate, the guideline for forgery/falsification of records. *Id.* at 911–12.

that consideration of this factor was relevant because FINRA's Sanction Guidelines state that, when determining sanctions, adjudicators should consider "[w]hether the member firm with which an individual respondent is/was associated disciplined the respondent for the same misconduct at issue prior to regulatory detection."[3] The court also found that the Commission had noted, but did not address, Saad's claim that "he was under severe stress with a hospitalized infant and a stressful job environment."[4] The court did not accept the Commission's contention that it had, at a minimum, implicitly rejected these claims of mitigation by denying all arguments that were inconsistent with the views expressed in the Commission's decision. The court instead ordered the Commission "to fully address *all* potentially mitigating factors that might militate against a lifetime bar," while noting that the court took "no position on the proper outcome of this case."[5]

We have determined to remand to FINRA the portion of this proceeding concerning the imposition of a bar to give FINRA an opportunity to explain its views on its Sanction Guidelines and Saad's claims of mitigation. We direct FINRA's particular attention to the following questions:

(1) When considering Principal Consideration Number 14 of FINRA's Sanction Guidelines (which concerns the consideration of whether a member firm disciplined an associated respondent prior to regulatory detection), does that guideline apply as to the member firm, the associated person, or both (*e.g.*, does the guideline apply when determining whether (a) the *member firm's* misconduct was mitigated because the firm disciplined an associated person before regulators detected the misconduct, (b) the *associated person's* misconduct was mitigated because the firm had already disciplined the associated person, or (c) *either* the member firm's *or* the associated person's misconduct was mitigated by such disciplinary action)?

(2) In light of FINRA's finding as to question (1) above, is Saad's claim that HTK had terminated his employment before FINRA detected his misconduct mitigating?

(3) Is Saad's claim that he was under personal and professional stress at the time of his misconduct mitigating?

(4) Are there any other considerations that Saad has raised (whether or not discussed in the D.C. Circuit's decision) that are mitigating?

(5) In light of FINRA's findings as to questions (1) through (4) above, what is an appropriate sanction in this case?

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3 *Id.* at 913 (quoting FINRA Sanction Guidelines ("Guidelines"), at 7 (Principal Consideration No. 14)).

4 *Id.* (quoting *Saad*, 2010 SEC LEXIS 1761, at *27). Unlike with Saad's claim regarding his termination, FINRA's Sanction Guidelines do not contain a guideline about whether claims of personal or professional stress can be mitigating.

5 *Id.* at 914 (emphasis in original).

At the conclusion of FINRA's proceeding on remand, Saad will have the right to file an application for review of FINRA's decision with the Commission pursuant to Section 19(d)(1) of the Securities Exchange Act of 1934 and Rule 420 of the Commission's Rules of Practice.[6]

Accordingly, IT IS ORDERED that this proceeding is remanded to FINRA for issuance of a decision in this matter as to the appropriate sanction for Saad's violation of NASD Rule 2110.[7]

By the Commission.

Elizabeth M. Murphy
Secretary

By: Lynn M. Powalski
Deputy Secretary

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6 15 U.S.C. § 78s(d)(1); 17 C.F.R. § 201.420. The Commission may also, on its own initiative, order review of FINRA's decision pursuant to Exchange Act Section 19(d)(1) and Rule of Practice 421. 15 U.S.C. § 78s(d)(1); 17 C.F.R. § 201.421.

7 We do not intend to suggest any view as to the appropriate outcome of these proceedings.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Rel. No. 9465 / October 9, 2013

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 70639 / October 9, 2013

Admin. Proc. File No. 3-14266

In the Matter of

JOHNNY CLIFTON
11680 Stephenville Drive
Frisco, TX 75035

CORRECTED ORDER DENYING MOTIONS FOR RECONSIDERATION AND A STAY

I.

On July 12, 2013, we issued an opinion ("the July 12 Opinion") and order finding that Johnny Clifton, who was president, chief executive officer, and principal of MPG Financial, LLC, a former Commission-registered broker-dealer, violated Sections 17(a)(1), 17(a)(2), and 17(a)(3) of the Securities Act of 1933[1] by making and causing to be made material misrepresentations and omissions in the offer and sale of oil-and-gas limited partnership interests.[2] We also found that Clifton violated Section 15(b) of the Securities Exchange Act of 1934[3] by failing to supervise at least one sales representative with a view to detecting and preventing that sales representative's Securities Act Section 17(a) violations.[4] For this violative conduct, we found it to be in the public interest to bar Clifton from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, to order him to cease and desist from violating Securities Act Section 17(a), and to assess a $150,000 third-tier civil money penalty.[5]

1 15 U.S.C. §§ 77q(a)(1), 77q(a)(2), 77q(a)(3).

2 *Johnny Clifton*, Securities Act Rel. No. 9417, 2013 WL 3487076, at *1 (July 12, 2013).

3 15 U.S.C. § 78o(b).

4 *Clifton*, 2013 WL 3487076, at *1.

5 *Id.*

Clifton, who is now proceeding pro se, has filed a motion asking that we reconsider the July 12 Opinion with a view to "lowering the penalties assessed." He also has filed three motions asking us to stay the sanctions imposed pending a possible appeal to the federal courts.[6] For the reasons set forth below, we have determined to deny Clifton's motions for reconsideration and a stay.

II.

We analyze Clifton's motion for reconsideration under Rule of Practice 470.[7] Rule 470 requires a motion for reconsideration to "briefly and specifically state the matters of record alleged to have been erroneously decided, the grounds relied upon, and the relief sought."[8] We have stated that reconsideration is an "extraordinary remedy"[9] "designed to correct manifest errors of law or fact, or to permit the presentation of newly discovered evidence."[10] Applicants may not use motions for reconsideration to reiterate arguments previously made or to cite authority previously available, and we will accept only such additional evidence that "the movant could not have known about or adduced before entry of the order subject to the motion for

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6 By order dated August 22, 2013, we granted an interim stay of the collateral bar and civil money penalty imposed on Clifton in order to maintain the status quo pending our review of the parties' pleadings. *Johnny Clifton*, Order Granting Interim Sanctions, Admin. Proc. File No. 3-14266 (Aug. 22, 2013).

7 17 C.F.R. § 201.470.

8 *Id.* § 201.470(b). Our Rules of Practice further provide that the text of any motion must be double-spaced and that the motion, together with any brief in support, cannot exceed 7,000 words in length, exclusive of any table of contents or authorities. *See id.* §§ 201.152(a)(5), 154(c); *see also id.* § 201.470(b). In general, a motion that does not exceed fifteen pages in length, exclusive of any table of contents or authorities, is presumptively considered to contain no more than 7,000 words. A motion that exceeds the length limitation must include a certificate by the attorney or, in this case, the unrepresented party stating that the motion complies with the length limitation and setting forth the number of words in the motion. *Id.* § 201.154(c). Clifton's motion is sixteen pages, single-spaced (excluding a table of contents), and thus appears to exceed the 7,000 word limit in Rule 154(c). It also does not include the required certification of compliance with that rule. Notwithstanding these apparent deficiencies in Clifton's motion, we have considered and decided the motion on its merits.

9 *See, e.g.*, *Eric J. Brown*, Order Denying Collins's Motion for Reconsideration of Civil Penalties, Securities Act Rel. No. 3393, 2012 WL 1143573, at *1 (Apr. 5, 2012), *appeal filed*, *Collins v. SEC*, No. 12-1241 (D.C. Cir. June 1, 2012).

10 *See id.* & n.7 (quoting *Perpetual Sec., Inc.*, Order Denying Motion for Reconsideration, Exchange Act Rel. No. 56962, 2007 WL 4372765, at *1 (Dec. 13, 2007)).

reconsideration."[11] Motions for reconsideration, therefore, are granted only in exceptional cases.[12]

Clifton's motion for reconsideration fails to meet these rigorous standards. The July 12 Opinion found, based on a de novo review of the record, that the preponderance of the evidence established the antifraud and failure to supervise violations and supported the sanctions imposed. While Clifton disputes certain factual findings and witnesses' credibility, he does not demonstrate any manifest error of fact. He also disputes his liability under Securities Act Section 17(a) and Exchange Act Section 15(b), but does not establish any manifest error of law. Instead, Clifton's motion largely repeats and reformulates arguments that we have previously considered and rejected, including that: (1) he did not engage in a scheme to defraud and did not act with scienter; (2) he did not conceal material, adverse information about the oil and gas well project from sales representatives or prospective investors; (3) he did not know that the third oil well was a dry hole until the afternoon of December 28, 2009; (4) he did not have primary responsibility for reviewing sales representatives' outgoing e-mail correspondence until October 2009; (5) after October 2009, he delegated to the firm's chief compliance officer the responsibility for reviewing e-mails; (6) he is remorseful about his conduct; and (7) he cannot afford to pay the $150,000 civil money penalty.

Moreover, as the July 12 Opinion stated, Clifton admitted on appeal that he made material misrepresentations and omissions during a December 23, 2009 investor conference call, that two sales representatives' e-mails to prospective investors contained material misrepresentations and omissions, and that he failed to follow appropriate procedures and review those e-mails.[13] Based on his admissions and other evidence in the record, the July 12 Opinion found that Clifton willfully violated Securities Act Section 17(a) and violated Exchange Act Section 15(b). Accordingly, the July 12 Opinion determined that barring him from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating, and imposing a single $150,000 third-tier civil money penalty were in the public interest and remedial. Given the egregious, recurrent, and fraudulent nature of Clifton's misconduct, we see no basis for reconsideration of the July 12 Opinion.

Clifton raises several new points in his reconsideration motion, but offers no explanation for failing to make these arguments or providing support for them in his prior briefs to us. For instance, Clifton argues that the administrative law judge improperly found that he did not admit to wrongful conduct, showed no remorse for his actions, and was not willing to take corrective action

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11 *Id.* & n.8 (quoting *Perpetual Sec.*, 2007 WL 4372765, at *1).

12 *Id.* & n.9.

13 *See Clifton*, 2013 WL 3487076, at *2 n.13, *9 & n.59, & *12 & n.83. In his motion for reconsideration, he continues to admit that he made misrepresentations during the December 23, 2009 conference call and failed to review e-mails containing false and misleading statements.

to ensure future compliance with the securities laws, rules, and regulations. In making this argument, Clifton overlooks the fact that once he filed his petition for review, the law judge's initial decision ceased to have any force or effect.[14] As a result, the Commission was free to decide, in the first instance, what remedial sanctions would be appropriate and should be ordered. Moreover, our briefing order issued in this case expressly stated that we had determined, on our own initiative, to review what sanctions were appropriate.[15]

Clifton also argues that "[t]here were several witnesses that [he] would have liked to have called in his defense," but, due to his "limited resources," his attorney "chose to just cross-examine the Division [of Enforcement]'s witnesses instead of calling new" witnesses. As the Supreme Court has recognized, a party is bound by the actions of the attorney he retained.[16] "[K]eeping [a] suit alive merely because [a party] should not be penalized for the [acts or] omissions of his own attorney would be visiting the sins of [the party's] lawyer upon the [opposing party]," which "would be wholly inconsistent with our system of representative litigation."[17]

Clifton requests oral argument so that he can present his case "face-to-face" before the Commission. We deny the request as untimely. Rule of Practice 451(b)[18] requires that any request for oral argument be made by a separate motion accompanying the initial brief on the merits. Clifton failed to do this and therefore did not comply with Rule 451(b). We also deny his unsupported requests for a new hearing and the introduction of unspecified additional evidence.

Clifton further argues for "a suspension instead of a collateral bar and a reduced fine with consideration given to [his] ability to pay." The July 12 Opinion found that Clifton committed fraud through his material misrepresentations and omissions about the Osage project and his actions to perpetuate the fraudulent scheme by concealing material, adverse information from sales representatives and ensuring that they, in turn, withheld such information from investors.[19]

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14 *See Steven Altman, Esq.*, Order Denying Motion for Reconsideration and a Stay, Exchange Act Rel. No. 63665, 2011 WL 52087, at *2 & nn.7-9 (Jan. 6, 2011).

15 *See Johnny Clifton*, Order Granting Petition for Review and Scheduling Briefs, Admin. Proc. File No. 3-14266 (Jan. 3, 2012) ("Pursuant to Rule of Practice 411(d), the Commission, on its own initiative, has determined to review what sanctions, if any, are appropriate in this matter.") (footnote omitted).

16 *See Link v. Wabash R. R. Co.*, 370 U.S. 626, 633-34 (1962) (stating that "[p]etitioner voluntarily chose this attorney as his representative in the action, and he cannot now avoid the consequences of the acts or omissions of this freely selected agent").

17 *Id.* at 634 & n.10.

18 17 C.F.R. § 201.451(b).

19 *Clifton*, 2013 WL 3487076, at *8-10.

Fraud is "especially serious and subject to the severest of sanctions."[20] In addition, Clifton failed to review materially false and misleading e-mails sent by a sales representative and failed to follow the procedures instituted for the supervision of sales representatives.[21] The July 12 Opinion concluded that "the pattern, self-serving nature, and egregiousness of Clifton's fraud demonstrates his unfitness to participate in the securities industry in any capacity."[22] As for the civil money penalty, the July 12 Opinion found that Clifton's violations created a "significant risk" of substantial losses to prospective investors. Based on this finding and the fact that inability to pay is but one factor to consider and is not dispositive of the penalties determination, the July 12 Opinion decided that the scope and severity of Clifton's misconduct warranted the imposition of a civil money penalty of $150,000 to deter Clifton and others like him.[23] We find no basis for altering our conclusions regarding the appropriate remedial sanctions here.

III.

Turning to Clifton's motions for a stay of sanctions pending a possible appeal to the federal courts, we generally consider a stay motion in light of four factors: whether the party seeking the stay is likely to prevail on appeal; whether the party seeking the stay is likely to suffer irreparable injury if the stay is not granted; whether any other party is likely to suffer substantial harm if the stay is granted; and whether the stay will serve the public interest.[24] The party seeking the stay has the burden of demonstrating that a stay is justified.[25]

We have evaluated Clifton's stay motions in light of the four factors and find that he has not established grounds for a stay. For instance, he has provided no basis to conclude, given his admissions and the egregiousness of his conduct, that he is likely to prevail on appeal.[26] Nor has

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20 *Id.* at *14 & n.95 (quoting *Marshall E. Melton*, Advisers Act Rel. No. 2151, 56 SEC 695, 2003 WL 21729839, at *9 (July 25, 2003)).

21 *Id.* at *14.

22 *Id.* at *16.

23 *Id.* Although we found that Clifton had waived the argument of inability to pay, we nonetheless considered it and ultimately determined to disregard it based on the egregiousness of his misconduct. *See id.* at *16 n.116.

24 *See Cuomo v. NRC*, 772 F.2d 972, 974 (D.C. Cir. 1985).

25 *Id.* at 978.

26 Clifton argues that the collateral bar was impermissibly retroactive, but failed to demonstrate how he has been harmed by this ruling such that a stay is warranted. Even if he were successful on that issue, he still would be subject to a broker-dealer bar and have to close his business.

he shown that the financial losses he claims he will suffer outweigh protecting the public.[27] Rather, granting the stay would risk exposing investors and the markets to securities industry participation by a person who has demonstrated "an unfitness to participate in the securities industry that goes beyond the professional capacity in which he was acting when he engaged in the misconduct underlying these proceedings."[28] Under the circumstances, it would be inappropriate to stay Clifton's remedial sanctions pending an appeal to the federal courts.

Accordingly, IT IS ORDERED that the motion for reconsideration filed by Johnny Clifton be, and it hereby is, DENIED, and it is further

ORDERED that Clifton's motions for a stay of the Commission's July 12, 2013 order imposing remedial sanctions be, and they hereby are, DENIED.

By the Commission.

Elizabeth M. Murphy
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

27 *See, e.g.*, *Wisconsin Gas Co. v. FERC*, 758 F.2d 669, 674 (D.C. Cir. 1985) (denying stay for failure to establish irreparable harm and indicating that the alleged injury must be "both certain and great," that "economic loss does not, in and of itself, constitute irreparable harm," and that "the movant [must] substantiate the claim that irreparable injury is 'likely' to occur").

28 *Clifton*, 2013 WL 3487076, at *15.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70640 / October 9, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15554

In the Matter of **MARK STEVEN BERG,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Mark Steven Berg ("Berg" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. From May 1999 to April 2008, Berg was a registered representative associated with Joseph Stevens & Co., Inc., which at the time of his association was a broker-dealer registered with the Commission. Berg, age 55, is a resident of New York.

2. On June 15, 2012, before the New York Supreme Court in People v. Mark Berg, Case No. 00492-2009, Berg pleaded guilty to one felony count of attempted enterprise corruption in violation of New York Penal Law § 110-460.20 and one count of criminal possession of stolen property in the third degree in violation of New York Penal Law § 165.50. On June 15, 2012, Berg was sentenced in that proceeding to five years of probation and ordered to pay $350,000 in restitution to his victims.

3. The count of attempted enterprise corruption to which Berg pleaded guilty arose out of the conduct of a broker-dealer and alleged, among other things, that between January 2000 and April 2008, Berg participated in a scheme at Joseph Stevens & Co. to defraud investors by providing blocks of stock to the firm's traders for the purpose of generating excessive commissions in stocks. Berg participated in a scheme involving the sale, negotiation, and purchase of securities in which he provided the firm's traders with large blocks of shares of companies, including Cypress Bioscience, Inc. and Repligen, Inc., for the purpose of inflating the price of such stocks to generate large commissions.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Berg's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Berg be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent, or other person who engages in activities with a broker, dealer, or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70641 / October 9, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15555

In the Matter of	
	ORDER OF SUSPENSION PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE
MARTIN E. WEISBERG,	
Respondent.	

I.

The Securities and Exchange Commission deems it appropriate to issue an order of forthwith suspension of Martin E. Weisberg ("Weisberg") pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.102(e)(2)].[1]

II.

The Commission finds that:

1. Weisberg, age 62 and a resident of Waccabuc, New York, was an attorney admitted to practice law in New York.

2. On May 21, 2012, Weisberg entered guilty pleas in *United States v. Martin Weisberg*, 08 CR 347 (NGG) and *United States v. Zev Saltsman, et al*, 07 CR 641 (S-2) (NGG) in the United States District Court for the Eastern District of New York, finding him guilty of one count of money laundering and one count of conspiracy to commit securities fraud in connection with the offerings of securities of Xybernaut Corporation ("Xybernaut").

1 Rule 102(e)(2) provides in pertinent part: "Any ... person who has been convicted of a felony or a misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission."

3. From 1996 through approximately May 2005, Weisberg was Xybernaut's attorney. Weisberg was also a member and Secretary of Xybernaut's Board of Directors.

4. During his allocution on May 21, 2012, Weisberg admitted that between April 2004 and December 2004, he agreed, with others, to file certain false disclosure documents with the Commission concerning certain private investment in public equity ("PIPE") transactions for Xybernaut. Weisberg admitted that he knowingly concealed certain related party transactions associated with these PIPE transactions.

5. On August 7, 2013, Weisberg was sentenced to 24 months imprisonment in a federal penitentiary to be followed by three years of supervised release, and ordered to pay restitution in the amount of $297,500.

III.

In view of the foregoing, the Commission finds that Weisberg has been convicted of a felony within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

Accordingly, it is ORDERED, that Martin Weisberg is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70642 / October 9, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3689 / October 9, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15556

In the Matter of **TIMOTHY J. GEIDEL,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Timothy J. Geidel ("Respondent" or "Geidel").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. From November 1989 to August 2010, Geidel was a registered representative associated with Royal Alliance Associates, Inc. ("Royal Alliance"), which at all relevant times was a broker-dealer registered with the Commission and an investment adviser registered with the Commission. Geidel, age 51, is a resident of New York.

B. RESPONDENT'S CRIMINAL CONVICTION

2. On September 13, 2011, Geidel pleaded guilty to one count of wire fraud in violation of 18 U.S.C. § 1343 and one count of structuring transactions to avoid reporting requirements in violation of 31 U.S.C. § 5324(a)(3) before the United States District Court for the Western District of New York, in United States v. Timothy J. Geidel, Crim. Information No. 1:11-CR-00012 (WMS-HBS). On April 17, 2012, Geidel was sentenced in that proceeding to a prison term of 42 months followed by three years of supervised release and ordered to make restitution in the amount of $1,301,981.95.

3. The wire fraud count to which Geidel pleaded guilty alleged, among other things, that while associated with Royal Alliance, Geidel knowingly devised a scheme and artifice to defraud an investor by falsely representing that he intended to invest the individual's money in high yield investment vehicles, but instead used the money to repay other investors whom he had defrauded and for his personal gain. For the purpose of executing the scheme and artifice, in September and October of 2009, Geidel knowingly transmitted wire transfers of funds.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b)(6) of the Exchange Act; and

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70645 / October 9, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15557

In the Matter of **ROBERT PETROZZO,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Robert Petrozzo ("Petrozzo" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. From January 1995 to April 2008, Petrozzo was a registered representative associated with Joseph Stevens & Co., Inc., which at the time of his association was a broker-dealer registered with the Commission. Petrozzo, age 55, is a resident of New York.

2. On December 1, 2008, before the New York Supreme Court in People v. Robert Petrozzo, Case No. SCI-05684-2008, Petrozzo pleaded guilty to one felony count of attempted enterprise corruption in violation of New York Penal Law § 110-460.20 and one felony count of grand larceny in the third degree in violation of New York Penal Law § 155.35. On May 4, 2012, Petrozzo was sentenced in that proceeding to conditional discharge and ordered to pay $101,123 in restitution to his victims.

3. The grand larceny count to which Petrozzo pleaded guilty alleged, among other things, that between July 2003 and October 2006, while he was associated with Joseph Stevens & Co., Petrozzo stole from an individual property with a value in excess of $3,000.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Petrozzo's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Petrozzo be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent, or other person who engages in activities with a broker, dealer, or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70649 / October 9, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15559

In the Matter of PETER D. KIRSCHNER, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Peter D. Kirschner ("Kirschner").

II.

In anticipation of the institution of these proceedings, Kirschner has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Kirschner consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Kirschner's Offer, the Commission finds that:

1. Kirschner, age 48, resides in Delray Beach, Florida, is a former managing member of Premiere Consulting, LLC (Premiere"), and a managing member of Advanced Equity Partners, LLC ("Advanced Equity"). From 1989 to 2004, Kirschner was a registered representative formerly associated with several broker-dealers including Stratton Oakmont Inc., Corporate Securities Group, Inc. and L.H. Ross & Co, Inc. In 2006, Kirschner was the subject of a Commission action involving microcap fraud. Kirschner consented to the entry of an order permanently enjoining him from future violations of Section 5(a), 5(c) and 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Kirschner also consented to disgorge $109,400 in ill-gotten gains plus pre-judgment interest, pay $55,000 in a civil money penalty and agreed to be barred from association with any broker or dealer, with the right to reapply after a five–year period. To date Kirschner has not exercised this right. Kirschner participated in an offering and sale of Thought Development, Inc. ("TDI") which is a penny stock.

2. On October 3, 2013, a judgment was entered by consent against Kirschner, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder in the civil action entitled Securities and Exchange Commission v. Advanced Equity Partners, LLC, et al., Civil Action Number 0:13-cv-62100-RSR, in the United States District Court for the Southern District of Florida.

3. The Commission's complaint alleged that, in connection with the offer and sale of unregistered TDI stock, Kirschner solicited investors and received transaction-based compensation in the form of undisclosed commissions and other fees derived from investors' proceeds. In addition, Kirschner recruited others to act as sales agents and paid them transaction-based compensation. Kirschner was not associated with a registered broker or dealer while selling TDI stock. The complaint also alleged Kirschner sold unregistered securities.

4. The complaint also alleged that Kirschner made numerous misrepresentations regarding the use of investor proceeds, failed to disclose sales commissions or other fees of 75% or more charged to investors in connection with the offer and sale of unregistered TDI stock, and otherwise engaged in a variety of conduct which operated as a fraud and deceit on investors. The complaint further alleged that, in connection with the sale of purported TDI stock, Kirschner and his sales agents generated and sent false documents to investors, including, in some instances, false stock purchase agreements and fake trade confirmations, to deceive them into believing they had purchased shares of TDI when in fact, they had not.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Kirschner's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Kirschner be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by Kirschner will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Kirschner, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Gallagher not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70651 / October 9, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15561

In the Matter of **STUART M. RUBENS,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Stuart M. Rubens ("Rubens").

II.

In anticipation of the institution of these proceedings, Rubens has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Rubens consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Rubens' Offer, the Commission finds that:

1. Rubens, age 61, resides in North Miami, Florida is a managing member Of Premiere Consulting, LLC ("Premiere"), and Advanced Equity Partners, LLC ("Advanced Equity"). Rubens is a former registered representative and has prior disciplinary history. In 1999, the NYSE Division of Enforcement censured Rubens and imposed a one-month bar for improperly giving guarantees to customers in connection with yields on certain high-yield bonds. In 2000 the Florida Division of Securities entered a cease and desist order against Rubens preventing him from seeking registration for one year for his unsuitable recommendations and excessive trading. Rubens participated in an offering and sale of Thought Development, Inc. ("TDI") which is a penny stock.

2. On October 3, 2013, a judgment was entered by consent against Rubens, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder in the civil action entitled Securities and Exchange Commission v. Advanced Equity Partners, LLC, et al., Civil Action Number 0:13-cv-62100-RSR, in the United States District Court for the Southern District of Florida.

3. The Commission's complaint alleged that, in connection with the offer and sale of unregistered TDI stock, Rubens solicited investors and received transaction-based compensation in the form of undisclosed commissions and other fees derived from investors' proceeds. In addition, Rubens recruited others to act as sales agents and paid them transaction-based compensation. Rubens was not associated with a registered broker or dealer while selling TDI stock. The complaint also alleged Rubens sold unregistered securities.

4. The complaint also alleged that Rubens made numerous misrepresentations regarding the use of investor proceeds, failed to disclose sales commissions or other fees of 75% or more charged to investors in connection with the offer and sale of unregistered TDI stock, and otherwise engaged in a variety of conduct which operated as a fraud and deceit on investors. The complaint further alleged that, in connection with the sale of purported TDI stock, Rubens and his sales agents generated and sent false documents to investors, including, in some instances, false stock purchase agreements and fake trade confirmations, to deceive them into believing they had purchased shares of TDI when in fact, they had not.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Rubens' Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Rubens be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by Rubens will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Rubens, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70650 / October 9, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15560

In the Matter of

SHAWN H. MOORE,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934 AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") against Shawn H. Moore ("Respondent" or "Moore").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Moore, 46, is a resident of Centerville, Utah. Moore was the manager of numerous entities that were part of a larger group of approximately 150 entities formed by VesCor Capital Corp ("VesCor"). From at least January 2000 until February 2008, Moore acted as an unregistered broker or dealer in violation of the federal securities laws by soliciting investors to purchase investment contracts issued by VesCor for first trusts deed notes in real property owned by VesCor, guaranteeing between 10.5% and 16% return on their investment. Moore maintained investment records for over 800 VesCor investors, supervised in the preparation of investor documents such as prospectuses and monthly and annual investment statements, and balanced investor payment reports with accounting reports on a monthly, quarterly, and annual basis. Between January 2000 and February 2008, Moore earned at least $325,773 in commissions and

20 of 70

consulting fees from VesCor for the money he raised from investors. Moore has never been registered with the Commission or any other regulatory agency.

B. ENTRY OF THE CRIMINAL CONVICTION

2. On November 18, 2008, the State of Utah charged Moore with four counts of securities fraud in violation of Utah Code Ann. § 61-1-1 (a second-degree felony), four counts of sales of securities by an unlicensed agent in violation of Utah Code Ann. § 61-1-3(1) (a third-degree felony), and one count of pattern of unlawful activity in violation of Utah Code Ann. § 76-10-1601 (a second-degree felony) in State of Utah v. Shawn H. Moore, Criminal No. 081908861 (3rd Dist. Utah). On February 6, 2013, Moore was convicted of five second-degree felony counts, including four counts of securities fraud and one count of pattern of unlawful activity, and four third-degree felony counts of the sale of securities by an unlicensed agent.

3. The counts of the criminal information to which Moore was found guilty alleged, among other things, that Moore defrauded investors and obtained money by means of materially false and misleading statements in connection with the fraudulent sale of unregistered promissory notes while Moore was not registered as a securities dealer or salesman. VesCor raised at least $180 million through the fraudulent sales of securities to approximately 800 investors.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative be instituted to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and,

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and prejudgment interest, and civil penalties pursuant to Section 21B of the Exchange Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70658 / October 10, 2013

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3506 / October 10, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15563

In the Matter of JOHN LAZORCHAK (CPA), Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against John Lazorchak ("Respondent" or "Lazorchak") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and admitting the Commission's jurisdiction over him, the subject matter of these proceedings and the findings contained in Section III., paragraph 2 below, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Lazorchak, age 42, is and has been a certified public accountant licensed to practice in the State of New Jersey. From 2007 until his termination in November 2012, Lazorchak served as Director of Financial Reporting at Celgene Corp., a biopharmaceutical company incorporated in Delaware with its principal place of business in Summit, New Jersey. At all relevant times, Celgene's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"), and traded on the NASDAQ National Market.

2. On November 19, 2012, the Commission filed a complaint against Lazorchak in SEC v. Lazorchak, et al., Civ. Act. No. 12-7164 (KSH) (D. N.J.). On October 7, 2013, the Court entered a Judgment permanently enjoining Lazorchak, by consent, from future violations of Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder and imposing an officer and director bar on him pursuant to Section 21(d)(2) of the Exchange Act. Lazorchak also was ordered to pay disgorgement of $63,800 and prejudgment interest of $7,246.83, for a total payment of $71,046.83.

3. The Commission's complaint alleged, among other things, that, as part of an insider trading scheme, Lazorchak used his position at Celgene, and his access to the company's confidential information, to tip material, nonpublic information to downstream tippees, both directly and through an intermediary participant in the scheme. These tips included material, nonpublic information regarding Celgene's acquisitions of Pharmion Corp. and Abraxis Bioscience, Inc., Celgene's corporate earnings, and Celgene's withdrawal of a request to expand the use of the drug Revlemid. In addition, the complaint alleged that an insider at Stryker Corp., who was a friend of Lazorchak, tipped material, nonpublic information regarding Orthovita Inc.'s impending acquisition of Stryker Corp. to Lazorchak, and that Lazorchak again tipped that information both directly and through an intermediary to downstream tippees. The complaint further alleged that, as part of this scheme, Lazorchak received kickbacks in the form of cash payments in exchange for the information he tipped. Finally, the complaint alleged that in the spring of 2008, Lazorchak misled regulators during an inquiry into trading preceding the Celgene/ Pharmion transaction.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Lazorchak's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that Lazorchak is suspended from appearing or practicing before the Commission as an accountant.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70659 / October 10, 2013

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3507 / October 10, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15564

In the Matter of **MARK S. CUPO (CPA),** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Mark S. Cupo ("Respondent" or "Cupo") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the

1 Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

Commission, or to which the Commission is a party, and admitting the Commission's jurisdiction over him, the subject matter of these proceedings and the findings contained in Section III., paragraph 2 below, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Cupo, age 52, is and has been a certified public accountant licensed to practice in the State of New Jersey. From 2002 until 2010, Cupo served as Senior Director of Accounting and Reporting at Sanofi, a pharmaceutical company incorporated in France with the principal office of its U.S. subsidiary located in Bridgewater, New Jersey. From 2010 to his resignation in November 2012, Cupo served as Director of Shared Services at Sanofi. At all relevant times, Sanofi's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"), and traded on the New York Stock Exchange.

2. On November 19, 2012, the Commission filed a complaint against Cupo in SEC v. Lazorchak, et al., Civ. Act. No. 12-7164 (KSH) (D. N.J.). On October 8, 2013, the Court entered a Judgment permanently enjoining Cupo, by consent, from future violations of Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder and imposing an officer and director bar on him pursuant to Section 21(d)(2) of the Exchange Act. Cupo also was ordered to pay disgorgement of $65,800 and prejudgment interest of $6,670.94, for a total payment of $72,470.94.

3. The Commission's complaint alleged, among other things, that, as part of a carefully-orchestrated insider trading scheme, an insider at Celgene Corp. ("Celgene") tipped material, nonpublic information to Cupo regarding Celgene's acquisitions of Pharmion Corp. and Abraxis Bioscience, Inc., Celgene's corporate earnings, and Celgene's withdrawal of a request to expand the use of the drug Revlemid. The complaint also alleged that Cupo, acting as the middle-man in this scheme, then tipped that information to two downstream tippees. In addition, the complaint alleged that an insider at Stryker Corp. tipped material, nonpublic information regarding Orthovita Inc.'s impending acquisition of Stryker Corp. indirectly to Cupo, and that Cupo tipped that information to two downstream tippees. Further, the complaint alleged that Cupo used his position at Sanofi, and his access to the company's confidential information, to tip material, nonpublic information regarding Sanofi's acquisition of Chattem, Inc. to two downstream tippees. Finally, the complaint alleged that, as part of this scheme, Cupo received kickbacks in the form of cash payments in exchange for the information he tipped.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Cupo's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that Cupo is suspended from appearing or practicing before the Commission as an accountant.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

October 11, 2013

In The Matter Of	:	
	:	
Pacific Clean Water Technologies, Inc.	:	**ORDER OF SUSPENSION OF TRADING**
	:	
File No. 500-1	:	

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Pacific Clean Water Technologies, Inc. ("PCWT") because of questions regarding the adequacy and accuracy of publicly disseminated information concerning, among other things, the company's business operations. PCWT is a Delaware corporation based in Irvine, California. It is quoted on OTC Link under the symbol PCWT.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 5:30 p.m. EDT on October 11, 2013 through 11:59 p.m. EDT, on October 24, 2013.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3690 / October 11, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15565

In the Matter of **Burton Douglas Morriss,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Burton Douglas Morriss ("Morriss" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Respondent Morriss, 51, resides in St. Louis, Missouri. From 2005 through 2011, Morriss, among other things, was chairman and CEO of Acartha Group, a Delaware limited liability company with offices in Missouri and New Jersey that was established as an alternative asset management company. During this time, Morriss acted as an unregistered investment adviser to two private equity funds, MIC VII and Acartha Technology Partners ("ATP"). Both of these companies were formed for the purpose of investing in early to mid-stage companies primarily in the financial services and technology sectors. Acartha Group was the managing member of MIC VII, and another company Morriss controlled was the manager of ATP. Morriss made investment decisions on behalf of both MIC VII and ATP.

2. On August 13, 2013, the United States District Court for the Eastern District of Missouri entered a judgment by consent against Morriss in the civil action entitled Securities and Exchange Commission v. Burton Douglas Morriss, et al., Case No. 4:12-CV-80, permanently enjoining Morriss from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

3. The Commission's complaint alleged that from approximately 2003 through 2011, Morriss and the companies he controlled raised at least $88 million from 97 investors to invest in preferred shares or membership interests that would be part of investments in early to mid-stage companies in the financial services and technology sectors. The complaint further alleged that Morriss misappropriated at least $9.1 million of investor money for various personal expenses, and diluted the investments of some investors by raising new funds without their permission as required by one company's operating agreement.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Morriss' Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, Respondent be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70686 / October 15, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15569

In the Matter of **JOHN MICCIOLA** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against John Micciola ("Micciola" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Micciola, 46 years old, resides in Freehold, New Jersey. From February 1995 through April 2008, Micciola was a registered broker associated with Joseph Stevens & Company, Inc., a broker-dealer registered with the Commission.

2. On August 1, 2011, Micciola was convicted in the Supreme Court of the State of New York in People of the State of New York v. Joseph Stevens & Co., Inc., et al., Case Number 02394-2009 of: (1) one count of securities fraud, a violation of New York General Business Law 352-c(5); (2) one count of securities fraud, a violation of New York General Business Law 0352-c(6); (3) one count of grand larceny in the second degree, a violation of New York Penal Law 155.40(1); and (4) one count of grand larceny in the third degree, a violation of New York Public Law 155.35. On November 4, 2011, Micciola was sentenced to five years' probation and ordered to make restitution in the amount of $197,753.00.

3. In connection with that conviction, Respondent admitted that:

(a) He participated in firm-wide schemes at Joseph Stevens & Co., Inc. in order to generate excessive and undisclosed commissions;

(b) At times, he encouraged customers to purchase shares so that he would receive extra commissions that were not disclosed to customers;

(c) He participated in tactics to delay the execution of customer orders until an artificially inflated price was achieved to enrich himself and others at the expense of customers;

(d) He engaged in fraud by making material false representations while engaged in promoting the sale and purchase of securities; and

(e) During the scheme, Micciola, along with others, stole over $420,000 from more than 20 customers.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70694 / October 16, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15570

In the Matter of **Knight Capital Americas LLC** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (the "Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (the "Exchange Act") against Knight Capital Americas LLC ("Knight" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below:

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

INTRODUCTION

1. On August 1, 2012, Knight Capital Americas LLC ("Knight") experienced a significant error in the operation of its automated routing system for equity orders, known as SMARS. While processing 212 small retail orders that Knight had received from its customers, SMARS routed millions of orders into the market over a 45-minute period, and obtained over 4 million executions in 154 stocks for more than 397 million shares. By the time that Knight stopped sending the orders, Knight had assumed a net long position in 80 stocks of approximately $3.5 billion and a net short position in 74 stocks of approximately $3.15 billion. Ultimately, Knight lost over $460 million from these unwanted positions. The subject of these proceedings is Knight's violation of a Commission rule that requires brokers or dealers to have controls and procedures in place reasonably designed to limit the risks associated with their access to the markets, including the risks associated with automated systems and the possibility of these types of errors.

2. Automated trading is an increasingly important component of the national market system. Automated trading typically occurs through or by brokers or dealers that have direct access to the national securities exchanges and other trading centers. Retail and institutional investors alike rely on these brokers, and their technology and systems, to access the markets.

3. Although automated technology brings benefits to investors, including increased execution speed and some decreased costs, automated trading also amplifies certain risks. As market participants increasingly rely on computers to make order routing and execution decisions, it is essential that compliance and risk management functions at brokers or dealers keep pace. In the absence of appropriate controls, the speed with which automated trading systems enter orders into the marketplace can turn an otherwise manageable error into an extreme event with potentially wide-spread impact.

4. Prudent technology risk management has, at its core, quality assurance, continuous improvement, controlled testing and user acceptance, process measuring, management and control, regular and rigorous review for compliance with applicable rules and regulations and a strong and independent audit process. To ensure these basic features are present and incorporated into day-to-day operations, brokers or dealers must invest appropriate resources in their technology, compliance, and supervisory infrastructures. Recent events and Commission enforcement actions[1] have demonstrated that this investment must be supported by an equally strong commitment to prioritize technology governance with a view toward preventing, wherever possible, software malfunctions, system errors and failures, outages or other contingencies and,

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[1] See, e.g., In the Matter of the NASDAQ Stock Market LLC, et al., Sec. Exch. Rel. No. 69655 (May 29, 2013) (available at http://www.sec.gov/litigation/admin/2013/34-69655.pdf) (violations occurred as a result of system design limitations and weaknesses in processes and procedures); In the Matter of New York Stock Exchange LLC, et al., Sec. Exch. Rel. No. 67857 (Sept. 14, 2012) (available at http://www.sec.gov/litigation/admin/2012/34-67857.pdf) (violations occurred after compliance department played no role in design, implementation, or operation of market data systems); In the Matter of EDGX Exchange, Inc., et al., Sec. Exch. Rel. No. 65556 (Oct. 13, 2011) (available at http://www.sec.gov/litigation/admin/2011/34-65556.pdf) (violations occurred against backdrop of weaknesses in systems, processes, and controls).

when such issues arise, ensuring a prompt, effective, and risk-mitigating response. The failure by, or unwillingness of, a firm to do so can have potentially catastrophic consequences for the firm, its customers, their counterparties, investors and the marketplace.

5. The Commission adopted Exchange Act Rule 15c3-5[2] in November 2010 to require that brokers or dealers, as gatekeepers to the financial markets, "appropriately control the risks associated with market access, so as not to jeopardize their own financial condition, that of other market participants, the integrity of trading on the securities markets, and the stability of the financial system."[3]

6. Subsection (b) of Rule 15c3-5 requires brokers or dealers with market access to "establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks" of having market access. The rule addresses a range of market access arrangements, including customers directing their own trading while using a broker's market participant identifications, brokers trading for their customers as agents, and a broker-dealer's trading activities that place its own capital at risk. Subsection (b) also requires a broker or dealer to preserve a copy of its supervisory procedures and a written description of its risk management controls as part of its books and records.

7. Subsection (c) of Rule 15c3-5 identifies specific required elements of a broker or dealer's risk management controls and supervisory procedures. A broker or dealer must have systematic financial risk management controls and supervisory procedures that are reasonably designed to prevent the entry of erroneous orders and orders that exceed pre-set credit and capital thresholds in the aggregate for each customer and the broker or dealer. In addition, a broker or dealer must have regulatory risk management controls and supervisory procedures that are reasonably designed to ensure compliance with all regulatory requirements.

8. Subsection (e) of Rule 15c3-5 requires brokers or dealers with market access to establish, document, and maintain a system for regularly reviewing the effectiveness of their risk management controls and supervisory procedures. This sub-section also requires that the Chief Executive Officer ("CEO") review and certify that the controls and procedures comply with subsections (b) and (c) of the rule. These requirements are intended to assure compliance on an ongoing basis, in part by charging senior management with responsibility to regularly review and certify the effectiveness of the controls.[4]

9. Beginning no later than July 14, 2011, and continuing through at least August 1, 2012, Knight's system of risk management controls and supervisory procedures was not reasonably designed to manage the risk of its market access. In addition, Knight's internal

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[2] 17 C.F.R. § 240.15c3-5. The initial compliance date for Rule 15c3-5 was July 14, 2011. On June 30, 2011, the Commission extended the compliance date for certain requirements of Rule 15c3-5 until November 30, 2011.

[3] Risk Management Controls for Brokers or Dealers with Market Access, 75 Fed. Reg. 69792, 69792 (Nov. 15, 2010) (final rule release).

[4] Id. at 69811.

reviews were inadequate, its annual CEO certification for 2012 was defective, and its written description of its risk management controls was insufficient. Accordingly, Knight violated Rule 15c3-5. In particular:

A. Knight did not have controls reasonably designed to prevent the entry of erroneous orders at a point immediately prior to the submission of orders to the market by one of Knight's equity order routers, as required under Rule 15c3-5(c)(1)(ii);

B. Knight did not have controls reasonably designed to prevent it from entering orders for equity securities that exceeded pre-set capital thresholds for the firm, in the aggregate, as required under Rule 15c3-5(c)(1)(i). In particular, Knight failed to link accounts to firm-wide capital thresholds, and Knight relied on financial risk controls that were not capable of preventing the entry of orders;

C. Knight did not have an adequate written description of its risk management controls as part of its books and records in a manner consistent with Rule 17a-4(e)(7) of the Exchange Act, as required by Rule 15c3-5(b);

D. Knight also violated the requirements of Rule 15c3-5(b) because Knight did not have technology governance controls and supervisory procedures sufficient to ensure the orderly deployment of new code or to prevent the activation of code no longer intended for use in Knight's current operations but left on its servers that were accessing the market; and Knight did not have controls and supervisory procedures reasonably designed to guide employees' responses to significant technological and compliance incidents;

E. Knight did not adequately review its business activity in connection with its market access to assure the overall effectiveness of its risk management controls and supervisory procedures, as required by Rule 15c3-5(e)(1); and

F. Knight's 2012 annual CEO certification was defective because it did not certify that Knight's risk management controls and supervisory procedures complied with paragraphs (b) and (c) of Rule 15c3-5, as required by Rule 15c3-5(e)(2).

10. As a result of these failures, Knight did not have a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of market access on August 1, 2012, when it experienced a significant operational failure that affected SMARS, one of the primary systems Knight uses to send orders to the market. While Knight's technology staff worked to identify and resolve the issue, Knight remained connected to the markets and continued to send orders in certain listed securities. Knight's failures resulted in it accumulating an unintended multi-billion dollar portfolio of securities in approximately forty-five minutes on August 1 and, ultimately, Knight lost more than $460 million, experienced net capital problems, and violated Rules 200(g) and 203(b) of Regulation SHO.

FACTS

A. Respondent

11. Knight Capital Americas LLC ("Knight") is a U.S.-based broker-dealer and a wholly-owned subsidiary of KCG Holdings, Inc. Knight was owned by Knight Capital Group, Inc. until July 1, 2013, when that entity and GETCO Holding Company, LLC combined to form KCG Holdings, Inc. Knight is registered with the Commission pursuant to Section 15 of the Exchange Act and is a Financial Industry Regulatory Authority ("FINRA") member. Knight has its principal business operations in Jersey City, New Jersey. Throughout 2011 and 2012, Knight's aggregate trading (both for itself and for its customers) generally represented approximately ten percent of all trading in listed U.S. equity securities. SMARS generally represented approximately one percent or more of all trading in listed U.S. equity securities.

B. August 1, 2012 and Related Events

Preparation for NYSE Retail Liquidity Program

12. To enable its customers' participation in the Retail Liquidity Program ("RLP") at the New York Stock Exchange,[5] which was scheduled to commence on August 1, 2012, Knight made a number of changes to its systems and software code related to its order handling processes. These changes included developing and deploying new software code in SMARS. SMARS is an automated, high speed, algorithmic router that sends orders into the market for execution. A core function of SMARS is to receive orders passed from other components of Knight's trading platform ("parent" orders) and then, as needed based on the available liquidity, send one or more representative (or "child") orders to external venues for execution.

13. Upon deployment, the new RLP code in SMARS was intended to replace unused code in the relevant portion of the order router. This unused code previously had been used for functionality called "Power Peg," which Knight had discontinued using many years earlier. Despite the lack of use, the Power Peg functionality remained present and callable at the time of the RLP deployment. The new RLP code also repurposed a flag that was formerly used to activate the Power Peg code. Knight intended to delete the Power Peg code so that when this flag was set to "yes," the new RLP functionality—rather than Power Peg—would be engaged.

14. When Knight used the Power Peg code previously, as child orders were executed, a cumulative quantity function counted the number of shares of the parent order that had been executed. This feature instructed the code to stop routing child orders after the parent order had been filled completely. In 2003, Knight ceased using the Power Peg functionality. In 2005, Knight moved the tracking of cumulative shares function in the Power Peg code to an earlier point in the SMARS code sequence. Knight did not retest the Power Peg code after moving the cumulative quantity function to determine whether Power Peg would still function correctly if called.

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[5] See Release No. 34-67347 (July 3, 2012) (order granting approval to NYSE proposed rule changes to establish a retail liquidity program for NYSE-listed securities and NYSE Amex equities on a 12-month pilot basis and granting exemptions from Rule 612(c) of Regulation NMS).

15. Beginning on July 27, 2012, Knight deployed the new RLP code in SMARS in stages by placing it on a limited number of servers in SMARS on successive days. During the deployment of the new code, however, one of Knight's technicians did not copy the new code to one of the eight SMARS computer servers. Knight did not have a second technician review this deployment and no one at Knight realized that the Power Peg code had not been removed from the eighth server, nor the new RLP code added. Knight had no written procedures that required such a review.

Events of August 1, 2012

16. On August 1, Knight received orders from broker-dealers whose customers were eligible to participate in the RLP. The seven servers that received the new code processed these orders correctly. However, orders sent with the repurposed flag to the eighth server triggered the defective Power Peg code still present on that server. As a result, this server began sending child orders to certain trading centers for execution. Because the cumulative quantity function had been moved, this server continuously sent child orders, in rapid sequence, for each incoming parent order without regard to the number of share executions Knight had already received from trading centers. Although one part of Knight's order handling system recognized that the parent orders had been filled, this information was not communicated to SMARS.

17. The consequences of the failures were substantial. For the 212 incoming parent orders that were processed by the defective Power Peg code, SMARS sent millions of child orders, resulting in 4 million executions in 154 stocks for more than 397 million shares in approximately 45 minutes. Knight inadvertently assumed an approximately $3.5 billion net long position in 80 stocks and an approximately $3.15 billion net short position in 74 stocks. Ultimately, Knight realized a $460 million loss on these positions.

18. The millions of erroneous executions influenced share prices during the 45 minute period. For example, for 75 of the stocks, Knight's executions comprised more than 20 percent of the trading volume and contributed to price moves of greater than five percent. As to 37 of those stocks, the price moved by greater than ten percent, and Knight's executions constituted more than 50 percent of the trading volume. These share price movements affected other market participants, with some participants receiving less favorable prices than they would have in the absence of these executions and others receiving more favorable prices.

BNET Reject E-mail Messages

19. On August 1, Knight also received orders eligible for the RLP but that were designated for pre-market trading.[6] SMARS processed these orders and, beginning at approximately 8:01 a.m. ET, an internal system at Knight generated automated e-mail messages (called "BNET rejects") that referenced SMARS and identified an error described as "Power Peg disabled." Knight's system sent 97 of these e-mail messages to a group of Knight personnel before the 9:30 a.m. market open. Knight did not design these types of messages to be system alerts, and Knight personnel generally did not review them when they were received. However,

[6] These orders were distinct from the 212 incoming parent orders that led to the executions described above.

these messages were sent in real time, were caused by the code deployment failure, and provided Knight with a potential opportunity to identify and fix the coding issue prior to the market open. These notifications were not acted upon before the market opened and were not used to diagnose the problem after the open.

C. Controls and Supervisory Procedures

SMARS

20. Knight had a number of controls in place *prior* to the point that orders reached SMARS. In particular, Knight's customer interface, internal order management system, and system for internally executing customer orders all contained controls concerning the prevention of the entry of erroneous orders.

21. However, Knight did not have adequate controls in SMARS to prevent the entry of erroneous orders. For example, Knight did not have sufficient controls to monitor the *output* from SMARS, such as a control to compare orders leaving SMARS with those that entered it. Knight also did not have procedures in place to halt SMARS's operations in response to its own aberrant activity. Knight had a control that capped the limit price on a parent order, and therefore related child orders, at 9.5 percent below the National Best Bid (for sell orders) or above the National Best Offer (for buy orders) for the stock at the time that SMARS had received the parent order. However, this control would not prevent the entry of erroneous orders in circumstances in which the National Best Bid or Offer moved by less than 9.5 percent. Further, it did not apply to orders—such as the 212 orders described above—that Knight received before the market open and intended to send to participate in the opening auction at the primary listing exchange for the stock.

Capital Thresholds

22. Although Knight had position limits for some of its trading groups, these limits did not account for the firm's exposure from outstanding orders. Knight also did not have pre-set capital thresholds in the aggregate for the firm that were linked to automated controls that would prevent the entry of orders if the thresholds were exceeded.

23. For example, Knight had an account—designated the 33 Account—that temporarily held multiple types of positions, including positions resulting from executions that Knight received back from the markets that its systems could not match to the unfilled quantity of a parent order. Knight assigned a \$2 million gross position limit to the 33 Account, but it did not link this account to any automated controls concerning Knight's overall financial exposure.

24. On the morning of August 1, the 33 Account began accumulating an unusually large position resulting from the millions of executions of the child orders that SMARS was sending to the market. Because Knight did not link the 33 Account to pre-set, firm-wide capital thresholds that would prevent the entry of orders, on an automated basis, that exceeded those thresholds, SMARS continued to send millions of child orders to the market despite the fact that the parent orders already had been completely filled.[7] Moreover, because the 33 Account held

[7] Knight does have automatic shutdown of its trading with respect to certain strategies of one of its trading groups when their P&L limits are exceeded.

positions from multiple sources, Knight personnel could not quickly determine the nature or source of the positions accumulating in the 33 Account on the morning of August 1.

25. Knight's primary risk monitoring tool, known as "PMON," is a post-execution position monitoring system. At the opening of the market, senior Knight personnel observed a large volume of positions accruing in the 33 Account. However, Knight did not link this tool to its entry of orders so that the entry of orders in the market would automatically stop when Knight exceeded pre-set capital thresholds or its gross position limits. PMON relied entirely on human monitoring and did not generate automated alerts regarding the firm's financial exposure. PMON also did not display the limits for the accounts or trading groups; the person viewing PMON had to know the applicable limits to recognize that a limit had been exceeded. PMON experienced delays during high volume events, such as the one experienced on August 1, resulting in reports that were inaccurate.

<u>Code Development and Deployment</u>

26. Knight did not have written code development and deployment procedures for SMARS (although other groups at Knight had written procedures), and Knight did not require a second technician to review code deployment in SMARS. Knight also did not have a written protocol concerning the accessing of unused code on its production servers, such as a protocol requiring the testing of any such code after it had been accessed to ensure that the code still functioned properly.

<u>Incident Response</u>

27. On August 1, Knight did not have supervisory procedures concerning incident response. More specifically, Knight did not have supervisory procedures to guide its relevant personnel when significant issues developed. On August 1, Knight relied primarily on its technology team to attempt to identify and address the SMARS problem in a live trading environment. Knight's system continued to send millions of child orders while its personnel attempted to identify the source of the problem. In one of its attempts to address the problem, Knight uninstalled the new RLP code from the seven servers where it had been deployed correctly. This action worsened the problem, causing additional incoming parent orders to activate the Power Peg code that was present on those servers, similar to what had already occurred on the eighth server.

D. Compliance Reviews and Written Description of Controls

<u>Initial Assessment of Compliance</u>

28. Knight's assessment of its controls and procedures began prior to the July 14, 2011 compliance date. Knight's compliance department initiated the assessment, which involved discussions among staff of that department, as well as the pertinent business and technology units. The participants concluded that Knight's system of controls satisfied Rule 15c3-5. The assessment largely focused on compiling an inventory of Knight's existing controls and confirming that they functioned as intended. The assessment did not consider possible problems within SMARS or the consequences of potential malfunctions in SMARS. This assessment also did not consider PMON's inability to prevent the entry of orders that would exceed a capital

threshold. Further, Knight did not document sufficiently the evaluation done of the controls so that subsequent reviewers could identify these gaps in the assessment.

Written Description

29. During the initial assessment, the compliance department prepared a document that listed Knight's systems and some of the controls. This document was incomplete and therefore did not satisfy the documentation requirements of Rule 15c3-5(b). In September 2011, nearly two months after the compliance date of Rule 15c3-5's provision requiring the written description of the risk management controls, the compliance department drafted a narrative intended to describe Knight's market access systems and controls. This document also was incomplete, and was inaccurate in some respects. For example, the narrative omitted Knight's proprietary Electronic Trading Group ("ETG"), which was a significant source of Knight's trading and order volumes. The compliance department and supervisory control group ("SCG"), working together with pertinent business and technology units, began to address the missing elements of the document in November 2011, which resulted in a revised draft in January 2012, nearly six months after the compliance date of Rule 15c3-5(b). Although this draft included aspects of ETG, it lacked the Lead Market Making ("LMM") desk and other important systems. As of the CEO certification in March 2012, discussed below, Knight still was adding key systems and controls to the document. Prior to certification, the CEO was informed about the pending revisions. It was not until July 2012, nearly a year after the compliance date, that Knight added the LMM desk, which had experienced erroneous trade events over the previous months.

Written Supervisory Procedures

30. In August 2011, subsequent to the compliance date of Rule 15c3-5's provision requiring written supervisory procedures, Knight adopted written supervisory procedures ("WSPs") to guide regular reviews of its compliance with Rule 15c3-5. Knight's compliance department drafted the WSPs, which assigned various tasks to be performed by SCG staff in consultation with the pertinent business and technology units. Taken together, the WSPs had the goal of evaluating the reasonableness of Knight's market access controls and Knight's compliance with Rule 15c3-5 on an ongoing basis. Each WSP required a senior member of the pertinent business unit to approve the work of the SCG staff. Further, a separate compliance department procedure required a compliance analyst twice a year to review the work done under the WSPs.

31. Some of the WSPs were incomplete as written, and Knight personnel had conflicting views regarding what some of the WSPs required. For example, relevant Knight personnel differed on whether some WSPs required an evaluation of the controls or merely an identification that controls and procedures existed. In addition, the WSP that was supposed to require an evaluation of the reasonableness of Knight's controls only required a review of certain types of controls and did not require an evaluation of controls to reject orders that exceed pre-set capital thresholds in the aggregate for the firm or that indicate duplicative orders.

Post-Compliance Date Reviews

32. Knight conducted periodic reviews pursuant to the WSPs. As explained above, the WSPs assigned various tasks to be performed by SCG staff in consultation with the pertinent

business and technology units, with a senior member of the pertinent business unit reviewing and approving that work. These reviews did not consider whether Knight needed controls to limit the risk that SMARS could malfunction, nor did these reviews consider whether Knight needed controls concerning code deployment or unused code residing on servers. Before undertaking any evaluation of Knight's controls, SCG, along with business and technology staff, had to spend significant time and effort identifying the missing content and correcting the inaccuracies in the written description.

33. Several previous events presented an opportunity for Knight to review the adequacy of its controls in their entirety. For example, in October 2011, Knight used test data to perform a weekend disaster recovery test. After the test concluded, Knight's LMM desk mistakenly continued to use the test data to generate automated quotes when trading began that Monday morning. Knight experienced a nearly $7.5 million loss as a result of this event. Knight responded to the event by limiting the operation of the system to market hours, changing the control so that this system would stop providing quotes after receiving an execution, and adding an item to a disaster recovery checklist that required a check of the test data. Knight did not broadly consider whether it had sufficient controls to prevent the entry of erroneous orders, regardless of the specific system that sent the orders or the particular reason for that system's error. Knight also did not have a mechanism to test whether their systems were relying on stale data.

E. CEO Certification

34. In March 2012, Knight's CEO signed a certification concerning Rule 15c3-5. The certification did not state that Knight's controls and procedures complied with the rule. Instead, the certification stated that Knight had in place "processes" to comply with the rule. This drafting error was not intentional, the CEO did not notice the error, and the CEO believed at the time that he was certifying that Knight's controls and procedures complied with the rule.[8]

F. Collateral Consequences

35. There were collateral consequences as a result of the August 1 event, including significant net capital problems. In addition, many of the millions of orders that SMARS sent on August 1 were short sale orders. Knight did not mark these orders as short sales, as required by Rule 200(g) of Regulation SHO.[9] Similarly, Rule 203(b) of Regulation SHO prohibits a broker or dealer from accepting a short sale order in an equity security from another person, or effecting a short sale in an equity security for its own account, unless it has borrowed the security, entered into a bona-fide arrangement to borrow the security, or has reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due (known as the "locate" requirement), and has documented compliance with this requirement.[10] Knight did not

[8] Before signing the certification, the CEO received a report concerning reviews that Knight personnel had performed pursuant to the WSPs. The report contained sub-certifications from eight senior Knight employees. Although the report contained a similar drafting error as the certification, all of the employees who signed the report to the CEO believed that Knight was in compliance with Rule 15c3-5.

[9] 17 C.F.R. § 242.200(g).

[10] 17 C.F.R. § 242.203(b).

obtain a "locate" in connection with Knight's unintended orders and did not document compliance with the requirement with respect to Knight's unintended orders.

VIOLATIONS

A. Market Access Rule: Section 15(c)(3) of the Exchange Act and Rule 15c3-5

36. Section 15(c)(3) of the Exchange Act, among other things, prohibits a broker or dealer from effecting any securities transaction in contravention of the rules and regulations the Commission prescribes as necessary or appropriate in the public interest, or for the protection of investors, to provide safeguards with respect to the financial responsibility and related practices of brokers or dealers. Knight violated this Section through its violations, described below, of a rule promulgated by the Commission thereunder.

37. Subsection (c)(1)(i) of Rule 15c3-5 requires that a broker or dealer's risk management controls and supervisory procedures shall be reasonably designed to prevent systematically the entry of orders that exceed appropriate pre-set credit or capital thresholds in the aggregate for each customer and the broker or dealer. Knight violated this requirement by failing to link pre-set capital thresholds to Knight's entry of orders so that Knight would stop sending orders when it breached such thresholds. Instead, Knight relied on tools, including PMON, that were not capable of preventing the entry of orders whose execution would exceed a capital threshold and did not link the 33 Account to pre-set capital thresholds. These inadequacies contributed to Knight's failure to detect promptly the severity of, and to resolve quickly, the problems on August 1 or to mitigate the effects prior to the resolution of the software issue.

38. Subsection (c)(1)(ii) of Rule 15c3-5 requires that a broker or dealer's risk management controls and supervisory procedures be reasonably designed to prevent systematically the entry of erroneous orders that exceed appropriate price or size parameters on an order-by-order basis or over a short period of time, or that indicate duplicative orders. Knight violated this requirement by failing to have controls reasonably designed to prevent the entry of erroneous orders at a point immediately prior to the submission of orders to the market by SMARS, which had the core function of dividing parent orders into child orders and sending them to the market. The controls that Knight had in place were not reasonably designed to limit Knight's financial exposure arising from errors within SMARS, such as problems in the operation of the software that sent child orders to fill parent orders. As evidenced by the events of August 1, the absence of adequate controls at the point immediately prior to Knight's submission of orders to the market left Knight vulnerable to the financial and regulatory risks of Knight's erroneous entry of orders and had substantial consequences to both Knight and the market.

39. Subsection (b) of Rule 15c3-5 requires, among other things, that a broker or dealer preserve a copy of its supervisory procedures and a written description of its risk management controls as part of its books and records in a manner consistent with Rule 17a-4(e)(7). As highlighted in the Adopting Release, this document serves the purpose of assisting Commission and Self-Regulatory Organization staff during an examination of the broker or dealer for compliance with the rule.[11] It also assists the broker or dealer in conducting the reviews and

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[11] 75 Fed. Reg. at 69812.

performing the certification required by the rule. Knight violated this requirement by failing to have an adequate written description of its risk management controls. Knight did attempt to create a narrative of its risk management controls after the compliance date of Rule 15c3-5, but this document remained incomplete and, in some instances, inaccurate through the summer of 2012. The insufficiencies in this document adversely affected the quality of the reviews Knight conducted of its risk controls after the compliance date of Rule 15c3-5. As described above, Knight's staff had to spend considerable time and effort identifying the missing content and correcting the inaccuracies in this document before they could evaluate Knight's controls.

40. Knight also violated the overarching requirement of subsection (b) of Rule 15c3-5 that brokers or dealers "shall establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks of" its market access. As explained above, Knight lacked adequate controls for its order router and failed to have an automated control to prevent the entry of orders that exceeded firm-wide pre-set capital thresholds. Knight also lacked reasonably designed controls and supervisory procedures to detect and prevent software malfunctions that can result from code development and deployment.

41. For example, a written procedure requiring a simple double-check of the deployment of the RLP code could have identified that a server had been missed and averted the events of August 1. Having a procedure that integrated the BNET Reject messages into Knight's monitoring of its systems likewise could have prevented the events of August 1. Further, in 2003, Knight elected to leave the Power Peg code on SMARS's production servers, and, in 2005, accessed this code to use the cumulative quantity functionality in another application without taking measures to safeguard against malfunctions or inadvertent activation. A written protocol requiring the retesting of the Power Peg code in 2005 could have identified that Knight had inadvertently disabled the cumulative quantity functionality in the Power Peg code. These shortcomings were made more consequential by the fact that Knight did not have controls in SMARS that were sufficient to address the risk posed by possible problems in the operation of the software as it sent child orders to fill a parent order.

42. Further, Knight did not have adequate controls and supervisory procedures to guide employees' response to incidents such as what occurred on August 1. In light of Knight's market access, Knight needed clear guidance for its technology personnel as to when to disconnect a malfunctioning system from the market.

43. Subsection (e) of Rule 15c3-5 requires that a broker or dealer establish, document, and maintain a system for regularly reviewing the effectiveness of the risk management controls and supervisory procedures required by Rule 15c3-5(b) and (c). Subsection (e)(1) of Rule 15c3-5 requires, among other things, that a broker or dealer review, no less frequently than annually, the business activity of the broker or dealer in connection with market access to assure the overall effectiveness of such risk management controls and supervisory procedures. Reasonably designed WSPs are an important component of the system required by the rule, because they help ensure that the broker or dealer fulfills its obligations to conduct a review of the overall effectiveness of its risk management controls and supervisory procedures.

44. Knight violated subsection (e) of Rule 15c3-5 because its system for regularly reviewing the effectiveness of its risk management controls was inadequate. For example, Knight's WSPs were incomplete as written and did not provide clear guidance as to what they required. Further, Knight's initial assessment of its market access controls did not sufficiently consider whether the controls were reasonably designed to manage Knight's market access risks or whether Knight needed additional controls. This review, and the post-compliance date reviews, failed to consider adequately the risks posed by possible malfunctions in SMARS, one of Knight's primary systems for accessing the markets, and failed to consider Knight's inability to prevent the entry of orders whose execution would exceed pre-set capital thresholds. These reviews also failed to assess adequately the consequences of Knight's reliance on PMON as a primary risk monitoring tool, such as the risks posed by the lack of automated alerts and PMON's inability to prevent the entry of orders that would exceed a capital threshold or position limit. Further, Knight's reviews did not adequately consider the root causes of previous incidents involving the entry of erroneous orders and the reasons why Knight's controls failed to limit the harm from those incidents. Knight reacted to the events narrowly, limiting its responses to changes designed to prevent the exact problem at hand from recurring.

45. Subsection (e)(2) of Rule 15c3-5 requires that a broker or dealer's CEO (or equivalent officer) certify on an annual basis that the firm's risk management controls and supervisory procedures comply with paragraphs (b) and (c) of Rule 15c3-5. The certification signed by Knight's CEO did not state that Knight's controls and supervisory procedures complied with those provisions of the rule. Rather, it stated that Knight had in place "processes" to comply with the rule. Certifying to the existence of processes is not equivalent to certifying that controls and procedures are reasonably designed and comply with the rule. Accordingly, Knight violated subsection (e)(2) of Rule 15c3-5.

B. Regulation SHO: Rules 200(g) and 203(b)

46. Rule 200(g) of Regulation SHO requires each broker or dealer to mark all sell orders of any equity security as "long," "short" or "short exempt."

47. Rule 203(b) of Regulation SHO states that a broker or dealer "may not accept a short sale order in an equity security from another person, or effect a short sale in an equity security for its own account, unless the broker or dealer has: (i) [b]orrowed the security, or entered into a bona-fide arrangement to borrow the security; or (ii) [r]easonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due; and (iii) [d]ocumented compliance with" these requirements.

48. Knight violated Rules 200(g) and 203(b) of Regulation SHO on August 1, 2012, by mismarking short sale orders as "long" and by failing to borrow, enter into a bona-fide arrangement to borrow, or have reasonable grounds to believe that the securities could be borrowed, so that they could be delivered on the date delivery was due, and failing to document compliance with this requirement, before effecting short sales.

49. Based on the foregoing, the Commission finds that Knight willfully[12] violated Section 15(c)(3) of the Exchange Act and Rule 15c3-5 thereunder, and Rules 200(g) and 203(b) of Regulation SHO.

REMEDIAL EFFORTS

50. In determining to accept the Offer, the Commission considered remedial acts that Knight undertook and the cooperation that Knight afforded to the Commission staff following the August 1 event.

UNDERTAKINGS

51. Respondent has undertaken to do the following:

A. Retain at its own expense one or more qualified independent consultants (the "Consultant") not unacceptable to the Commission staff to conduct a comprehensive review of Respondent's compliance with Exchange Act Rule 15c3-5, including but not limited to:

i. Respondent's software development lifecycle processes for all of Knight's business critical systems and applications, including trading systems, finance, risk, and compliance; and

ii. Respondent's risk management controls and supervisory procedures, including those pertaining to Respondent's: (a) deployment of new software and code; (b) order routers; (c) firm-wide capital thresholds and the linkage, on an automated, pre-trade basis, of such thresholds to the entry of orders; and (d) incident response protocols.

Such Consultant shall prepare a written report (the "Report") that:

iii. evaluates the adequacy of Respondent's software development lifecycle processes and its risk management controls and supervisory procedures to manage Respondent's financial, regulatory, and other risks of market access; and

iv. as may be needed, makes recommendations about how Respondent should modify or supplement its processes, controls, and procedures to manage its financial, regulatory, and other risks of market access.

Respondent shall provide a copy of the engagement letter within fourteen (14) days of the date of this Order detailing the Consultant's responsibilities

[12] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" Id. (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

to Commission staff.

B. Cooperate fully with the Consultant, including providing the Consultant with access to Respondent's files, books, records, and personnel (and Respondent's affiliated entities' files, books, records, and personnel, in each case to the extent they relate to Respondent), as reasonably requested for the above-mentioned reviews, and obtaining the cooperation of respective employees or other persons under Respondent's control. Respondent shall require the Consultant to report to Commission staff on its activities as the staff may request.

C. Permit the Consultant to engage such assistance, clerical, legal, or expert, as necessary and at a reasonable cost, to carry out its activities, and the cost, if any, of such assistance shall be borne exclusively by Respondent.

D. Require the Consultant within thirty (30) days of being retained, unless otherwise extended by Commission staff for good cause, to provide Respondent and Commission staff with an estimate of the time needed to complete the review and prepare the Report and provide a proposed deadline for the Report, subject to the approval of Commission staff.

E. Require the Consultant to issue the Report by the approved deadline and provide the Report simultaneously to both Commission staff and Respondent.

F. Submit to Commission staff and the Consultant, within thirty (30) days of the Consultant's issuance of the Report, the date by which Respondent will adopt and implement any recommendations in the Report, subject to Sections F(1)-(3) below and subject to the approval of Commission staff.

(1) As to any recommendation that Respondent considers to be, in whole or in part, unduly burdensome or impractical, Respondent may submit in writing to the Consultant and Commission staff a proposed alternative reasonably designed to accomplish the same objectives, within sixty (60) days of receiving the Report. Respondent shall then attempt in good faith to reach an agreement with the Consultant relating to each disputed recommendation and request that the Consultant reasonably evaluate any alternative proposed by Respondent. If, upon evaluating Respondent's proposal, the Consultant determines that the suggested alternative is reasonably designed to accomplish the same objectives as the recommendations in question, then the Consultant shall approve the suggested alternative and make the recommendations. If the Consultant determines that the suggested alternative is not reasonably designed to accomplish the same objectives, the Consultant shall reject Respondent's proposal. The Consultant shall inform Respondent of the Consultant's final determination

concerning any recommendation that Respondent considers to be unduly burdensome or impractical within fourteen (14) days after the conclusion of the discussion and evaluation by Respondent and the Consultant.

(2) In the event that Respondent and the Consultant are unable to agree on an alternative proposal, Respondent shall accept the Consultant's recommendations.

(3) Within thirty (30) days after final agreement is reached on any disputed recommendation, Respondent shall submit to the Consultant and Commission staff the date by which Respondent will adopt and implement the agreed-upon recommendation, subject to the approval of Commission staff.

G. Adopt and implement, on the timetable set forth by Respondent in accordance with Item F, the recommendations in the Report. Respondent shall notify the Consultant and Commission staff when the recommendations have been implemented.

H. Require the Consultant to certify, in writing, to Respondent and Commission staff, that Respondent has implemented the agreed-upon recommendations for which the Consultant was responsible and that Knight's risk management controls and supervisory procedures are reasonably designed to manage the financial, regulatory, and other risks of market access. The Consultant's certification shall be received within sixty (60) days after Respondent has notified the Consultant that the recommendations have been implemented.

I. Within one hundred and eighty (180) days from the date of the applicable certification described in paragraph H above, require the Consultant to have completed a review of Knight's revised product development processes and risk management controls and supervisory procedures and submit a final written report ("Final Report") to Respondent and Commission staff. The Final Report shall describe the review made of Knight's revised processes, controls, and procedures, and describe how Knight is implementing, enforcing, and auditing the enforcement and implementation of those processes, controls, and procedures. The Final Report shall include an opinion of the Consultant as to whether the revised processes, controls, and procedures and their implementation and enforcement by Respondent and Respondent's auditing of the implementation and enforcement of those processes, controls, and procedures are reasonably designed to manage the financial, regulatory, and other risks of market access.

J. To ensure the independence of the Consultant, Respondent shall not have the authority to terminate the Consultant without prior written approval of Commission staff and shall compensate the Consultant and persons

engaged to assist the Consultant for services rendered pursuant to this Order at their reasonable and customary rates.

K. Require the Consultant to enter into an agreement that provides for the period of engagement and for a period of two years from the completion of the engagement, that the Consultant shall not enter into any employment, consultant, attorney-client, auditing, or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Consultant will require that any firm with which he/she/it is affiliated or of which he/she/it is a member, and any person engaged to assist the Consultant in performance of his/her/its duties under this Order shall not, without prior written consent of Commission staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Respondent, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

L. Respondent may apply to Commission staff for an extension of the deadlines described above before their expiration and, upon a showing of good cause by Respondent, Commission staff may, in its sole discretion, grant such extensions for whatever time period it deems appropriate.

M. Certification of Compliance by Respondent: Respondent shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Robert A. Cohen, Assistant Director, Market Abuse Unit, Division of Enforcement, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

IV.

In view of the foregoing, the Commission deems it necessary and appropriate in the public interest, and for the protection of investors, to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Knight cease and desist from committing or causing any violations and any future violations of Section 15(c)(3) of the Exchange Act and Rule 15c3-5 thereunder, and Rules 200(g) and 203(b) of Regulation SHO.

B. Respondent Knight is censured.

C. Pursuant to Section 21B(a)(1) and (2) of the Exchange Act, Respondent Knight shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $12,000,000 ($12 million) to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Such payment must be made in one of the following ways: (1) Respondent Knight may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or (3) Respondent Knight may pay by certified check, bank cashier's check, or United States postal money order made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Knight as a Respondent in these proceedings and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Daniel M. Hawke, Chief, Market Abuse Unit, Division of Enforcement, Securities and Exchange Commission, The Mellon Independence Center, 701 Market Street, Philadelphia, PA 19106-1532.

D. Respondent Knight shall comply with the Undertakings enumerated above.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9466 / October 16, 2013

SECURITIES EXCHANGE ACT OF 1934
Release No. 70698 / October 16, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30743 / October 16, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-14848

In the Matter of OPTIONSXPRESS, INC., THOMAS E. STERN, and JONATHAN I. FELDMAN	ORDER GRANTING IN PART AND DENYING IN PART THE MOTIONS TO ADDUCE ADDITIONAL EVIDENCE REGARDING THE CBOE SETTLEMENT

On April 16, 2012, the Commission instituted administrative proceedings against optionsXpress, Inc., a registered broker-dealer; Thomas E. Stern, chief financial officer of optionsXpress; and Jonathan I. Feldman, an optionsXpress customer.[1] The Order Instituting Administrative and Cease-and-Desist Proceedings alleged that a number of optionsXpress customers, including Feldman, employed illegal options trading strategies that lacked a legitimate economic purpose and that violated Securities Act § 17(a) and Exchange Act § 10(b) and Rules 10b-5 and 10b-21.[2] The OIP further alleged that these strategies caused optionsXpress to have continuing "failure-to-deliver" positions in various securities for extended periods of time, and that optionsXpress willfully violated the delivery and close-out requirements in Rules 204 and 204T of Regulation SHO.[3] Finally, the OIP alleged that Stern caused and willfully aided and abetted these violations.

On June 7, 2013, the administrative law judge issued an initial decision finding that Respondents had willfully violated (and/or aided and abetted in the violation of) the above-listed statutes, regulations, and rules.[4] Respondents have timely petitioned for review of the initial

1 *optionsXpress, Inc.*, Exchange Act Release No. 66815, 2012 WL 1264508 (Apr. 16, 2012).

2 15 U.S.C. §§ 77q(a), 78j(b); 17 C.F.R. §§ 240.10b-5, 240.10b-21.

3 17 C.F.R. §§ 242.204, 242.204T.

4 *optionsXpress, Inc.*, Initial Dec. Release No. 490, 2013 WL 2471113 (June 7, 2013).

decision. Presently pending before us are three motions, one filed by each of the Respondents, requesting that the Commission take judicial notice of its June 11, 2013 settlement with the Chicago Board Options Exchange ("CBOE Settlement")[5] and accept the settlement order as additional evidence in this proceeding. Stern and Feldman additionally seek an order requiring the Division of Enforcement ("Division") to produce documents related to the CBOE Settlement, which they claim were withheld in violation of Rule of Practice 230(b)(2). Finally, Stern and Feldman seek leave to re-examine witnesses regarding the CBOE Settlement. We grant the motions in part and deny them in part.

BACKGROUND

A. Rule 204

Rule 204 of Reg. SHO[6] governs when a clearing broker-dealer (such as optionsXpress) must deliver securities to a registered clearing agency (such as the National Securities Clearing Corporation) for clearance and settlement.[7] A "fail to deliver" position in a security occurs when a broker-dealer does not have enough shares in its account with the clearing agency for the broker-dealer to satisfy its delivery obligation by the trade date plus three days (T+3). The clearing agency may at that point issue the non-delivering broker-dealer a "buy-in notice" stating that the broker-dealer must deliver the shares within a certain time or else be involuntarily "bought in" by the non-receiving party. Whether or not a buy-in notice is issued, Rule 204 requires the broker-dealer, in the event of a failure to deliver, to, "by no later than the beginning of regular trading hours on the settlement day following the settlement date [*i.e.*, T+4], immediately close out its fail to deliver position by borrowing or purchasing securities of like kind and quantity."[8]

B. The Initial Decision

The law judge found that Feldman and other optionsXpress customers employed an options trading strategy that caused optionsXpress to have a fail to deliver position in a number of securities, thereby triggering the close-out requirement of Rule 204. According to the initial decision, rather than purchasing the security on behalf of the customers and delivering it to the clearing agency, optionsXpress allowed those customers to place "buy-writes." A buy-write, the law judge explained, is a purchase of a security coupled with a simultaneous sale of a deep-in-

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5 *Chicago Bd. Options Exch., Inc.*, Exchange Act Release No. 69726, 2013 WL 2540903 (June 11, 2013).

6 Rule 204T of Regulation SHO was adopted as an interim final rule with an expiration date of July 31, 2009, when it was superseded by Rule 204. No party has suggested that there are differences between Rules 204 and 204T that are material for present purposes, so we shall treat them interchangeably.

7 17 C.F.R. § 242.204.

8 *Id.* § 242.204(a).

the-money call option for the same amount of the same security.[9] Because deep-in-the-money call options have a strike price substantially below the current market price, there is a high likelihood that they will be immediately exercised. The law judge found that, although it was not certain that any particular deep-in-the-money call written by Feldman would be exercised and then randomly assigned to him, the bulk of the buy-writes he placed were closed by assignment, often on the same day. That assignment, in turn, would create a new delivery obligation and thus, according to the law judge, perpetuate the already existing fail to deliver position. As a consequence, there were securities as to which optionsXpress had a continuous fail to deliver position for a number of consecutive settlement days. The initial decision concluded that these buy-writes were sham "reset" transactions designed to evade Rule 204's delivery and close-out requirements and, in effect, maintain a naked short position.

Before the law judge, Respondents argued that buy-writes satisfied the letter of Rule 204 and, moreover, that optionsXpress had received specific reassurances from regulators, including CBOE and the Financial Industry Regulatory Authority ("FINRA"), about the propriety of its conduct. The initial decision rejected this argument. It found that optionsXpress was not fully forthcoming with regulators and that there was no evidence that optionsXpress had described the use of buy-writes to cover failures to deliver when it responded to CBOE's inquiries about surveillance reports that its customers' trading had triggered.

C. The CBOE Settlement

The Commission instituted administrative proceedings against CBOE on June 11, 2013. In anticipation of those proceedings, CBOE submitted an offer of settlement that was accepted by the Commission in the CBOE Settlement order of the same date. The order found, among other things, that CBOE failed to adequately enforce Reg. SHO because its staff was not properly trained on the rule and that CBOE did not adequately investigate whether member firms were attempting to circumvent Rule 204's delivery and close-out requirements. The CBOE Settlement order also stated that, in response to CBOE's surveillance, an unnamed "member firm"—which the parties here agree is actually optionsXpress—provided documents to CBOE showing that the firm had "a failure to deliver position for a number of consecutive settlement days." According to the CBOE Settlement order, CBOE took no action against optionsXpress as a result of these surveillance exceptions and "closed the inquiry merely because the firm had represented . . . that it did not receive any buy-ins for the securities involved."

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9 The holder of a call option has the right to buy shares of the security at the strike price; when the holder decides to exercise the option, it is randomly assigned to an option writer, who then must honor the contract by delivering the security.

DISCUSSION

Respondents seek an order taking judicial notice of the CBOE Settlement order. Stern and Feldman also seek an order requiring the Division to produce documents related to the settlement, and granting them leave to re-examine witnesses regarding the settlement. We address each of these requests in turn.

A. The Commission Will Take Judicial Notice of the CBOE Settlement Order

Respondents request that we take judicial notice of the CBOE Settlement order and admit it as additional evidence. They argue that the findings in that order "contradict, or at least critically weaken, the [law judge's] findings of fact and conclusions of law in [the] Initial Decision." For example, they claim that the order shows that optionsXpress received a green light from CBOE after providing it with all the information needed to evaluate whether buy-writes complied with Rule 204. The Division does not oppose our consideration of the CBOE Settlement, but it does dispute Respondents' characterization of the findings in the CBOE Settlement order.

Rule of Practice 323 provides that "[o]fficial notice may be taken of any material fact which might be judicially noticed by a district court of the United States, any matter in the public official records of the Commission, or any matter which is peculiarly within the knowledge of the Commission as an expert body."[10] Published by the Commission as an official, public document, the CBOE Settlement order qualifies for judicial notice under this standard.

Rule of Practice 452 allows a respondent to submit additional evidence after the conclusion of the hearing if the evidence is material and there were reasonable grounds for not adducing such evidence previously.[11] Respondents draw one set of inferences from the CBOE Settlement order's findings, while the Division draws a contrary one. We will defer assessment of the CBOE Settlement until our consideration of the petitions for review.[12] Under the circumstances, we find that the CBOE Settlement is material for purposes of Rule 452. As for timeliness, the CBOE Settlement order was issued on June 11, four days after the initial decision was rendered, so we agree that Respondents could not have adduced it any earlier. For these reasons, we accept the CBOE Settlement as additional evidence under Rule 452.

Accordingly, we grant the pending motions insofar as we will consider the CBOE Settlement order as part of the record in this proceeding, though this should not be construed as suggesting any view as to that order's ultimate probative weight.

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10 17 C.F.R. § 201.323.

11 *Id.* § 201.452.

12 *See, e.g., Tang v. Rhode Island Dep't of Elderly Affairs*, 163 F.3d 7, 11 (1st Cir. 1998) ("[a] ruling on admissibility . . . [is] interlocutory and subject to reconsideration"); *United States v. Bond*, 87 F.3d 695, 700 n.1 (5th Cir. 1996) (an "evidentiary ruling [is], of course, subject to reconsideration at any time before final judgment").

B. Respondents Have Not Established That the Division Failed To Comply with Rule 230(b)(2) and *Brady*

Stern and Feldman argue that the Division has improperly withheld documents subject to disclosure under Rule of Practice 230(b)(2) and *Brady v. Maryland*.[13] Under *Brady*, the prosecution in a criminal proceeding must disclose materially exculpatory or impeaching evidence in the government's possession. Although *Brady* has no direct application to civil or administrative proceedings such as this one,[14] we have "incorporated the Supreme Court's *Brady* doctrine" in our administrative proceedings by adopting Rule of Practice 230(b)(2).[15] To that end, although Rule 230(b)(1) enumerates certain grounds on which the Division may withhold documents, Rule 230(b)(2) makes clear that the former subsection does not "authorize[] the Division . . . to withhold, contrary to the doctrine of *Brady*[,] . . . documents that contain material exculpatory evidence."[16] To trigger the disclosure obligation under Rule 230(b)(2), "the evidence must be 'material either to [the respondent's] guilt or punishment,'"[17] with the test of materiality being whether there is a "reasonable probability" that the evidence's disclosure would have resulted in a different outcome.[18]

Invoking Rule 230(b)(2) and *Brady*, Stern and Feldman seek to compel the Division to turn over all "transcripts, memoranda and other internal work product related to the CBOE Settlement." In particular, they argue that the Division should be ordered to produce "correspondence and 'other documents'" concerning settlement negotiations with CBOE (including drafts of the settlement), "any Wells Memoranda" or other submissions by the CBOE to the Commission, and the "Division's Action Memorandum that it presented to the Commission concerning the CBOE."

The Division responds that the "documentary and testimonial evidence underlying the CBOE Settlement was produced well in advance of the hearing." It represents that, in April and May 2012, "soon after the institution of these proceedings," it provided Respondents with the

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13 *See* 373 U.S. 83 (1963).

14 *Williams v. Wynne*, 533 F.3d 360, 372 (5th Cir. 2008); *Tandon v. Comm'r*, 210 F.3d 372 (table), 2000 WL 331926, at *1 (6th Cir. Mar. 23, 2000); *Mister Discount Stockbrokers, Inc. v. SEC*, 768 F.2d 875, 878 (7th Cir. 1985); *NLRB v. Nueva Eng'g, Inc.*, 761 F.2d 961, 969 (4th Cir. 1985); *SEC v. Pentagon Capital Mgmt. PLC*, No. 08 Civ. 3324, 2010 WL 4608681, at *1 (S.D.N.Y. Nov. 12, 2010); *SEC v. Reyes*, No. C 06-04435 CRB, 2007 WL 528718, at *4 (N.D. Cal. Feb. 13, 2007).

15 *Orlando Joseph Jett*, Admin. Proc. Rulings Release No. 514, 1996 WL 360528, at *1 (June 17, 1996); *accord Mitchell M. Maynard*, Advisers Act Release No. 2875, 2009 WL 1362796, at *7 n.17 (May 15, 2009) (explaining that Rule 230(b)(2) is "consistent" with *Brady*).

16 17 C.F.R. § 201.230(b)(2).

17 *Elizabeth Bamberg*, Exchange Act Release No. 27672, 50 SEC 201, 1990 WL 1102421, at *3 (1990) (citation omitted).

18 *Kyles v. Whitley*, 514 U.S. 419, 434 (1995).

"underlying bases" of the CBOE Settlement order's findings concerning Reg. SHO, "including "over 223,000 pages" of documents produced by CBOE, document requests and subpoenas issued to CBOE, the transcripts and exhibits associated with the testimony of current and former CBOE employees involved in the Reg. SHO investigation and CBOE's surveillance of optionsXpress, and any "internal notes and emails of Commission staff that could have been construed as being subject to *Brady* and Rule 230(b)(2)." On May 9, 2012, the Division also provided Respondents with a Withheld Documents List specifying that the Division had withheld "correspondence and other documents related to the settlement discussions" with CBOE.

The Division acknowledges that *Brady* requires the disclosure of material exculpatory facts not otherwise available to the respondent even when those facts are recited in privileged documents,[19] but it represents that its review has not identified any such facts. In sum, the Division represents that it is "unaware of any additional *Brady* material that was not previously produced" and that "no material exculpatory evidence related to the CBOE Settlement has been withheld" from Respondents.

We find Stern and Feldman's arguments to be without merit and deny the relief sought. To begin with, their *Brady* claim is, with two exceptions,[20] untimely because they could have—but did not—object below to the withholding of the documents they now seek. The Division's Withheld Documents List placed Stern and Feldman on notice in May 2012 that the Division had withheld "correspondence and other documents related to the settlement discussions" with CBOE. Yet at no time did Stern and Feldman challenge the withholding of settlement-related documents before the law judge. It was only on July 12, 2013—over a year later, *after* the initial decision was issued—that they asked the Division to produce these additional documents related

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19 Letter from Frederick L. Block, Assistant Chief Litigation Counsel, Division of Enforcement, U.S. Securities and Exchange Commission to Gregory T. Lawrence, Conti Fenn & Lawrence, LLC (July 17, 2013) (attached as Ex. 2 to Jonathan I. Feldman's Mot. for Leave to Adduce Additional Evidence (July 22, 2013)). Put another way, the "underlying [material] exculpatory facts" may be discoverable under *Brady* even if the document containing them is as a whole privileged and not subject to disclosure. *Morris v. Ylst*, 447 F.3d 735, 742 (9th Cir. 2006); *United States v. NYNEX Corp.*, 781 F. Supp. 19, 26 (D.D.C. 1991) ("The government should, and apparently already has, disclosed exculpatory facts, even if contained in internal documents otherwise protected by the work product privilege.").

20 Stern and Feldman seek production of two documents whose existence could not have been known to Respondents prior to the hearing and we conclude that their *Brady* claim is timely with respect to those documents. The first document was prepared by CBOE and submitted to the Division after this proceeding was initiated. As characterized by the Division, it summarizes the cases that CBOE "brought against firms for various violations, including violations of Reg. SHO." Div. Opp. to Feldman Mot. at p. 6 n.2. The second document is a white paper submitted by CBOE to the Division on November 16, 2012, also after this proceeding was initiated, that "explained improvements that had been made to CBOE's regulatory and surveillance programs including those related to Reg. SHO." *Id.* at p. 7 n.3. Although we find their *Brady* claim to be timely in these respects, Stern and Feldman have failed to make the required "plausible showing" that the documents contain information that both favorable and material to their defense. *See infra* pp. 9-13.

to the CBOE investigation and settlement. They "offer[] no explanation of the reason [they] did not request the materials" earlier.[21]

In our view, Stern and Feldman's failure to timely raise the issue before the law judge as set forth in by Rule of Practice 230(c),[22] which "vests the law judge with discretion to determine whether the Division's withholding of documents was appropriate,"[23] is sufficient reason to deny their belated *Brady* claim. As we have previously made clear, the appropriate way to present a *Brady* claim is to "bring[] [the allegedly withheld documents] to the [law] judge's attention," make at least a "'plausible showing' . . . that the documents in question contain information that is both favorable and material to [their] defense," and ask that the law judge conduct an *in camera* review of the disputed documents.[24] A respondent who "for the first time before the Commission" seeks production of "potentially exculpatory items" that it "failed to bring . . . to the law judge's attention . . . even though it had been provided with documents referring to them" prior to the hearing cannot obtain relief.[25]

Our conclusion that Stern and Feldman failed to exercise reasonable diligence in seeking the purportedly withheld CBOE Settlement-related materials is reinforced by how energetically Respondents pursued discovery of *other* investigative materials. For example, on July 19, 2012, Stern sought to subpoena CBOE for the documents that precipitated its investigation of optionsXpress. Feldman sought twice (once on August 13, 2012 and again on August 22, 2012) to obtain the Division's action memorandum recommending that the Commission institute the present proceeding. And optionsXpress sought to have FINRA turn over its communications with Commission staff regarding the Reg. SHO investigation, specifically addressing in its papers the Division's assertion of an investigative privilege with respect to those documents. All this suggests that Respondents simply had different priorities about what avenues of factual

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21 *John Montelbano*, Exchange Act Release No. 47227, 2003 WL 147562, at *12 (Jan. 22, 2003) (rejecting as "untimely" request to produce allegedly "withheld [and] buried" documents when documents were not sought while case was pending before hearing panel).

22 17 C.F.R. § 201.230(b) (providing that the "hearing officer may require the Division . . . to submit any document withheld, and may determine whether any such document should be made available for inspection and copying").

23 *Thomas C. Bridge*, Exchange Act Release No. 60736, 2009 WL 3100582, at *20 (Sept. 20, 2009).

24 *Jett*, 1996 WL 360528, at *1 (quoting *Pennsylvania v. Ritchie*, 480 U.S. 39, 58 n.15 (1987)); *see KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 2001 WL 47245, at *18 n.90 (Jan. 19, 2001) ("[T]o obtain in camera review, [a] plausible showing must be made that document in question contains information that is both favorable and material to respondent's defense[.]"); *accord Davis v. Litscher*, 290 F.3d 943, 947-48 (7th Cir. 2002) (articulating "plausible showing" standard for *in camera* review of disputed *Brady* evidence); *United States v. Runyan*, 290 F.3d 223, 245 (5th Cir. 2002); *Riley v. Taylor*, 277 F.3d 261, 301 (3d Cir. 2001); *United States v. Williams-Davis*, 90 F.3d 490, 514 (D.C. Cir. 1996); *Love v. Johnson*, 57 F.3d 1305, 1313-15 (4th Cir. 1995).

25 *KPMG Peat Marwick LLP*, 2001 WL 47245, at *18 n.90 (rejecting *Brady* claim) (quotation marks omitted).

inquiry to pursue. We perceive no sound reason to relieve them of the consequences of their strategic litigation choices and "permit[] [them] at this late date to search for evidence that they expect to find" in the Division's files."[26]

Stern and Feldman nonetheless contend that the Division has a continuing duty to produce *Brady* material under Rule 230(b)(2) until the Commission enters an order of finality, and that this makes it irrelevant that they did not earlier raise a *Brady* claim. But even a continuing duty of disclosure (assuming for the sake of argument that such a duty exists) would not relieve Stern and Feldman of the need to timely raise their *Brady* claim. The underlying "*obligation* to disclose exculpatory material" is not to be conflated with the "appropriate *method* of assessing" a defendant's or respondent's claim that *Brady* material has been improperly withheld.[27] Absent a substantiated and timely request—one that Stern and Feldman failed to make—the respondent is not entitled to demand that we (or the law judge) conduct an *in camera* review of the government's files, let alone "conduct his own search of the State's files to argue relevance."[28] As courts have uniformly held, parties who are unambiguously on notice of undisclosed documents that may constitute *Brady* material—*e.g.*, when, as here, the documents were specifically identified by the government as withheld—yet elect to sleep on their rights, proceed at their own peril.[29] Any other result would countenance gamesmanship, and we accordingly hold that Stern and Feldman's *Brady* claim is, with two exceptions,[30] not preserved for our review.

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26 *Russo Secs., Inc.*, Exchange Act Release No. 44186, 2001 WL 379064, at *8 (Apr. 17, 2001); *see also Sidney C. Eng*, Exchange Act Release No. 40297, 1998 WL 433050, at *7 (Aug. 3, 1998) ("[A] respondent cannot be permitted to gamble on one course of action and, upon an unfavorable decision, to try another course of action.'" (quoting *David T. Fleischman*, 43 SEC 518, 522 (1967))).

27 *Ritchie*, 480 U.S. at 58-59 & n.15 (emphasis added).

28 *Id.*

29 *See, e.g.*, *United States v. Huggans*, 650 F.3d 1210, 1227 (8th Cir. 2011) (rejecting *Brady* claim as waived because the defendant did not "ask[] the district court to review [the documents] *in camera*"); *United States v. Jumah*, 599 F.3d 799, 811 (7th Cir. 2010) ("[The defendant's] failure to ask for an *in camera* inspection of the Government's records further counsels against any relief from this court."); *United States v. Roberts*, 534 F.3d 560, 572 (7th Cir. 2008) ("[The defendant] declined to request a *Brady* hearing before the district court. Accordingly, he has waived this issue."); *United States v. Schier*, 438 F.3d 1104, 1106 n.1 (11th Cir. 2006) (rejecting defendant's argument that the "district court . . . should have . . . [found] a violation of *Brady*, without so much as . . . a request for the materials to which she now claims she was entitled"); *United States v. Hayes*, 120 F.3d 739, 743 (8th Cir. 1997) ("The defendants offered no good cause for waiting . . . to request this alleged *Brady* material. We agree . . . that the motion was untimely."); *United States v. Flores*, 63 F.3d 1342, 1365 (5th Cir. 1995) ("[The defendant] never made a specific *Brady* request for these notes and, until his appeal, never suggested that these notes might contain *Brady* material. In these circumstances, the district court did not err in accepting the government's representation that it has furnished the defendant with all *Brady* materials.").

30 *See supra* note 20.

In any event, Stern and Feldman have failed to establish that the Division has withheld material exculpatory evidence in violation of Rule 230(b)(2) and *Brady*, and we deny relief on this ground as well. As we have previously stated, "*Brady* is not a discovery rule."[31] Rule 230(b)(2) instead is "intended to insure that exculpatory material known to the Division is not kept from the respondent."[32] Its purpose "is not to provide [the respondent] with a complete disclosure of all evidence . . . which might conceivably assist him in preparation of his defense."[33] Thus, a respondent is "not entitled to conduct a fishing expedition . . . in an effort to discover something that might assist [it] in [its] defense . . . or in the hopes that some evidence will turn up to support an otherwise unsubstantiated theory."[34]

We find that Stern and Feldman have not made the requisite "plausible showing" that the "documents in question contain information that is both favorable and material to [their] defense."[35] As noted above, the Division has unequivocally represented that it is aware of the appropriate standards for *Brady* disclosure, that it has turned over all disclosable material in its investigative files leading up to the Reg. SHO portion of the CBOE Settlement (including internal staff communications that could be construed as containing material exculpatory facts subject to disclosure under *Brady*), and that it is not aware of any additional *Brady* material.[36]

Stern and Feldman cite no evidence to contradict these representations. They merely speculate that because (in their view) the CBOE Settlement order contains findings that are inconsistent with those in the initial decision, communications and other work product leading up to the settlement necessarily would contain exculpatory material. But our precedent makes clear that a respondent's speculation that a different proceeding's investigative file "might . . . contain exculpatory material" because the "theory of liability" advanced in that proceeding is supposedly

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31 *E.g.*, *Warren Lammert*, Exchange Act Release No. 56233, 2007 WL 2296106, at *6 (Aug. 9, 2007) (quotation marks omitted).

32 *E.g.*, *id.* (quotation marks omitted).

33 *E.g.*, *id.* (quotation marks omitted).

34 *E.g.*, *Eric J. Brown*, Exchange Act Release No. 66469, 2012 WL 625874, at *22 & n.77 (Feb. 27, 2012) (quotation marks omitted); *Haight & Co.*, Exchange Act Release No. 9082, 44 SEC 481, 1971 WL 120486, at *20 (1971) (rejecting contention that *Brady* permits "a wholesale 'fishing expedition' into investigative materials"); *Harris Clare & Co.*, Exchange Act Release No. 8004, 43 SEC 198, 1966 WL 84125, at *3 (1966) (rejecting contention that *Brady* "require[es] the wholesale production of investigative materials in administrative proceedings").

35 *Jett*, 1996 WL 360528, at *1; *see also supra* note 24. Because Stern and Feldman have failed to make even this threshold showing, we have concluded that they are not entitled to demand an *in camera* review of disputed *Brady* materials before their claim is denied. *See Jett*, 1996 WL 360528, at *2 (vacating law judge's order directing the Division to turn over internal memoranda for *in camera* review because respondents had not made requisite "plausible showing").

36 *Cf.* Rule of Practice 153, 17 C.F.R. § 201.153 (stating that a signature on a filing constitutes a certification that, to the best of the signer's, knowledge, "the filing is well grounded in fact"); *Brown*, 2012 WL 625874, at *22 & 76 (relying on representation made in the Division's pleadings).

"inconsistent" with the legal theories in the present proceeding is not enough to make out a viable claim of a *Brady* violation.[37] Furthermore, as we have repeatedly explained, we are entitled to rely on the Division's representation "that it is not aware of any *Brady* material in any of the investigative files at issue" in rejecting a respondent's *Brady* claim.[38] For example, we have held that the "law judge was entitled to rely" on the Division's representations that it had searched for "all disclosable material and had turned over all such material" and that it had reviewed "relevant action memoranda from staff to the Commission and was satisfied that there was not *Brady* material in those memoranda."[39] "[I]t takes more than the adverse party's conclusory suspicions to impel the adjudicator to delve behind the government's representation that it has conducted a *Brady* review and found nothing."[40]

When juxtaposed with the Division's explicit representations and the extensive discovery that the Division has already provided, the type of documents that Stern and Feldman seek gives us further reason to be skeptical of their *Brady* claim.[41] Neither Stern nor Feldman has even attempted to identify any *factual* information—*e.g.*, witness statements, documentary evidence produced by CBOE or any other third-party, interview transcripts, notes of telephone conversations, or exhibits—underlying the findings in the CBOE Settlement order that they contend was improperly withheld and that could potentially be introduced into evidence in the instant proceeding.[42] Rather, they claim to be entitled to a broad array of what are essentially *legal* analyses submitted to the Commission or prepared by the Commission's staff, such as the "Division's Action Memorandum . . . concerning the CBOE," the "Wells Memoranda submitted

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37 *Lammert*, 2007 WL 2296106, at *6.

38 *Id.*; *see also Brown*, 2012 WL 625874, at *22 & n.76; *Bridge*, 2009 WL 3100582, at *20; *Jett*, 1996 WL 360528, at *1.

39 *KPMG Peat Marwick LLP*, 2001 WL 47245, at *18 n.90.

40 *Landry v. FDIC*, 204 F.3d 1125, 1137 (D.C. Cir. 2000); *see also Jett*, 1996 WL 360528, at *1 ("Mere speculation that government documents may contain *Brady* material is not enough to require the judge to make an *in camera* review."); *Williams-Davis*, 90 F.3d at 513 ("Except for bare speculation, [the defendant] has nothing to suggest the existence of favorable materials.").

41 To be clear, we do not hold that documents like the ones sought by Stern and Feldman are non-discoverable as a class. But we do find, based on the arguments that are before us, that they have not made a plausible showing that the specific documents they seek contain undisclosed information that is favorable and material to their defense.

42 *Cf. Wood v. Bartholomew*, 516 U.S. 1, 6 (1995) (per curiam) (nondisclosure of inadmissible evidence is by definition not material under *Brady* because it could not have reached the jury and could not have affected the outcome); *United States v. Wilson*, 605 F.3d 985, 1005 (D.C. Cir. 2010) ("[T]o be 'material' under *Brady*, undisclosed information or evidence acquired through that information must be admissible." (quoting *United States v. Derr*, 990 F.2d 1330, 1336-37 (D.C. Cir. 1993))).

by the CBOE," and other memoranda submitted by CBOE. They also claim to be entitled to documents detailing the settlement negotiations between the Division and CBOE.[43]

We have rejected past attempts by respondents to invoke Rule 230(b)(2) and *Brady* to obtain the "staff's recommendation[s]" to us and the staff's "analyses of the facts developed during the investigation and of the relevant law."[44] As a federal district court put it, a defendant "may be entitled to all exculpatory evidence," but he or she is not "entitled to have any document revealing what attorneys at the SEC *think* about such evidence."[45] That is so because "*Brady* obligates the government to disclose '*evidence* favorable to the accused,'" but "[i]t does not obligate the government to give the defendant *legal theories*."[46] At bottom, a "government attorney's opinion as to the strength or weakness" of an argument or "as to the clarity or meaning of" a legal requirement "would not preclude a contrary argument during litigation by the government or bind a court's ruling," and so *Brady* does not "require that attorney opinions on legal issues must be made available to the other side."[47] We accept the Division's representation

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43 Feldman also asserts in passing that the Division must produce "any other documents concerning *any* investigation of the CBOE," without limitation as to the time period or as to the subject matter. We reject this argument. Feldman does not even try to explain how an unrelated investigation of CBOE having nothing to do with Reg. SHO could generate *Brady* material relevant for this case, and Feldman clarifies in his reply that he is seeking only documents related to "CBOE's settlement with the SEC concerning their investigation of optionsXpress."

44 *Jett*, 1996 WL 360528, at *1.

45 *Reyes*, 2007 WL 528718, at *4.

46 *United States v. Coker*, 514 F.3d 562, 570 (6th Cir. 2008) (quoting *Brady*, 373 U.S. at 87; citation omitted; emphasis in original); *see also Morris*, 447 F.3d at 742 (holding that *Brady* "does not encompass an obligation on the prosecutor's part to reveal his or her strategies, legal theories, or impressions of the evidence"); *Williamson v. Moore*, 221 F.3d 1117, 1182-83 (11th Cir. 2000) (holding that *Brady* does not typically require disclosure of opinion work product because an attorney's "mental impressions, conclusions, opinions, or legal theories" would not be admissible at trial); *United States v. Torrez-Ortega*, 184 F.3d 1128, 1137 (10th Cir. 1999) ("*Brady* would not extend to a merely subjective assessment by a prosecutor of a witness's veracity."); *United States v. Edelin*, 128 F. Supp. 2d 23, 40-41 (D.D.C. 2001) (recommendations "conveyed by the United States Attorney to the Department of Justice" not discoverable under *Brady*); *cf. Goldberg v. United States*, 425 U.S. 94, 98 n.3 (1976) (reserving question whether the government's work product must be disclosed under *Brady*).

So that there is no confusion, our conclusion does not rest on a finding that the materials sought by Stern and Feldman in fact constitute opinion work product, although, if true, that might provide an additional justification for withholding the documents. The determination of whether a document is covered by a particular privilege—*e.g.*, settlement, work product, law enforcement, attorney-client, deliberative process—calls for a fact-specific inquiry. It is unnecessary to undertake that analysis here, where Stern and Feldman have failed to make even a threshold showing that the documents plausibly might contain material exculpatory evidence subject to disclosure under *Brady*.

47 *NYNEX Corp.*, 781 F. Supp. at 25-26 (rejecting *Brady* request for opinions prepared by government attorneys "that might reflect on the merits of [the defendant's] interpretation of the consent decree . . . , which in turn might indicate whether the decree was unambiguous").

that it has reviewed its internal memoranda for material, exculpatory evidence not otherwise disclosed in this proceeding. Thus, we reject Feldman's argument that *Brady* additionally entitles him to the Division's analysis and evaluation of "CBOE's position as to why optionsXpress did not violate Reg. SHO," whether contained in an Action Memorandum or any other document.

Similar considerations apply to any Wells submission that CBOE may have made to the Commission. That document (assuming it existed) would invariably contain legal argumentation and set forth CBOE's position on the merits or demerits of the contemplated enforcement action. As a piece of advocacy prepared by counsel, it is unlikely to contain or lead to novel, factual information—that is, admissible *evidence*—not present in the voluminous documentary material already turned over to Respondents. The same would likely be true of the white paper that CBOE submitted to the Division describing "improvements that had been made to CBOE's . . . surveillance programs[,] including those related to Reg. SHO[,]" after the conduct at issue here took place. Respondents do not explain how CBOE's subsequent remedial changes to its surveillance programs would constitute material, exculpatory evidence.

We are similarly dubious of Feldman's claim that the case summaries submitted by CBOE to the Division would plausibly contain undisclosed *Brady* material.[48] Feldman argues that these "summaries of Reg. SHO investigations that the CBOE conducted at other brokers may shed light on whether other firms and customers were engaged in the same trading strategies and whether they too received guidance from the CBOE that their activity did not violate Reg. SHO." Although it could well be that CBOE's *investigations* of other broker-dealers would be relevant to CBOE's views on what constituted a violation of Reg. SHO, we think that the same cannot be said of CBOE's after-the-fact *summaries* of those investigations, particularly when those summaries were submitted in the course of settlement negotiations with the Division. Notably, Feldman does not assert that any CBOE records contemporaneously created as part of the investigations was undisclosed. And as CBOE points out in its submission, "the full text of each of those decisions is publicly available on CBOE's website and [Respondents are] free to review them and decide if they are relevant to [their] defenses."[49] The fact that Respondents already were "aware of the essential *facts* that would enable [them] to take advantage"[50] of

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48 The document summarizes the cases that CBOE has brought against firms for various violations, including for violations of Reg. SHO.

49 On August 9, 2013, CBOE filed what it styled as a "Submission Regarding the Respondents' Motions Seeking the Production of Settlement Documents." CBOE did not seek leave to file this document or to participate in the proceeding as a non-party. *Cf.* Rule of Practice 210(c), 17 C.F.R. § 201.210(c). Nonetheless, given that our resolution of these motions could affect CBOE's interests, we have considered CBOE's position, as well as the arguments in Feldman's response to CBOE's submission.

50 *Henness v. Bagley*, 644 F.3d 308, 325 (6th Cir. 2011) (emphasis added) (rejecting *Brady* claim premised upon "police informational summaries that were not provided" where the defendant already knew of the underlying facts); *see also Pederson v. Fabian*, 491 F.3d 816, 827 (8th Cir. 2007) (rejecting *Brady* claim premised upon undisclosed summary of grand jury testimony and police statements when the "actual grand jury testimony and police statements were available for use by the defense").

CBOE's regulatory activities as a defense bolsters our conclusion that Feldman has not made a plausible showing that these summaries constitute undisclosed, material exculpatory evidence.

Finally, although Stern and Feldman claim to be entitled to settlement communications between the Division and CBOE, such as drafts of proposed findings, they do not explain why these documents qualify as *Brady* material. They identify no authority for the proposition (and we are aware of none) "holding that the government must disclose all proffers,"[51] or that it must disclose "material contained in the back-and-forth hypothesizing that commonly occurs during plea negotiations between the prosecution and defense attorneys."[52] Speculation is no substitute for a "plausible showing" that the withheld materials contain *Brady* material, so we find that Stern and Feldman have not established an entitlement to this category of documents either.

Accordingly, we reject Stern and Feldman's claim that the Division has failed to produce material exculpatory evidence in violation of Rule 230(b)(2) and *Brady*.

C. Stern and Feldman's Request to Re-examine Witnesses Fails to Satisfy the Requirements of Rule 452

Finally, Stern and Feldman seek leave to elicit additional testimony regarding CBOE's Reg. SHO investigation. They argue that the Division's supposed withholding of *Brady* material impeded their "ability to effectively question fact witnesses from both CBOE and Trading & Markets" during the hearing about CBOE's asserted misunderstanding of Reg. SHO. Having already considered and rejected their arguments that the Division withheld documents related to the CBOE Settlement in violation of Rule of Practice 230(b)(2) and *Brady*, we likewise deny their request to re-examine witnesses.

A respondent's "request . . . for testimony in addition to that given at the hearing" is governed by Rule of Practice 452 because it is in substance a motion for leave to introduce additional evidence after the hearing's conclusion.[53] As noted earlier, Rule 452 provides that the Commission may allow the submission of additional evidence if the party seeking to introduce such evidence "show[s] with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously."[54] Stern and Feldman have not shown that there were reasonable grounds for failure to adduce such evidence previously because, as discussed above, in May 2012—four months before the hearing—the

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[51] *United States v. Wilkes*, 662 F.3d 524, 535 (9th Cir. 2011); *see also United States v. Zuazo*, 243 F.3d 428, 430-31 (8th Cir. 2001) (affirming denial of *Brady* motion seeking disclosure of co-conspirator's proffer statements when the "underlying facts comprising the relevant evidence contained in those statements were not unknown" to the defendant).

[52] *Spicer v. Roxbury Correctional Inst.*, 194 F.3d 547, 558 (4th Cir. 1999).

[53] *David Henry Disraeli*, Exchange Act Release No. 56045, 2007 WL 2011036, at *2 (July 11, 2007).

[54] 17 C.F.R. § 201.452.

Division produced the underlying evidentiary material that was the basis for the findings in the CBOE Settlement order. Stern and Feldman were free to introduce the documents at the hearing and use them when examining CBOE and Trading & Markets witnesses. Indeed, at the hearing, testimony was elicited about many of the same topics touched upon in the CBOE Settlement order, such as the fact that CBOE investigators never received formal training on Reg. SHO.[55]

Feldman argues that he did not know "that the Commission was investigating CBOE or was planning on issuing the Order" and that this explains why he could not have introduced the material at the hearing. Along similar lines, he claims that "did not know why these documents were relevant to his defenses until the CBOE Order was issued after the hearing." We do not credit these assertions. Respondents could not possibly have been surprised that CBOE was under investigation in connection with CBOE's enforcement of Reg. SHO and, in particular, CBOE's scrutiny of optionsXpress and that the Commission might settle the CBOE matter. As detailed above,[56] the Division's May 9, 2012 Withheld Documents List explicitly stated that the Division was withholding "correspondence and other documents related to the settlement discussions" with CBOE. The Division also produced document requests and subpoenas issued to CBOE as part of its investigation. Thus, Respondents surely "should have foreseen" that CBOE's regulatory activities were a "subject of scrutiny" and they "have not shown that there were reasonable grounds for their failure to adduce the evidence previously."[57]

In sum, "[i]t was [Respondents'] obligation 'to marshall *all* the evidence in [their] defense,'"[58] and if they believed that additional evidence or testimony pertaining to the Commission's investigation of CBOE would have been helpful, they could and "should have introduced it during the hearing."[59] Because they "had a full opportunity to present evidence and argument," there is "no reason why [they] should be permitted to start over again."[60] For these reasons, Stern and Feldman's request to re-examine witnesses is denied.

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55 *See* Division's Resp. to optionsXpress's Mot. for Consideration of New Evidence at p. 4 n.2 (collecting transcript citations) (July 10, 2013).

56 *See supra* at pp. 5-6.

57 *FCS Secs.*, Exchange Act Release No. 64852, 2011 WL 2680699, at *8-9 (July 11, 2011);

58 *Russo Secs.*, 2001 WL 379064, at *8 (emphasis added; quoting *Laurie Jones Canady*, Exchange Act Release No. 41713, 1999 WL 587941, at *3 (Aug. 6, 1999)).

59 *FCS Secs.*, 2011 WL 2680699, at *8.

60 *Disraeli*, 2007 WL 2011036, at *1 n.9 (quotation marks omitted).

Accordingly, IT IS ORDERED that the motions are granted insofar as judicial notice is taken of the CBOE Settlement order pursuant to Rule of Practice 323 and as the CBOE Settlement order is accepted as additional evidence pursuant to Rule of Practice 452. The motions are in all other respects denied.

By the Commission.

Elizabeth M. Murphy
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

Commissioner Aguilar not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3692 / October 16, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15571

In the Matter of **MICHAEL J. FULCHER,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Michael J. Fulcher ("Fulcher" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. SJK Investment Management, LLC ("SJK") was a North Carolina-based investment adviser that had been registered with the Commission since 2009. SJK's sole owner and Chief Executive Officer was Stanley J. Kowalewski ("Kowalewski"). SJK's Chief Financial Officer was Michael J. Fulcher. Fulcher, 56, is a resident of Greensboro, North Carolina.

2. On January 6, 2011, the Commission filed a civil action entitled Securities and Exchange Commission v. Stanley J. Kowalewski and SJK Investment Management, LLC, Civil Action Number 1:11-CV-0056-TCB, in the United States District Court for the Northern District of Georgia.

3. The Commission's complaint alleged, inter alia, that Kowalewski and SJK made numerous misrepresentations to investors in raising investor proceeds, misused and misappropriated investor funds, including purchasing personal homes in which he allowed his relatives to live rent-free, sent out false account statements to investors and otherwise engaged in a variety of conduct which operated as a fraud and deceit on investors.

4. In connection with the Commission's investigation of Kowalewski and SJK, the Commission took the testimony of Kowalewski on November 29, 2010.

5. On April 19, 2013, Fulcher pleaded guilty to one count of conspiracy to obstruct an SEC proceeding in violation of Title 18 United States Code, Section 1505 before the United States District Court for the Northern District of Georgia, in United States v. Michael J. Fulcher, 1:13-cr-00135-WBH. The Court ordered the sentencing date to be set later.

6. The count of the criminal information to which Fulcher pleaded guilty alleged, inter alia, that Fulcher, at Kowalewski's direction, in violation of Title 18 United States Code 1505, obstructed a Commission investigation by conspiring with Kowalewski to create fraudulent and backdated leases to conceal Kowalewski's self-dealing transactions wherein Kowalewski's relatives lived rent-free in homes purchased with investor funds. Kowalewski subsequently provided those leases to the Commission in the course of its investigation and testified falsely to the Commission about them on November 29, 2010.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Fulcher's Offer.

Accordingly, it is hereby ORDERED pursuant Section 203(f) of the Advisers Act that Respondent Fulcher be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Gallagher
Commissioner Piwowar
not participating

SECURITIES AND EXCHANGE COMMISSION

Release No. IA-3693 / 803-00215

Davidson Kempner Capital Management LLC; Notice of Application

October 17, 2013

Agency: Securities and Exchange Commission ("Commission").

Action: Notice of application for an exemptive order under Section 206A of the Investment Advisers Act of 1940 (the "Advisers Act") and Rule 206(4)-5(e) thereunder.

Applicant: Davidson Kempner Capital Management LLC ("Applicant").

Relevant Advisers Act Sections: Exemption requested under section 206A of the Advisers Act and rule 206(4)-5(e) thereunder from rule 206(4)-5(a)(1) under the Advisers Act.

Summary of Application: Applicant requests that the Commission issue an order under section 206A of the Advisers Act and rule 206(4)-5(e) thereunder exempting it from rule 206(4)-5(a)(1) under the Advisers Act to permit Applicant to receive compensation from three government entities for investment advisory services provided to the government entities within the two-year period following a contribution by a covered associate of Applicant to an official of the government entities.

Filing Dates: The application was filed on October 16, 2012, and an amended and restated application was filed on July 5, 2013.

Hearing or Notification of Hearing: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving Applicant with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on November 12, 2013, and should be accompanied by proof of service on Applicant, in the form of an affidavit or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons may request notification of a hearing by writing to the Commission's Secretary.

Addresses: Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, D.C. 20549-1090. Applicant, Davidson Kempner Capital Management LLC, c/o Shulamit Leviant, 65 East 55th Street, 19th Floor, New York, New York 10022.

For Further Information Contact: Melissa S. Gainor, Senior Counsel, or Sarah A. Buescher, Branch Chief, at (202) 551-6787 (Investment Adviser Regulation Office, Division of Investment Management).

Supplementary Information: The following is a summary of the application. The complete application may be obtained for a fee at the SEC's Public Reference Branch, 100 F Street, NE, Washington, D.C. 20549-0102 (telephone (202) 551-5850).

Applicant's Representations:

1. Applicant is a limited liability company registered with the Commission as an investment adviser under the Advisers Act. Applicant serves as investment adviser to Davidson Kempner Institutional Partners, L.P. (the "Fund"), an issuer excluded from the definition of investment company pursuant to section 3(c)(7) of the Investment Company Act of 1940. Three of the investors in the Fund (the "Clients") are Ohio public pension plans. The investment decisions for each Client are overseen by a board of between 9 and 11 trustees that includes one individual appointed by the Ohio State Treasurer.

2. On May 22, 2011, Anthony Yoseloff, a managing member and senior investment professional of Applicant (the "Contributor"), made a contribution of $2,500 (the "Contribution") to the federal senate campaign of Joshua Mandel, the Ohio State Treasurer (the

"Official"). The Contributor's wife also made a contribution for the same amount. Applicant represents that the amount of the Contribution, profile of the candidate and characteristics of the campaign are consistent with the pattern of the Contributor's other political contributions.

3. Applicant represents that the Contributor did not solicit any persons to make contributions to the Official's campaign, and that the executive managing member of Applicant was informed of the Contributor's plan to meet with the Official, but never learned that the Contributor made the Contribution.

4. Applicant represents that each Client's relationship with the Applicant pre-dates the Contribution and only one investment made by the Clients occurred after the contribution. The Applicant also represents that it took steps designed to limit the Contributor's contact with each Client and each Client's representatives during the duration of the two-year compensation time out. Applicant represents that the Contributor's role with the Clients was limited to making substantive presentations to the Client's representatives regarding the investment strategy for which the Contributor is a manager. Applicant represents that the Contributor had no contact with any representative of a Client outside of those presentations, and no contact with any member of a Client's board. No member of a Client's board serving at the time of the Contribution was appointed by the Official.

5. Applicant represents that at no time did any employees of the Adviser other than the Contributor have any knowledge of the Contribution prior to its discovery by the Adviser on November 2, 2011. The Contribution was discovered by the Adviser's compliance department during compliance testing that included random testing of campaign contribution databases for the names of employees. After discovery of the Contribution, the Adviser and Contributor obtained the Official's agreement to return the full amount of the Contribution, which was

subsequently returned. An escrow account was established and all fees paid from the Clients' capital accounts in the Fund for the two-year period beginning on May 22, 2011 were deposited in the account. Applicant represents that it notified each Client of the Contribution and resulting two-year prohibition on compensation absent exemptive relief from the Commission.

6. The Adviser's policies and procedures regarding pay-to-play ("Pay-to-Play Policies and Procedures") were initially adopted and implemented in August 2009 and required covered employees of the Adviser to pre-clear contributions to state and local office incumbents (including state and local officials running for federal office) and candidates. Applicant represents that the Contributor's violation of Applicant's Pay-to-Play Policies and Procedures resulted from his mistaken belief that all contributions to federal campaigns were permissible and exempt from Pay-to-Play Policies and Procedures. After learning of the Contributor's misunderstanding, Applicant represents that it revised its Pay to Play Policies and Procedures to require covered employees of the Adviser to pre-clear all campaign contributions to avoid similar misunderstandings by covered associates.

Applicant's Legal Analysis:

1. Rule 206(4)-5(a)(1) under the Advisers Act prohibits a registered investment adviser from providing investment advisory services for compensation to a government entity within two years after a contribution to an official of the government entity is made by the investment adviser or any covered associate of the investment adviser. Each Client is a "government entity," as defined in rule 206(4)-5(f)(5), the Contributor is a "covered associate" as defined in rule 206(4)-5(f)(2), and the Official is an "official" as defined in rule 206(4)-5(f)(6). Rule 206(4)-5(c) provides that when a government entity invests in a covered investment pool, the investment adviser to that covered investment pool is treated as providing

advisory services directly to the government entity. The Fund is a "covered investment pool," as defined in rule 206(4)-5(f)(3)(ii).

2. Section 206A of the Advisers Act grants the Commission the authority to "conditionally or unconditionally exempt any person or transaction . . . from any provision or provisions of [the Advisers Act] or of any rule or regulation thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of [the Advisers Act]."

3. Rule 206(4)-5(e) provides that the Commission may exempt an investment adviser from the prohibition under Rule 206(4)-5(a)(1) upon consideration of the factors listed below, among others:

(1) Whether the exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Advisers Act;

(2) Whether the investment adviser: (i) before the contribution resulting in the prohibition was made, adopted and implemented policies and procedures reasonably designed to prevent violations of the rule; and (ii) prior to or at the time the contribution which resulted in such prohibition was made, had no actual knowledge of the contribution; and (iii) after learning of the contribution: (A) has taken all available steps to cause the contributor involved in making the contribution which resulted in such prohibition to obtain a return of the contribution; and (B) has taken such other remedial or preventive measures as may be appropriate under the circumstances;

(3) Whether, at the time of the contribution, the contributor was a covered associate or otherwise an employee of the investment adviser, or was seeking such employment;

(4) The timing and amount of the contribution which resulted in the prohibition;

(5) The nature of the election (e.g., federal, state or local); and

(6) The contributor's apparent intent or motive in making the contribution which resulted in the prohibition, as evidenced by the facts and circumstances surrounding such contribution.

4. Applicant requests an order pursuant to section 206A and rule 206(4)-5(e) thereunder, exempting it from the two-year prohibition on compensation imposed by rule 206(4)-5(a)(1) with respect to investment advisory services provided to the Clients within the two-year period following the Contribution.

5. Applicant submits that the exemption is necessary and appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act. Applicant further submits that the other factors set forth in rule 206(4)-5(e) similarly weigh in favor of granting an exemption to the Applicant to avoid consequences disproportionate to the violation.

6. Applicant states that each Client determined to invest with Applicant and established those advisory relationships on an arms' length basis free from any improper influence as a result of the Contribution. In support of this argument, Applicant notes that each Client's relationship with the Applicant pre-dates the Contribution and only one investment made by the Clients occurred after the contribution. Furthermore, the Official's influence on each Client is limited, as was the Contributor's contact with each Client's representatives. Applicant also argues that the interests of the Clients are best served by allowing the Applicant and its Clients to continue their relationship uninterrupted.

7. Applicant notes that it adopted and implemented Pay-to-Play Policies and Procedures compliant with the rule's requirements and it implemented compliance testing procedures prior to the date of the Contribution. Applicant further represents that at no time did any employees of Applicant other than the Contributor have any knowledge that the Contribution had been made prior to discovery by the Applicant in November 2011. After learning of the Contribution, Applicant and the Contributor obtained the Official's agreement to return the Contribution, which was subsequently returned, and the Applicant set up an escrow account for all fees charged to the Clients' capital accounts in the Fund for the two-year period beginning May 22, 2011.

8. Applicant states that the Contributor's apparent intent in making the Contribution was not to influence the selection or retention of Applicant. Applicant represents that the amount of the Contribution, profile of the candidate and characteristics of the campaign are consistent with the pattern of the Contributor's other substantial political donations. Applicant notes that the Contributor failed to appreciate that contributions to federal candidates who held state or local office could trigger the prohibition on compensation under Rule 206(4)-5 or that such contributions were subject to the Applicant's Pay-to-Play Policies and Procedures. Applicant represents that the Contributor had no contact with any representative of the Clients (or their boards) outside of making limited substantive presentations to the Clients' representatives and consultants about the investment strategy he manages and that the Applicant took steps designed to limit such contact during the duration of the two-year time out on compensation.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
Release No. 34-70701

October 17, 2013

Order Providing Broker-Dealers a Temporary Exemption from the Requirements of Certain New Amendments to the Financial Responsibility Rules for Broker-Dealers under the Securities Exchange Act of 1934

I. BACKGROUND

On July 30, 2013, the Securities and Exchange Commission ("Commission") voted to adopt amendments to the broker-dealer net capital rule (Rule 15c3-1),[1] customer protection rule (Rule 15c3-3),[2] books and records rules (Rules 17a-3 and 17a-4),[3] and notification rule (Rule 17a-11)[4] promulgated under the Securities Exchange Act of 1934 ("Exchange Act"). The amendments are designed to address several areas of concern regarding the financial responsibility requirements for broker-dealers. The adopting release provided that the amendments are effective on October 21, 2013.[5]

Industry representative have indicated through physical and telephonic meetings with Commission staff that, as broker-dealers have worked to meet the October 21, 2013 effective date, some have determined that they will be unable to complete by that date the significant operational and systems changes necessary to comply with certain of the final rule amendments. For example, broker-dealers that maintain custody of customer securities and cash (a "carrying broker-dealer") have said they are unable to comply with the requirements of paragraph (e)(5) of

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1 17 CFR 240.15c3-1.

2 17 CFR 240.15c3-3.

3 17 CFR 240.17a-3 and 17a-4.

4 17 CFR 240.17a-11. Financial Responsibility Rules for Broker-Dealers, Exchange Act Release No. 70072 (July 30, 2013), 78 FR 51824 (Aug. 21, 2013).

5 Financial Responsibility Rules for Broker-Dealers, Exchange Act Release No. 70072 (July 30, 2013), 78 FR 51824 (Aug. 21, 2013).

Rule 15c3-3 by the current effective date. This provision places restrictions on a carrying broker-dealer's ability to use cash bank deposits to meet customer or PAB reserve deposit requirements by excluding cash deposits held at an affiliated bank and limiting cash held at non-affiliated banks to an amount no greater than 15% of the bank's equity capital, as reported by the bank in its most recent Call Report.[6] These carrying broker-dealers indicated that it would be a challenge to open new reserve accounts and make the appropriate systems changes by October 21, 2013 because, in part, negotiating new reserve account deposit agreements and obtaining acknowledgement letters required by paragraph (f) of Rule 15c3-3 from new banks generally take significantly more time than the 60 days afforded under the final rule amendments.

Further, broker-dealers have indicated that 60 days is insufficient for implementing the system changes necessary for the customer account opening documentation and processes, as well as account notices and disclosures, required in connection with new requirements under paragraph (j)(2) to Rule 15c3-3 regarding the treatment of customers' free credit balances. Additionally, broker-dealer representatives have indicated that some broker-dealers may need additional time to completely and accurately document their market, credit, and liquidity risk management controls under new paragraph (a)(23) to Rule 17a-3.[7]

Therefore, the Commission has determined to provide a temporary exemption to broker-dealers from the requirements of the following new amendments to the broker-dealer financial

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6 See paragraph (e)(5) of Rule 15c3-3, as adopted. See also Financial Responsibility Rules for Broker-Dealers, 78 FR at 51904. The final rules define the term PAB account to mean a proprietary securities account of a broker or dealer (which includes a foreign broker or dealer, or a foreign bank acting as a broker or dealer) other than a delivery-versus-payment account or a receipt-versus-payment account. The term does not include an account that has been subordinated to the claims of creditors of the carrying broker or dealer. See paragraph (a)(16) of Rule 15c3-3, as adopted. See also Financial Responsibility Rules for Broker-Dealers, 78 FR at 51903.

7 See paragraph (a)(23) of Rule 17a-3, as adopted and paragraph (e)(9) of Rule 17a-4, as adopted. See also Financial Responsibility Rules for Broker-Dealers, 78 FR at 51907.

responsibility rules adopted in Exchange Act Release No. 70072: (1) Rule 15c3-3, except paragraph (j)(1);[8] (2) Rule 15c3-3a; (3) Rule 17a-3; (4) Rule 17a-4; and (5) paragraph (c)(2)(iv)(E)(2) of Rule 15c3-1.[9] The temporary exemption will sunset on March 3, 2014. This will facilitate an orderly transition to the new requirements by providing broker-dealers with more time to make any necessary operational or systems changes. For example, industry representatives have indicated that many firms initiate freezes around the year end with respect to changing systems and codes. As a result of this temporary exemption, the Commission is directing the staff to delay from October 21, 2013 to March 3, 2014 the date for the withdrawal of the November 8, 1998 staff no-action letter that addresses the net capital treatment of proprietary accounts of introducing broker-dealers.[10]

The Commission is not granting a temporary exemption from the remaining new requirements adopted in Exchange Act Release No. 70072: (1) the requirement in paragraph (j)(1) of Rule 15c3-3; (2) the new requirements in Rule 15c3-1 (other than the requirement in paragraph (c)(2)(iv)(E)(2) of Rule 15c3-1); (3) and the new requirements in Rule 17a-11. Broker-dealers have not identified these requirements as presenting a challenge in terms of achieving compliance by October 21, 2013. In addition, this temporary exemption does not

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8 As adopted paragraph (j)(1) of Rule 15c3-3 incorporates certain requirements from Rule 15c3-2 (customers' free credit balances), including the requirement that broker-dealers inform customers of the amounts due to them and that such amounts are payable on demand. Rule 15c3-2 is being eliminated as a separate rule because it is largely irrelevant in light of the requirements in Rule 15c3-3. See paragraph (j)(1) of Rule 15c3-3, as adopted. See also Financial Responsibility Rules for Broker-Dealers, 78 FR at 51836-51837.

9 As adopted paragraph (c)(2)(iv)(E)(2) of Rule 15c3-1 provides that a broker-dealer need not deduct cash and securities held in a securities account at a carrying broker-dealer except where the account has been subordinated to the claims of creditors of the carrying broker-dealer. See paragraph (c)(2)(iv)(E)(2) of Rule 15c3-1, as adopted. See also Financial Responsibility Rules for Broker-Dealers, 78 FR at 51831-51832.

10 See Letter of Michael A. Macchiaroli, Associate Director, Division of Market Regulation, Commission, to Raymond J. Hennessy, Vice President, NYSE, and Thomas Cassella, Vice President, NASD Regulation, Inc. (Nov. 3, 1998). See also Financial Responsibility Rules for Broker-Dealers, 78 FR at 51828 (directing the staff to withdraw the no-action letter as of the effective date of the amendments).

apply to any other requirements in Rule 15c3-3, Rule 15c3-3a, Rule 17a-3, Rule 17a-4, or Rule 15c3-1.

The effective date is quickly approaching, and granting a limited exemption until March 3, 2014 to broker-dealers from certain new requirements will help to facilitate an orderly implementation of the final rule amendments.

For the foregoing reasons, the Commission finds that this temporary exemption is necessary and appropriate in the public interest, and is consistent with the protection of investors.[11]

II. CONCLUSION

Accordingly, pursuant to Section 36 of the Exchange Act,

IT IS HEREBY ORDERED that broker-dealers are temporarily exempt until March 3, 2014 from the requirements of the following new amendments to the broker-dealer financial responsibility rules adopted in Exchange Act Release No. 70072: (1) Rule 15c3-3, except paragraph (j)(1); (2) Rule 15c3-3a; (3) Rule 17a-3; (4) Rule 17a-4; and (5) paragraph (c)(2)(iv)(E)(2) of Rule 15c3-1.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

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11 Section 36 of the Exchange Act authorizes the Commission, by rule, regulation, or order, to conditionally or unconditionally exempt any person from any rule under the Exchange Act, to the extent that the exemption is necessary or appropriate in the public interest and is consistent with the protection of investors. 15 U.S.C. 78mm.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70716 / October 18, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15575

In the Matter of **JAMES A. PHILBROOK,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934** **AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against James A. Philbrook ("Respondent" or "Philbrook").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Philbrook, 63 years old, is a resident of Manchester, New Hampshire.

2. From October 2002 through December 2006, Philbrook was a registered representative of The O.N. Equity Sales Company, a broker-dealer registered with the Commission. From May 1988 through June 2002, Philbrook was associated, consecutively, with four other firms registered with the Commission as broker-dealers or dually registered with the Commission as broker-dealers and investment advisers.

B. ENTRY OF THE RESPONDENT'S CRIMINAL CONVICTION

3. On November 2, 2012, Philbrook was convicted in Maine Superior Court of one count of theft by misapplication of property, in violation of Title 17-A M.R.S.A. § 358(1)(B)(1), and one count of violating the Maine Uniform Securities Act, in violation of 32 M.R.S.A. §16508, in State of Maine v. James Philbrook, Docket No. HOUSC-CR-2011-00010. The order of judgment and commitment entered against Philbrook sentenced him to a prison term of eight years with all but three years suspended and credit for time served. In addition, the judgment and commitment ordered, among other things, that Philbrook be placed on probation for three years upon completion of the unsuspended term of imprisonment and make restitution in the amount of $195,000.

4. The counts of the criminal indictment pursuant to which Philbrook was convicted alleged, inter alia, that from on or about June 7, 2005 to on or about July 20, 2006, Philbrook, acting intentionally or knowingly and in connection with the offer and sale of a security, obtained money from two individuals. Philbrook misrepresented to the individuals that he intended to make investments on their behalf in a pay-per-view television event and a college-funding business venture, but in fact did not invest their money and instead diverted their money for his own personal use.

5. Philbrook's conviction was for a felony or misdemeanor involving (i) the purchase or sale of a security and (ii) the theft or misappropriation of funds or securities. His misconduct occurred while he was associated with a broker-dealer registered with the Commission.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chair White
Commissioner Gallagher
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9467 / October 18, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3696 / October 18, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30746 / October 18, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15574

In the Matter of **HARDING ADVISORY LLC and WING F. CHAU,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 203(e), 203(f), AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Harding Advisory LLC ("Harding Advisory" and together with its predecessor, "Harding") and Wing F. Chau ("Chau" and together with Harding Advisory, "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. Summary

1. This matter involves violations of the federal securities laws by Harding and its principal Wing F. Chau in their role as investment managers for certain collateralized debt obligation transactions ("CDOs"). As the Collateral Manager of these CDOs, Harding was responsible for the selection, acquisition, and monitoring of portfolios of assets – the collateral – backing tranches of securities issued to investors by special-purpose vehicles (the "Issuers"), including one named Octans I CDO Ltd. ("Octans I").

2. Unbeknownst to investors and in conflict with the marketing materials and offering circular for Octans I, a third party named Magnetar Capital LLC (together with affiliates, "Magnetar") – a hedge fund firm whose interests were not aligned with those of the debt investors in Octans I – had undisclosed rights over the selection of collateral for Octans I. Magnetar's influence led Harding to select assets for Octans I that Harding's own personnel disfavored.

3. The Octans I transaction was a $1.5 billion CDO that closed on September 26, 2006. The collateral for the transaction consisted mostly of credit default swaps ("CDS") referencing subprime residential mortgage-backed securities ("RMBS"),[1] as well as securities of other CDOs backed by RMBS. Octans I was structured and marketed by subsidiaries of Merrill Lynch & Co., Inc. (collectively "Merrill"), which also lent their balance sheet to store, or "warehouse," collateral acquired for Octans I in the months leading up to the closing of the transaction. By April 3, 2008, Octans I had failed, costing the transaction's outside investors approximately $1.1 billion. Harding received approximately $4.5 million in fees for its role in the transaction.

4. The warehouse agreement governing the process of accumulating collateral prior to the closing of the Octans I transaction was actually a three-way agreement among Harding, Merrill, and Magnetar. The agreement gave Magnetar important rights, chief of which was the right to veto Harding's selection of collateral for the Octans I portfolio. Consistent with the agreement, Magnetar exercised significant control over the composition of the portfolio, but this right, among the others granted to Magnetar, was not disclosed to the debt investors in Octans I.

5. The so-called "pitchbook" and offering circular used to market Octans I, the relevant portions of which were drafted or reviewed by Harding, described Harding's credit-selection processes and represented that the collateral would be selected by Harding and housed at Merrill in accordance with a warehouse agreement between Merrill and Harding. These representations were materially misleading because they did not disclose Magnetar's rights in and influence over the collateral selection process.

6. The offering circular and a Collateral Management Agreement with the Octans I Issuer executed by Chau also represented that Harding, in selecting collateral for the CDO, would perform its obligations as collateral manager:

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[1] RMBS are bonds backed by pools of residential mortgage loans, in this case subprime loans. CDS are explained below.

> with reasonable care (i) using a degree of skill and attention no less than that which [Harding] would exercise with respect to comparable assets that it manages for itself and (ii) without limiting the foregoing, in a manner consistent with the customary standards, policies and procedures followed by institutional managers of national standing relating to assets of the nature and character of the [Octans I collateral].

This was a material misrepresentation in that Harding and Chau, as they knew or at least recklessly disregarded, compromised their standards to accommodate trades requested by Magnetar.

7. Harding and Chau also later breached their obligations by purchasing, for inclusion in several other CDOs managed by Harding, tens of millions of dollars' worth of notes from a troubled Magnetar-related CDO underwritten by Merrill known as Norma. Harding and Chau bought the Norma securities despite their basically unfavorable view of them, adding lower-rated notes to their prior Norma commitment only after receiving pressure from Merrill and a direct request from Magnetar. Chau was apparently trying to return a favor and show that he was a "team player" who "never forget[s] my true friends." For each of the CDOs into which Harding placed the Norma notes, the collateral management agreement contained standard of care representations similar to that in the collateral management agreement for Octans I.

8. Harding and Chau committed the breaches described in this Order because they wanted fees that could be earned only if Magnetar agreed to close the Octans I transaction, and because they were seeking to please Merrill and Magnetar. Merrill had arranged the Octans I transaction at the impetus and behest of Magnetar, which, together with Merrill, had selected Harding as the collateral manager. Merrill and Magnetar had sent, and were in a position to continue sending, significant CDO business to Harding. As such, Harding's interests were in keeping Merrill and Magnetar happy, and Harding put those interests ahead of its obligations to the Issuers and their investors.

B. <u>Respondents</u>

9. **Harding Advisory LLC** is a registered investment adviser located in Morristown, New Jersey. Harding's principal and near-100% owner is Wing Chau. Harding was founded in or around July 2006 as the successor to an affiliate of Maxim Group LLC. Harding has been the adviser or sub-adviser to 21 CDOs, including Octans I. At its peak in 2007, Harding had approximately $20 billion in assets under management. Harding remains collateral manager for nine CDOs with total assets of approximately $1 billion.

10. **Wing F. Chau**, age 46 and a resident of Basking Ridge, New Jersey, has served since 2006 as Harding's CEO, Managing Member, and Chief Compliance Officer.

C. <u>Other Relevant Entities</u>

11. **Merrill Lynch, Pierce, Fenner & Smith Incorporated** ("MLPFS"), a registered broker-dealer and investment adviser based in New York, at all relevant times was the principal

U.S. broker-dealer subsidiary of Merrill Lynch & Co., Inc. MLPFS structured and marketed the Octans I transaction, and was one of the leading arrangers of CDOs between 2005 and 2008. Merrill was formerly one of the world's leading investment banks. Merrill was acquired by Bank of America Corporation on January 1, 2009.

12. **Merrill Lynch International**, a Merrill affiliate incorporated under the laws of England, was the warehouse provider for Octans I.

13. **Magnetar Capital LLC** is a hedge fund manager headquartered in Evanston, Illinois. During 2006-07 Magnetar was involved in creating a series of CDOs with Merrill and other arranging banks. These CDOs were typically named after astronomical constellations, and so are sometimes known as "Constellation CDOs."

14. **Octans I CDO Ltd.** was a special-purpose vehicle incorporated in the Cayman Islands.

D. Facts

Background on CDOs and CDS

15. A CDO is a special-purpose vehicle that issues debt to investors and uses the proceeds to invest in fixed income securities or loans. The CDO's debt is issued in different tranches that feature varying levels of risks and returns. The senior tranche is the highest rated, is first in the priority of repayment through what is called the CDO's waterfall and has the lowest risk of default. Because of the lower risk of default and the priority of repayment in the CDO's waterfall, the holders of the senior tranche have lower rates of return. The inverse is true for the lowest-rated tranche in the CDO. Typically, that tranche (usually referred to as "equity") is unrated, has the highest rate of return, is last in terms of the priority of repayment through the CDO's waterfall and has the highest risk of default.

16. A CDS is a type of derivative through which two parties transfer the risk of ownership of a particular reference obligation. The protection buyer ("short") of a CDS pays to purchase protection upon the occurrence of certain events, such as an event of default, failure to pay interest, writedowns or substantial credit ratings downgrade of the reference obligation (collectively, "Credit Events"). The protection seller ("long") sells that protection and assumes the risk of a Credit Event on the reference obligation. In 2006, the protection buyer normally paid the protection seller a premium or spread as part of the CDS.[2] Reference obligations can take many forms but in this case took the form of RMBS or CDOs comprised of them. In essence, a CDS mimics the performance of the referenced asset. Thus, an investor can gain exposure to an asset by entering into a CDS that references the asset, instead of by purchasing the asset itself.

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[2] For example, a protection buyer may agree to pay a protection seller 150 basis points to purchase protection against default on a $10 million of a designated reference obligation, or $150,000 per annum, paid periodically.

17. A CDO can be backed by bonds (a "cash CDO") or by CDS (a "synthetic CDO"). A CDO backed by both bonds and CDS is called a "hybrid CDO." Octans I was a hybrid CDO with approximately 90 percent synthetic assets. Typically, a collateral manager would acquire synthetic collateral by, among other things, sending out BWICs (bids wanted in competition) or responding to OWICs (offers wanted in competition). Generally speaking, BWICs were sent out by a "long" party seeking quotes from potential "short" counterparties on the assets referenced in the BWIC. The winner of a BWIC would be the party that offered to pay the highest premium amount. OWICs were sent out by a "short" party seeking quotes from a potential "long" counterparties on the assets referenced in the OWIC. The winner of an OWIC would be the party willing to accept the lowest premium amount.

Roles of Harding and Merrill

18. As Collateral Manager, Harding's role was to act as investment adviser for Octans I, selecting and managing a portfolio pursuant to a Warehouse Agreement and a Collateral Management Agreement.

19. In general, the collateral manager for a CDO must determine whether a potential asset is appropriate for inclusion in the CDO's portfolio. A CDO transaction may or may not have a collateral manager. However, when a CDO was managed, the manager's independent selection of assets was an important selling point to potential investors, and information on the collateral manager's selection process was included in the marketing materials and offering circular by which the CDO's debt was sold.

20. Octans I was structured and marketed by Merrill, which also acted as the warehouse provider and as the initial counterparty on the CDS collateral that went into the transaction. A warehouse is essentially a segregated account through which the arranging bank finances the acquisition of collateral before the transaction closes. During the warehouse phase, Harding's role was to select collateral that would be held in the warehouse until closing, at which point the collateral would be placed into the Issuer's portfolio.

Origin of Octans I CDO

21. Octans I was a "reverse-inquiry" transaction, meaning that Magnetar approached Merrill to create the deal, as opposed to Merrill having been engaged by an asset manager to create the deal and then seeking out investors to purchase the securities issued in the transaction.

22. In the spring of 2006, Magnetar approached Merrill to arrange a series of CDO transactions. At a meeting in May 2006, a Magnetar representative ("Magnetar Representative") discussed with officials at Merrill, as the Merrill salesperson covering Magnetar ("Merrill Salesperson") later put it in an email, an arrangement whereby Merrill and Magnetar would "pick mutually agreeable [collateral] managers to work with, Magnetar plays a significant role in the structure and composition of the portfolio . . . and in return [Magnetar] retain[s] the equity class and [Merrill] distribute[s] the debt."

23. The equity piece of a CDO transaction was typically the hardest to sell and therefore the greatest impediment to closing a CDO. Magnetar's willingness to buy the equity in a series of CDOs, including Octans I, therefore gave it substantial leverage in the assembly of these transactions.

24. Magnetar and Merrill jointly agreed on Harding as the collateral manager for Octans I. On or about May 26, 2006, Merrill, Harding, and Magnetar entered into an Engagement Letter that assigned the parties roles in the transaction. The agreement contemplated that Magnetar would purchase the equity piece of the transaction. Chau executed the Engagement Letter on behalf of Harding.

25. Chau understood that Magnetar was interested in investing as the equity buyer in a series of potential CDO transactions. Chau also understood that Magnetar's strategy included "hedging" its equity positions in CDOs, potentially by taking short positions on RMBS or certain tranches of CDOs, including the CDOs it was investing in. Chau therefore understood that, because Magnetar stood to profit if the CDOs failed to perform, Magnetar's interests were not aligned with those of potential investors in the debt tranches of Octans I, whose investment depended solely on the CDO performing well.

26. Octans I was the seventh CDO arranged by Merrill for which Harding became collateral manager. Over the course of the year following this Engagement Letter, Harding was selected as collateral manager for four more CDOs arranged by Merrill, as well as three other Constellation CDOs.

<u>The Three-Way Warehouse Agreement</u>

27. On or about May 26, 2006, Merrill, Harding, and Magnetar also entered into a Warehouse Agreement to govern the acquisition of collateral for the Octans I portfolio. Chau executed the Warehouse Agreement on behalf of Harding. The agreement gave Magnetar the right to receive 85% of the "carry" (essentially, the returns on the assets during the time they were warehoused) in exchange for taking 85% of the risk on the warehouse. Harding had never managed, nor had Merrill ever arranged, a CDO with a tri-party warehouse agreement prior to Octans I.

28. The Warehouse Agreement also gave Magnetar a series of rights over the collateral selection process, including:

- the right to veto collateral selected by Harding prior to purchase for the warehouse;
- the right to mutually agree with Merrill and Harding on the price to be paid for collateral selected for the warehouse; and
- the right to veto a designation by Merrill of any warehoused collateral as "Ineligible" for the Issuer's portfolio because Harding or Merrill has determined that the collateral no longer satisfies certain criteria.

29. Chau understood that granting a veto right relating to collateral selection to a third party like Magnetar would cede some of the collateral manager's authority and impair its independence.

30. Harding, Merrill, and Magnetar were in close contact as Harding accumulated collateral for the Octans I portfolio. On the morning of May 30, 2006, a Harding vice president ("Harding VP") emailed the Magnetar Representative, copying Chau and a senior manager at Harding ("Senior Manager"):

> Now that we have the documents signed up, we just wanted to touch base with you regarding process. It sounds like you want us to send you a copy of our bid lists for your review prior to sending it to the street. If so, should we send the lists to you or to someone else at Magnetar?
>
> Please let me know how you would like this to work.

The Magnetar Representative responded, copying Chau and the Senior Manager: "Yes . . . . Please send the lists to me. Also, would like to talk frequently so I'm up to date on your plan of action, how things are going, etc."

31. Harding complied, typically sending bid lists to Magnetar before circulating them to the market, and, at times with Merrill, seeking Magnetar's approval before collateral was added to the Octans I warehouse.

<u>The ABX Trade</u>

Harding Agrees to Magnetar's Request

32. Magnetar was seeking, for reasons related to its own CDO investment strategy, to have the Constellation CDOs, including Octans I, acquire exposure to the RMBS bonds referenced in an investment product known as the ABX Index.

33. Launched in January 2006, the ABX Index was a standardized CDS referencing a benchmark basket of 20 RMBS. The ABX Index was available at various levels of credit rating. The relevant levels in this case were BBB and BBB-. New ABX Indices became available twice per year, and in each case referenced RMBS issued in the preceding six months. Thus, for example, ABX 2006-1 referenced a basket of 20 RMBS issued in the second half of 2005.

34. In late May 2006, Magnetar had discussions, first with Merrill and then with Chau and others at Harding, about acquiring exposure to the ABX Index at the BBB (Baa2) or BBB- (Baa3) levels for the Octans I warehouse. However, the Collateral Manager might not regard all of the bonds in the ABX index as acceptable. The parties therefore discussed having the Octans I warehouse first buy the index in a block and then exclude (via offsetting "short" positions on individual RMBS bonds) those bonds that Harding disfavored.

35. Harding agreed to the concepts of acquiring exposure to the ABX Index and of excluding from that exposure selected bonds. In a three-way telephone conversation on the

afternoon of May 30, 2006, Magnetar and Merrill asked the Harding Senior Manager which RMBS bonds Harding wanted to exclude from the index. The Senior Manager said Harding would report back. After the call, the Merrill Salesperson promised the Magnetar Representative in an email: "We'll push to get names [i.e. RMBS bonds] they [i.e. Harding] have issue with [i.e. want excluded from the index exposure] tomorrow am."

36. Shortly after the telephone call, the Harding VP, apparently unaware of the agreement on the ABX trade, sent the Magnetar Representative, with a copy to a distribution list of Harding's CDO professionals, including Chau ("Group List"), "a list of names we'd like to circulate [i.e. to collect bids on in the marketplace for ultimate inclusion in the CDO] first thing tomorrow morning. We have not shown these to Merrill yet. Please let us know what you think." The Magnetar Representative replied to the Harding VP: "Great, these look fine," and then later that evening sent the Harding VP another email, copying Chau and the Harding Senior Manager: "Noticed some index bonds in the list . . . . We're going to do a big block trade of the index names, so please leave them off of any other lists you do."

37. In other words, the Magnetar Representative asked Harding not to acquire exposure to any constituent bonds of the index via the usual BWIC process because a separate block index trade was planned. The Harding VP agreed to comply in an email to the Magnetar Representative copied to the Harding Senior Manager and Chau. And Harding in fact complied with Magnetar's directions as to how to acquire collateral for the CDO, stripping the index bonds from a bid list that Harding sent to Merrill on May 31.

Harding's Selections

38. Shortly after the three-way telephone call on the afternoon of May 30, the Senior Manager sent a list of the ABX Index bonds to a credit analyst at Harding ("Analyst 1"), apparently so Harding's credit team could identify constituents of the ABX Index to which Octans I should not be exposed. The Harding Senior Manager was aware that Magnetar would have preferred that Harding exclude as few bonds as possible.

39. On the morning of May 31, 2006, even as the credit team was beginning its analysis of the ABX Index bonds, the Magnetar Representative continued to press Harding for the list of ABX Index bonds that Harding would exclude from the block index exposure. At or about 9:40 a.m., he emailed the Senior Manager, copying Chau: "you have abx names that you want out [i.e. excluded from the index], ready to trade?" In emails later that morning to the Harding Senior Manager, VP, and Chau, the Magnetar Representative followed up: "For our block index trade, u guys were going to let us know if there were any of the 20 index names you wanted to exclude, we had a call w [the Senior Manager] and [a Merrill trader] last nite." The Senior Manager replied, copying Chau and the Harding VP: "Yes, we should have these names to you and [the Merrill trader] soon. Wing and I just got back from a meeting away from the office this morning."

40. At or about 4:22 p.m. on May 31, Analyst 1 sent the Senior Manager an email titled "ABX Index Rejections." Attached to the email was a list of 12 bonds in the ABX Index. Four were at the BBB (Baa2) level; eight were at the BBB- (Baa3) level. This was the list for

which Magnetar had been pressing Harding. Over the next week, Merrill, Magnetar, and Harding worked together to acquire, for the Octans I portfolio, $300 million worth of block exposure to the ABX Index at the combined BBB (Baa2) and BBB- (Baa3) levels. The twelve bonds identified as "Index Rejections" were then excluded from the index exposure (which included 40 bonds – 20 at each of the two rating levels), such that the Octans I portfolio was left with approximately $220 million worth of long exposure to 28 bonds. In selecting twelve bonds to *ex*clude from the index, therefore, Harding also effectively selected 28 index bonds for *in*clusion in Octans I (the "Accepted Index Bonds").

Harding's Negative Analysis of the Selected Credits

41. Harding's internal communications indicate that many of the 28 Accepted Index Bonds were disfavored within Harding and would likely not have been included in the Octans I portfolio but for Magnetar's desire to have the portfolio exposed to the ABX Index, and Harding's desire to please Magnetar.

42. At approximately 2 p.m. on May 31, a Harding trader sent an email to Harding's Group List: "Here is an OWIC due at 4PM today. Maybe we can see if there are any names we've done the work on already to see if there is a fit for us." The list of bonds attached to this email happened to be the same 40 bonds in the ABX Index at the BBB (Baa2) and BBB- (Baa3) levels. At or about 2:17 p.m., a Harding credit analyst ("Analyst 2") asked a junior colleague to update Harding's credit files on some of the 40 bonds. The junior colleague sent his results at 2:28 p.m. to Analysts 1 and 2.

43. At or about 2:49 p.m., Analyst 1 wrote to the trader and the Group List (emphasis added): "Out of the 40 bonds in this list, we have already looked at 29 bonds. Out of those, 10 have been approved, and *19 have been rejected*. These are the approved deals: [listing bonds]."

44. At or about 3:04 p.m., Analyst 2 wrote to the trader and the Group List: "here's the results for the 4 pm owic. Attached are the 40 bonds. [T]here is a correction. We are not okay on the MABS deal [i.e. an RMBS named MABS]. Some we have already seen as [Analyst 1] mentioned below." The attached spreadsheet had a "Y" (signifying that Harding's credit team approved the bond) next to 15 of the bonds, and a "N" (signifying that Harding's credit team rejected the bond) next to the other 25 bonds, including the "MABS" RMBS at both rating levels.

45. As noted above, however, the email from Analyst 1 at 4:22 p.m. reflected the selection of the 28 Accepted Index Bonds to which the Octans I portfolio ultimately became exposed. Those 28 accepted bonds included all of the 15 bonds marked "Y" at 3:04 p.m., and another 13 bonds that had been marked "N" in that email (including the "MABS" bonds). The 28 acceptances and 12 exclusions, moreover, changed from the 2:49 p.m. email in which Analyst 1 noted that previously "10 have been approved, and 19 have been rejected."

46. There is no contemporaneous record of Harding's reasons for accepting many of these bonds. The only relevant credit work on May 31 of which there is any record (apart from

what is reviewed above) was circulated to Analyst 1 at or about 1:12 p.m., and it was largely negative. For most of the bonds analyzed (which included ten of the 13 bonds that Analyst 2 had marked "N"), the credit analysis indicated substantial write-downs.

47. Subsequent communications confirm that Harding compromised, allowing into the Octans I portfolio bonds that it would have been unlikely to select but for Magnetar's desire for ABX Index bonds.

48. On the morning of June 1, 2006, the Harding VP wrote to Chau and the Senior Manager: "I don't think we can do [$]15[million] of each name even if we do a 1.5B deal since we are buying 2 classes of each issue" – i.e. each index bond at the Baa2 and Baa3 levels – "and the 1% limit applies to the issue. Most we can do is probably 7.5M." The Senior Manager replied to the Harding VP and Chau (emphasis added): "That's correct and we should push them to short [i.e. cause the Octans I portfolio to go long] the Baa2's since *we are less comfortable with some of these index names at the Baa3 level.*"

49. Later that morning the Harding Senior Manager sent the Magnetar Representative an email titled "Index names" in which he wrote: "Sent [Merrill] the list yesterday. Don't know if you've got it, so here it is again" – listing the Accepted Index Bonds. The Senior Manager continued (emphasis added): "We can do $15mm each issuer (Baa2 and Baa3 together) *and prefer the Baa2's.*"

50. In other words, Harding disfavored some of the Baa3 assets within the set of Accepted Index Bonds but either was not fully in control of, or was willing to leave to others, how much exposure the portfolio gained to the Approved Index Bonds at the two different rating levels.

"Lesser of Evils"

51. Octans I was not the only Constellation CDO for which Harding accepted index bonds seemingly disfavored by its credit team. Harding later executed ABX Index trades for different Constellation CDOs for which it served as collateral manager. In late August 2006 Analysts 1 and 2 debated whether certain index bonds should be internally marked as a "N" or a "Y" on Harding's central bid lists. The analysts did not approve of the bonds but apparently had been pressured by Harding's portfolio managers to accept them in connection with ABX Index trades for a Constellation CDO. Analyst 2 wrote of one bond (emphasis added): "due to the fact *we had to pick the lesser of evils when we were looking at the index* we said 'Y.' . . . . I would stick to the 'N' and note that we are a 'Y' if it were an index trade. Can we do this? Too complicated?"

52. Analyst 1 agreed with Analyst 2's suggestion, and several days later, Analyst 2 suggested doing the same with a different index bond (emphases added): "We had it on the index for a 'Maybe' because *we knew we had to pick the less worse*. So let's . . . [s]witch it back to a 'N' and make a comment noting that we did *not* short it for the index trade."

53. In September 2006, after receiving information about ABX Index trades done for a third Constellation CDO, Analyst 1 wrote to a Harding trader, copying Analyst 2: "Not as bad as I thought. 2 rejected bonds traded with [the Magnetar Representative] from the index. . . . [T]o the extent that you can control it, please refrain from letting any index trades happen for [the third Constellation CDO and another CDO underwritten by Merrill]."

Misrepresentations and Omissions Regarding Collateral Selection for Octans I

54. Magnetar's rights regarding, and role in, the selection of collateral for Octans I were not disclosed.

55. The pitchbook used to solicit investors in the transaction, the relevant portions of which were drafted by Harding and had been reviewed by Chau, described Harding's investment approach and credit processes, but said nothing about Magnetar's control rights and actual influence over the Octans I portfolio.

56. Similarly, the offering circular, which Harding had reviewed, represented that the collateral acquired by the Issuer from the warehouse on closing was "selected by [Harding] and held by [Merrill] pursuant to warehousing agreements between [Merrill] and [Harding]." This disclosure omitted any mention of Magnetar's involvement in the warehouse phase. Harding and Chau knew or were reckless in not knowing of this representation and the reasons why it was false or misleading. Harding and Chau failed to ensure the accurate disclosure of Magnetar's warehouse rights.

57. In the Collateral Management Agreement (CMA), which Chau executed at closing on behalf of Harding, Harding represented to the Issuer that Harding in relevant part would "perform its obligations hereunder (including with respect to any exercise of discretion) with reasonable care (i) using a degree of skill and attention no less than that which [Harding] would exercise with respect to comparable assets that it manages for itself and (ii) without limiting the foregoing, in a manner consistent with customary standards, policies and procedures followed by institutional managers of national standing relating to assets of the nature and character of the Collateral." In the CMA, Harding further represented as relevant here that all collateral acquired on closing – that is, the warehoused collateral – would satisfy the applicable terms and conditions of the CMA.

58. The offering circular described the CMA, and repeated the standard of care representation quoted above. These representations to the Issuer and investors were materially false or misleading in that Chau and Harding, in order to accommodate Magnetar's preferences, caused Octans I to acquire collateral that Harding's personnel disfavored. Harding and Chau knew the standard of care representation in the CMA and knew or were reckless in not knowing that it was repeated in the offering circular and was false or misleading.

59. These misrepresentations and omissions were material. Investors in the securities of Octans I would have considered it important that an undisclosed party with interests not aligned with those of the other investors had influence over or rights regarding collateral selection.

The Norma Purchases

60. In January 2007, Merrill was in the process of marketing a Constellation CDO known as Norma. On January 9, Chau, after reviewing information about Norma, wrote to a Merrill salesperson: "Turbo structure is very weak."[3] On January 16, 2007, Merrill's head of CDO syndication ("Syndicate Head") asked Chau in an electronic conversation: "ready to talk about your participation [in the Norma offering]?" Harding then requested from Merrill certain information about the loan pools backing the RMBS referenced in the Norma portfolio.

61. On January 19, 2007, after further conversation with Merrill's sales staff, Chau and Harding agreed to purchase $40 million worth of Norma's A-rated tranche for several CDOs managed by Harding.

62. Chau at first did not agree to buy Norma's lower-rated tranches. But on January 23, the Magnetar Representative emailed Chau with the subject heading "Pls buy some norma bbb." The email continued: "Stop complaining about turbo. :) Remember who was there for u when u were a little guy." Shortly afterwards, Chau wrote: "Did ML tell u I am in for 40mm single-As in Norma – team player!!!"

63. Also on January 23, the Syndicate Head wrote to Chau: "what's your level" – i.e. what coupon rate would make the bond acceptable – "on BBB or BBB- if we can't change the turbo?" Chau responded: "ah-so . . . let me sharpen the pencil," to which the Syndicate Head replied: "sweet."

64. The next day, the Syndicate Head asked Chau if he had "'sharpened your pencil' on norma BBBs yet?" Chau replied: "I never forget my true friends," and subsequently agreed to acquire, at an improved coupon rate, $20 million worth of the Norma BBB notes.

65. When a Merrill sales representative later asked Chau if he had heard the news that Merrill had decreased Harding's allocation of the Norma BBBs from $20 million to $15 million, Chau replied: "Now that's what I'm talking about, the love is in the air" – further suggesting that he had not wanted to purchase those notes in the first place.

66. Although Harding's orders for Norma were placed in January 2007, Norma itself did not close, and its securities were not available for purchase, until March 1. Shortly before Norma's close, an analyst circulated within Harding, including to Chau, a highly critical credit report. The commentary noted that "[t]here's quite a large percentage of deals [i.e. RMBS to which the Norma portfolio was exposed] failing surveillance tests, on the watchlist and on the do not buy list. Also, there is almost 15% exposure to [two RMBS sponsors generally disfavored within Harding.]"

[3] "Turbo" is a feature in a CDO structure that, when triggered, diverts excess cash flow to pay down principal on the notes of certain debt tranches.

67. Harding nevertheless proceeded with the Norma purchases, placing the notes into the portfolios of several CDOs it managed.

68. For each of those CDOs, Chau, on behalf of Harding, executed Collateral Management Agreements containing standard of care provisions similar to the one in the Octans I CMA. In each case, the offering circular for the transaction described the CMA and the standard of care set forth within it.

69. Harding and Chau breached their advisory obligations to those Issuers. Without disclosure, they put their desire to please Merrill and Magnetar – which by January 2007 were together responsible for tens of millions of dollars of revenue for Harding – ahead of the best interests of the portfolio, which they knew were not served by the Norma bonds.

E. Violations

70. As a result of the conduct described above, Respondents willfully violated Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer and sale of securities.

71. As a result of the conduct described above, Chau willfully aided and abetted and caused Harding Advisory's violations of Section 17(a) of the Securities Act.

72. As a result of the conduct described above, Respondents willfully violated Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser.

73. As a result of the conduct described above, Chau willfully aided and abetted and caused Harding Advisory's violations of Sections 206(1) and 206(2) of the Advisers Act.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Sections 203(e) and 203(f) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Sections 203(i) and 203(j) of the Advisers Act;

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Sections 9(d) and 9(e) of the Investment Company Act; and

D. Whether, pursuant to Section 8A of the Securities Act and Section 203(k) of the Advisers Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 206(1) and (2) of the Advisers Act and Section 17(a) of the Securities Act; and whether Respondents should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act and Section 203(k)(5) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

October 21, 2013

In the Matter of **High End Ventures, Inc.,** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of High End Ventures, Inc. because it has not filed any periodic reports since the period ended June 30, 2009.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on October 21, 2013, through 11:59 p.m. EDT on November 1, 2013.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70724 / October 21, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15577

In the Matter of **High End Ventures, Inc.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against the Respondent named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. High End Ventures, Inc. ("HEVE")[1] (CIK No. 1357694) is a delinquent Colorado corporation located in Zollikon, Switzerland with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). HEVE is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2009, which reported a net loss of $80,580 for the prior nine months. As of October 16, 2013, the common stock of HEVE was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Group Inc., had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, has repeatedly failed to meet its obligations to file timely periodic

[1] The short form of the issuer's name is also its ticker symbol.

reports and failed to bring its filings current in response to the delinquency letter sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations.

3. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

4. As a result of the foregoing, the Respondent failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondent an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondent identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that the Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If the Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon the Respondent personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70722 / October 21, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15576

In the Matter of Newtech Resources Ltd., Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against the Respondent named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Newtech Resources Ltd. ("NTHR")[1] (CIK No. 1080001) is a revoked Nevada corporation located in Zollikon, Switzerland with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). NTHR is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended May 31, 2009, which reported a net loss of $67,409 for the prior nine months. As of October 16, 2013, the common stock of NTHR was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Group Inc., had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

[1] The short form of the issuer's name is also its ticker symbol.

B. DELINQUENT PERIODIC FILINGS

2. As discussed in more detail above, the Respondent is delinquent in its periodic filings with the Commission, has repeatedly failed to meet its obligations to file timely periodic reports and failed to bring its filings current in response to the delinquency letter sent to it by the Division of Corporation Finance requesting compliance with its periodic filing obligations.

3. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

4. As a result of the foregoing, the Respondent failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondent an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondent identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that the Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If the Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of the Respondent, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon the Respondent personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

October 21, 2013

In the Matter of **Newtech Resources Ltd.,** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Newtech Resources Ltd. because it has not filed any periodic reports since the period ended May 31, 2009.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on October 21, 2013, through 11:59 p.m. EDT on November 1, 2013.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70727 / October 21, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15578

In the Matter of

Peter C. Orthos,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Peter C. Orthos ("Orthos" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Orthos, 46 years old, resides in Manhasset, New York. From April 1994 through April 2008, Orthos was a registered representative associated with Joseph Stevens & Company, Inc., a broker-dealer registered with the Commission.

2. On July 29, 2011, Orthos was convicted by guilty plea of three counts of engaging in a Securities Fraud Scheme in violation of New York General Business Law 0352-c(5), one count of Grand Larceny in the Second Degree in violation of New York Penal Law Section 155.40(1), and two counts of Grand Larceny in the Third Degree in violation of New York Penal Law 155.35, before the Supreme Court of the State of New York, in People of New York v. Joseph Stevens & Company, Inc., Case Number 02394-2009. On November 18, 2011, Orthos was sentenced to five years' probation and ordered to make restitution in the amount of $397,721.

3. The counts of the indictment to which Orthos pleaded guilty alleged, inter alia, that from in or about January 2001 to in or about September 2005, Orthos participated in a scheme to defraud investors that resulted in excessive and undisclosed commissions in stocks.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3697 / October 21, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15579

In the Matter of **STEPHEN E. GAGNON,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940** **AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Stephen E. Gagnon ("Respondent" or "Gagnon").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Gagnon, age 47, is a resident of Riverside, Rhode Island.

2. From August 2010 through March 2013, Gagnon was associated with CCO Investment Services Corp. ("CCO"), an investment adviser and broker-dealer registered with the Commission. From January 1996 through August 2010, Gagnon was associated, successively, with five other entities dually registered with the Commission as broker-dealers and investment advisers including, from January 2006 to July 2009, LPL Financial Corporation ("LPL"), and, from July 2001 to January 2006, Commonwealth Financial Network ("Commonwealth Financial"). Prior to that, Gagnon was associated with broker-dealers registered with the Commission from November 1994 through December 1995 and from December 1989 through March 1990. Gagnon was also

associated, at separate times during the period April 2002 through October 2006, with two investment advisers registered with the state of Rhode Island.

B. ENTRY OF THE FINAL STATE ORDER

2. On March 25, 2013, the Rhode Island Department of Business Regulation, an agency which, among other things, performs similar functions to a state securities commission, entered a consent order entitled *In the Matter of Stephen E. Gagnon*, DBR No. 125C086 ("Rhode Island Order") against Gagnon. The Rhode Island Order found that Gagnon violated, among others, the anti-fraud provisions of Rhode Island's securities laws and certain Rhode Island laws concerning insurance producers. The Rhode Island Order, among other things, required Gagnon to cease and desist from any further violations of those laws, revoked Gagnon's investment adviser representative and insurance producer licenses, and stated that Gagnon shall have the right to apply for re-registration as a broker-dealer, sales representative, insurance producer, investment adviser, and/or investment adviser representative in the state of Rhode Island after ten years.

3. According to the Rhode Island Order, Gagnon admitted to the following facts: In April 2011, a CCO customer who in April 2004 had purchased a variable annuity sold by Gagnon when he was associated with Commonwealth Financial complained to the Rhode Island Department of Business Regulation's Division of Securities. The customer's complaint alleged that in July 2007, Gagnon, while associated with LPL, convinced her to terminate the original variable annuity and replace it with two other variable annuities that were, among other things, inappropriate investments for someone of her age. The customer further alleged that she was subjected to charges in excess of $18,000 for termination of the original variable annuity. The customer further alleged that a signature in her name, dated July 16, 2007, which appeared on the client signature line of a disclosure document required by LPL for annuity replacements, was not in fact her signature. Gagnon's name and an illegible signature, also dated July 16, 2007, appeared on the branch manager lines of the same disclosure document. Gagnon agreed to enter into the Order without contesting the allegations and before any evidentiary hearing.

4. The Rhode Island Order constitutes a final order of a state securities commission (or agency or officer performing like functions) that (i) is based on violations of laws or regulations that prohibit fraudulent, manipulative, or deceptive conduct and/or (ii) imposes a bar from association with an entity regulated by such state securities commission or from engaging in the business of securities or insurance.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER OF THE CURRENCY
[Docket ID OCC-2013-0014]

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
[Docket No. OP-1465]

FEDERAL DEPOSIT INSURANCE CORPORATION

NATIONAL CREDIT UNION ADMINISTRATION

BUREAU OF CONSUMER FINANCIAL PROTECTION
[Docket No. CFPB-2013-0029]

SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-70731; File No. S7-08-13]

PROPOSED INTERAGENCY POLICY STATEMENT ESTABLISHING JOINT STANDARDS FOR ASSESSING THE DIVERSITY POLICIES AND PRACTICES OF ENTITIES REGULATED BY THE AGENCIES AND REQUEST FOR COMMENT

AGENCIES: Office of the Comptroller of the Currency ("OCC"); Board of Governors of the Federal Reserve System ("Board"); Federal Deposit Insurance Corporation ("FDIC"); National Credit Union Administration ("NCUA"); Bureau of Consumer Financial Protection ("CFPB"); and Securities and Exchange Commission ("SEC").

ACTION: Notice of proposed interagency policy statement with request for public comment.

SUMMARY: The OCC, Board, FDIC, NCUA, CFPB, and SEC (each an "Agency" and collectively, the "Agencies") are proposing joint standards for assessing the diversity policies and practices of the entities they regulate. Section 342 of the Dodd-Frank Wall

Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act")[1] directed the establishment of an Office of Minority and Women Inclusion ("OMWI Office") in each Agency. Each OMWI Office is headed by a Director and is responsible for all Agency matters relating to diversity in management, employment, and business activities. Section 342(b)(2)(C) directs each Agency's OMWI Director to develop standards for assessing the diversity policies and practices of entities regulated by that Agency. This proposed interagency policy statement ("Statement") identifies these proposed standards and requests comment on all aspects of this Statement.

DATES: Comments must be received on or before [INSERT 60 DAYS FROM DATE OF PUBLICATION IN FEDERAL REGISTER].

ADDRESSES: Interested parties are encouraged to submit written comments to any of the Agencies listed below. To avoid duplication, the Agencies request that commenters not submit the same comment to more than one Agency. The Agencies will share comments with each other, as appropriate.

<u>OCC</u>: Because paper mail in the Washington, DC area and at the OCC is subject to delay, commenters are encouraged to submit comments by e-mail, if possible. Please use the title "Proposed Interagency Policy Statement Establishing Joint Standards For Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies and Request for Comment" to facilitate the organization and distribution of the comments. You may submit comments by any of the following methods:

[1] Pub. L. 111-203, 124 Stat. 1376, 1541 (July 11, 2010), codified as 12 U.S.C. 5452.

- E-mail: regs.comments@occ.treas.gov.
- Mail: Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency, Mail Stop 9W-11, 400 7th Street, SW., Washington, DC 20219.
- Fax: (571) 465-4326.
- Hand Delivery/Courier: 400 7th Street, SW., Washington, DC 20219

Instructions: You must include "OCC" as the agency name and "Docket ID OCC-2013-0014" in your comment. In general, the OCC will enter all comments received into the docket and publish them on the Regulations.gov Web site without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments that pertain to this notice by:

Viewing Comments Personally: You may personally inspect and photocopy comments at the OCC, 400 7th Street, SW., Washington, DC. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 649-6700. Upon arrival, visitors will be required to present valid government-issued photo identification and to submit to security screening in order to inspect and photocopy comments.

Board: You may submit written comments, identified by Docket No. OP-1465, by any of the following methods:

- Agency Web Site: http://www.federalreserve.gov. Follow the instructions for submitting comments at http://www.federalreserve.gov/apps/foia/proposedregs.aspx.
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- Email: regs.comments@federalreserve.gov. Include the docket number in the subject line of the message.
- Fax: (202) 452-3819 or 202-452-3102.
- Mail: Address to Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW., Washington, DC 20551.

Please send comments by one method only.

All public comments will be made available on the Board's Web site at http://www.federalreserve.gov/apps/foia/proposedregs.aspx as submitted, unless modified for technical reasons. Accordingly, comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, NW.) between 9:00 a.m. and 5:00 p.m. on weekdays.

FDIC: You may submit comments by any of the following methods:

- FDIC Web Site: http://www.fdic.gov/regulations/laws/federal/purpose.html. Follow instructions for submitting comments on the agency Web site.
- FDIC Email: Comments@fdic.gov. Include "Comments" on the subject line of the message.
- FDIC Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.
- Hand Delivery to FDIC: Comments may be hand-delivered to the guard station at the rear of the building at 550 17th Street (located on F Street), Washington, DC, on business days between 7:00 a.m. and 5:00 p.m.

Please note: All comments received will be posted generally without change to http://www.fdic.gov/regulations/laws/federal/propose.html, including any personal information provided.

Please include your name, affiliation, address, email address and telephone number(s) in your comment. Where appropriate, comments should include a short Executive Summary (no more than five single-spaced pages). All statements received, including attachments and other supporting materials, are part of the public record and subject to public disclosure. You should submit only information that you wish to make available publicly.

NCUA: You may submit comments by any one of the following methods (please send comments by one method only):

- Federal rulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- NCUA Web site: http://www.ncua.gov/Legal/Regs/Pages/PropRegs.aspx. Follow the instructions for submitting comments.
- E-mail: Address to regcomments@ncua.gov. Include "[Your name] – Comments on Proposed Interagency Policy Statement Establishing Joint Standards For Assessing the Diversity Policies and Practices of Regulated Entities" in the e-mail subject line.
- Fax: (703) 518-6319. Use the subject line described above for e-mail.
- Mail: Address to Gerard Poliquin, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.
- Hand Delivery/Courier: Same as mail address.

Public Inspection: You can view all public comments on NCUA's Web site at http://www.ncua.gov/Legal/Regs/Pages/PropRegs.aspx as submitted, except for those we cannot post for technical reasons. NCUA will not edit or remove any identifying or contact information from the public comments submitted. You may inspect paper copies of comments in NCUA's law library at 1775 Duke Street, Alexandria, Virginia 22314, by appointment weekdays between 9:00 a.m. and 3:00 p.m. To make an appointment, call (703) 518–6546 or send an e-mail to OGCMail@ncua.gov.

CFPB: You may submit comments, identified by Docket No. CFPB-2013-0029, by any of the following methods:

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

- Mail/Hand Delivery/Courier: Monica Jackson, Office of the Executive Secretary, Bureau of Consumer Financial Protection, 1700 G Street, NW., Washington, DC 20552.

Instructions: All submissions must include the Agency name and docket number. In general, all comments received will be posted without change to http://www.regulations.gov. In addition, comments will be available for public inspection and copying at 1700 G Street, NW., Washington, DC 20552, on official business days between the hours of 10:00 a.m. and 5:00 p.m. Eastern Time. You can make an appointment to inspect the documents by telephoning (202) 435-7275. All comments, including attachments and other supporting materials, will become part of the public record and subject to public disclosure. Sensitive personal information, such as account numbers or social security numbers, should not be included. Comments will not be edited to remove any identifying or contact information.

SEC: Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov);
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-08-13 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.
- All submissions should refer to File Number S7-08-13. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov). Comments also are available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT:

OCC: Joyce Cofield, Executive Director, Office of Minority and Women Inclusion, at (202) 649-6460 or Karen McSweeney, Senior Attorney, Law Department, at (202) 649-6295, Office of the Comptroller of the Currency, 400 7th Street, SW., Washington, DC 20219.

BOARD: Sheila Clark, Director, Office of Diversity and Inclusion, at (202) 452-2883; or Katherine Wheatley, Associate General Counsel, Legal Division, at (202) 452-3779.

FDIC: Melodee Brooks, Senior Deputy Director, Office of Minority and Women Inclusion, (703) 562-6090; Henry R.F. Griffin, Assistant General Counsel, (703) 562-6404; or Michelle M. Borzillo, Senior Counsel, (703) 562-6083; or Robert Lee, Counsel, (703) 562-2020, Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429-0002.

NCUA: Tawana James, Director, Office of Minority and Women Inclusion, at (703) 518-1650, or Cynthia Vaughn, Diversity Outreach Program Analyst, Office of Minority and Women Inclusion, at (703) 518-1653, or Steven W. Widerman, Senior Staff Attorney, Office of General Counsel, at (703) 518-6540.

CFPB: Stuart Ishimaru, Director, Office of Minority and Women Inclusion, at (202) 435-9012, or To-Quyen Truong, Deputy General Counsel, Legal Division at (202) 435-7434, Bureau of Consumer Financial Protection, 1700 G Street, NW., Washington, DC 20552.

SEC: Pamela A. Gibbs, Director, Office of Minority and Women Inclusion, (202) 551-6046, or Tracey L. McNeil, Counsel, Office of Minority and Women Inclusion, (202) 551-3392, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. Background

Each Office of Minority and Women Inclusion (OMWI) is headed by a Director who is responsible for Agency matters relating to diversity in management, employment, and business activities. Section 342(b)(2)(C) requires each Agency's OMWI Director to develop standards for "assessing the diversity policies and practices of entities regulated by the agency." Such standards take into account section 342(b)(4), which states that nothing in section 342(b)(2)(C) "may be construed to mandate any requirement on or otherwise affect the lending policies and practices of any regulated entity, or to require any specific action based on the findings of the assessment."

The Agencies believe that a goal of section 342 is to promote transparency and awareness of diversity policies and practices within the entities regulated by the Agencies. The establishment of standards will provide guidance to the regulated entities and the public for assessing the diversity policies and practices of regulated entities. In addition, by facilitating greater awareness and transparency of the diversity policies and practices of regulated entities, the standards will provide the public a greater ability to assess diversity policies and practices of regulated entities. The Agencies recognize that greater diversity and inclusion promotes stronger, more effective, and more innovative businesses, as well as opportunities to serve a wider range of customers.

The Agencies believe that the term "assessment" encompasses many different types of assessments including self-assessment and provides an opportunity for the Agencies and the public to understand the diversity policies and practices of regulated entities. The assessment envisioned by the Agencies is not one of a traditional examination or other supervisory assessment. Thus, the Agencies will not use the examination or supervision process in connection with these proposed standards.

The Agencies are cognizant that regulated entities (a) with 100 or more employees; or (b) who are federal contractors with 50 or more employees and are prime contractors or first-tier subcontractors, with contracts of $50,000 or more are required to file an Employer Information Report EEO-1 ("EEO-1 Report") with the Equal Employment Opportunity Commission. These reports contain data on the employment diversity at these regulated entities, and should assist the regulated entities in assessing their diversity policies and practices. We encourage regulated entities that are not required to file EEO-1 Reports to monitor and assess their diversity policies and practices and to use the proposed standards as a guide.

The OMWI Directors have worked together to develop a set of proposed standards for assessing the diversity policies and practices of entities regulated by the Agencies. In developing these standards, the Agencies took into account individual entities' circumstances (for example, asset size of the entity, number of employees, governance structure, income, number of members and/or customers, contract volume, geographic location, and community characteristics). We seek comments specifically on how we might better take into account individual entities' circumstances, especially for small regulated entities.

II. The Development of Proposed Joint Standards

During 2012, to encourage input and to learn more about diversity policies and practices, the OMWI Directors and staff held a series of roundtable discussions and teleconferences across the country with representatives of depository institutions, holding companies, credit unions, and industry trade groups. These outreach efforts served as an opportunity for regulated entities to provide input on assessment standards and for the Agencies to learn about the challenges and successes of current diversity programs and policies.

The OMWI Directors also held roundtable discussions with members of groups representing financial services professionals, communities, and consumer advocates. These meetings provided the Agencies with a greater understanding of the issues facing minorities and women with respect to employment and business contracting opportunities within the financial services industry.

Based on feedback received from the outreach sessions, the Agencies together have drafted proposed standards for assessing the diversity policies and practices of the entities regulated by the Agencies. These proposed standards address a regulated entity's employment practices and its business practices with regard to the procurement of goods and services.

The Agencies recognize that these standards may need to change and improve over time. Accordingly, the Agencies are open to ideas and input from the public to strengthen and develop this policy statement. Legal responsibility for insured depository institutions, credit unions, and depository institution holding companies shall be with the primary prudential regulator with respect to section 342 of the Dodd-Frank Act and these standards.

The proposed Statement follows.

Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies and Request for Comment

I. Introduction

Section 342 of the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 requires the Directors of the Offices of Minority and Women Inclusion (OMWI) to develop standards by which the diversity policies and practices of the entities regulated by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Bureau of Consumer Financial Protection, and Securities and Exchange Commission ("the Agencies") may be assessed. To promote consistency in this area, the OMWI Directors worked together to develop joint proposed standards.

II. The Joint Standards

An assessment of diversity policies and practices of the entities regulated by the Agencies may include the factors listed below. These standards may be tailored to take into consideration an individual entity's size and other characteristics (for example, total assets, number of employees, governance structure, revenues, number of members and/or customers, contract volume, geographic location, and community characteristics).

1) Organizational Commitment To Diversity And Inclusion

The leadership of a successful organization demonstrates its commitment to diversity and inclusion. Leadership comes from the governing body such as a board of directors, senior officials, and those managing the organization on a day-to-day basis. These standards inform how an entity promotes diversity and inclusion both in employment and contracting, and how an entity fosters a corporate culture that embraces diversity and inclusion.

Standards:

In a manner reflective of the individual entity's size and other characteristics,

- The regulated entity includes diversity and inclusion considerations in both employment and contracting as an important part of its strategic plan including hiring, recruiting, retention and promotion.
- The entity has a diversity and inclusion policy that is approved and supported by senior leadership, including senior management and the board of directors.
- The entity provides regular progress reports to the board and/or senior management.
- The entity conducts equal employment opportunity and diversity and inclusion education and training on a regular and periodic basis.
- The entity has a senior level official who oversees and directs the entity's diversity efforts. For some institutions, these responsibilities are assigned to an executive-level Chief Diversity Officer (or equivalent position) with dedicated resources to support diversity strategies and initiatives. For other entities, such as smaller entities, these responsibilities are assigned to a senior officer with sufficient authority.
- The entity takes proactive steps to promote a diverse pool of candidates, including women and minorities, in its hiring, recruiting, retention, and promotion, as well as in its selection of board members, senior management, and other senior leadership positions.

2) Workforce Profile And Employment Practices

Many entities promote the fair inclusion of minorities and women in their workforce by publicizing employment opportunities, creating relationships with minority and women professional organizations and educational institutions, creating a culture that values the contribution of all employees, and encouraging focus on these objectives when evaluating performance of managers. Entities with diversity and inclusion programs regularly evaluate their programs and identify areas that can be improved.

Entities use various analytical tools to evaluate a wide range of business objectives, including metrics to track and measure the inclusiveness of their workforce (e.g., race, ethnicity, and gender). Regulated entities that are subject to the Equal Employment Opportunity Commission (EEOC) and the Office of Federal Contract Compliance Programs (OFCCP) reporting requirements[2] currently provide data and supporting documentation that serve as analytical tools to evaluate diversity and inclusion programs. For entities not subject to the EEOC and OFCCP reporting requirements, these tools may serve as valuable models for data analysis to evaluate and assess diversity efforts.

Standards:

In a manner reflective of the individual entity's size and other characteristics,

- Entities that file an annual EEO-1 Report as required by Title VII of the Civil Rights Act of 1964, or otherwise track their workforce data, use the data to evaluate and assess workforce diversity and inclusion efforts.

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[2] The Employer Information Report EEO-1 (EEO-1 Report) is required to be filed annually with the EEOC by (a) private employers with 100 or more employees or (b) federal contractors who have 50 or more employees, and are prime contractors or first-tier subcontractors, with contracts of $50,000 or more.

- Entities that prepare annual Affirmative Action Plans as required by Executive Order 11246 under the jurisdiction of the OFCCP use those plans to evaluate and assess workforce diversity and inclusion efforts.
- The entity utilizes metrics to evaluate and assess workforce diversity and inclusion efforts, such as recruitment, applicant tracking, hiring, promotions, separations (voluntary and involuntary), career development support, coaching, executive seminars and retention across all levels and occupations of the organization including executive and managerial ranks.
- The entity holds management accountable for diversity and inclusion efforts.
- The entity has policies and practices that create diverse applicant pools for both internal and external opportunities that may include:
    - Outreach to minority and women organizations;
    - Outreach to educational institutions serving significant minority and women student populations; and
    - Participation in conferences, workshops, and other events to attract minorities and women and inform them of employment and promotion opportunities.

3) Procurement And Business Practices – Supplier Diversity

We recognize that there is limited public information available on supplier diversity at regulated entities and it may be more challenging to compare supplier diversity policies and practices among regulated entities. Some smaller institutions may also face greater challenges in gathering such information.

Companies increasingly understand the competitive advantage of using a broader choice of available businesses with benefits such as price, quality, attention to detail, and future relationship building. A number of entities have achieved success at broadening the range of available business options by increasing outreach to minority-owned and women-owned businesses.

As in the employment context, entities often use metrics to know the baseline of how much they spend on procuring goods and services and contracting for other business services, how much they spend with minority-owned and women-owned businesses, the availability of relevant minority-owned and women-owned businesses, and the growth in usage over time. Similarly, entities can use outreach methods to inform minority-owned and women-owned businesses (and affinity groups representing these constituencies) of the availability of these opportunities and the mechanism used by the entity for procurement.

In addition, entities' prime contractors often use subcontractors to fulfill the obligations of various contracts. The use of minority-owned and women-owned businesses as subcontractors provides valuable opportunities for both the minority-owned and women-owned businesses as well as for the prime contractor. The prime contractor can use this opportunity to work with minority-owned and women-owned businesses, and can expand the prime contractor's own capability under the contract. Entities can encourage the use of minority-owned and women-owned subcontractors by incorporating this objective in their business contracts.

Standards:

In a manner reflective of the individual entity's size and other characteristics,

- The entity has a supplier diversity policy that provides for a fair opportunity for minority-owned and women-owned businesses to compete in procurements of business goods and services. This includes contracts of all types, including contracts for the issuance or guarantee of any debt, equity, or security, the sale of assets, the management of assets of the entity, and the making of equity investments by the entity.
- The entity has methods to evaluate and assess its supplier diversity, which may include metrics and analytics related to:
  - Annual contract spending by the entity;
  - Percentage spent with minority-owned and women-owned business contractors by race, ethnicity, and gender;
  - Percentage of contracts with minority-owned and women-owned business sub-contracts; and
  - Demographics of the workforce for contractors and subcontractors.
- The entity has practices to promote a diverse supplier pool which may include:
  - Outreach to minority-owned and women-owned contractors and representative organizations;
  - Participation in conferences, workshops and other events to attract minority-owned and women-owned firms and inform them of contracting opportunities; and
  - An ongoing process to publicize its procurement opportunities.

4) Practices To Promote Transparency Of Organizational Diversity And Inclusion

To promote the objectives of section 342, an entity's diversity and inclusion program should be transparent. Transparency and publicity can be an important aspect of assessing diversity policies and practices. Greater awareness and transparency can give members of the public information that allows them to assess those policies and practices. Entities can publicize information on their diversity and inclusion efforts through normal business methods, which can include, among other things, displaying information on their Web sites, in their promotional materials and in their annual reports to shareholders, if applicable. Making public an entity's commitment to diversity and inclusion, its plans for achieving diversity and inclusion, and its metrics used to measure success in both workplace and supplier diversity, informs a broad constituency – its investors, employees, potential employees and suppliers, customers, and the general community. Publication of this information can open new markets to new communities and can illustrate the progress that has been made toward an important business goal.

Standards:

In a manner reflective of the individual entity's size and other characteristics, the regulated entity provides transparency in its activities regarding diversity and inclusion by making the following information available to the public annually through its public Web site or other appropriate communication methods:

- its diversity and inclusion strategic plan;
- its commitment to diversity and inclusion; and
- its progress toward achieving diversity and inclusion in its workforce and procurement activities, which may include its:

- current workforce and supplier demographic profiles;
- current employment and procurement opportunities;
- forecasts of potential employment and procurement opportunities; and
- the availability and use of mentorship and developmental programs for employees and contractors.

III. Proposed Approach to Assessment

In developing the standards proposed in this Statement, the Agencies believe that the term "assessment" contemplates both self-assessment and an opportunity for the Agencies and the public to understand the diversity policies and practices of regulated entities. The assessment envisioned by the Agencies is not one of a traditional examination or other supervisory assessment. Thus, the Agencies will not use the examination or supervision process in connection with these proposed standards.

A model assessment would include:

- A self-assessment utilizing the proposed standards to conduct a quantitative and qualitative evaluation of the diversity and inclusion policies and practices, as stated in Section II (The Joint Standards).
- Voluntary disclosure to the appropriate Agency of the self-assessment and other information the entity deems relevant. The Agencies will monitor the information submitted over time for use as a resource in carrying out their diversity and inclusion responsibilities.
- The entity displays information on its public Web site and in its annual reports, and in other materials, regarding its efforts to comply with these proposed standards as an opportunity for more public awareness and understanding of its diversity policies and practices. The Agencies may

periodically review information on regulated entities' public Web sites to monitor diversity and inclusion practices.

Entities that are required to file an EEO-1 Report are encouraged to use the proposed standards to develop and monitor diversity policies and practices. Entities that do not file EEO-1 Reports may also consider using the standards in a manner reflective of the individual entity's size and other characteristics.

The OMWI Directors will also continue to reach out to regulated entities and other interested parties to discuss diversity and inclusion practices and methods of assessment.

IV. Request for Comment

The Agencies request comments on all aspects of this draft policy statement, including but not limited to those set forth below. The Agencies will revise the Statement as appropriate after a review of public comments.

1) Are the proposed joint standards effective and appropriate to promote diversity and inclusion? Why or why not? If not, what standards would be appropriate and why? How would such standards support or hinder the objectives of section 342?

2) Are the proposed joint standards sufficiently flexible but still effective to allow meaningful assessments of entities with a wide range of particular characteristics or circumstances (for example, asset size; number of employees; contract volume; income stream; and number of members and/or customers)? Are there other ways to approach the standards for smaller entities, such as those with small contracting

dollar volumes or those not required to file EEO-1 reports? What other approaches or characteristics would be appropriate for any such alternative, modified or scaled approach? How would such modification or scaling support or hinder the objectives of section 342?

3) What other factors, if any, would be useful in assessing the diversity policies and practices of the regulated entities, and why should such factors be considered? How would such factors support or hinder the objectives of section 342?

4) Is the proposed model approach to assessment effective and appropriate to promote diversity and inclusion? Why or why not? If not, what approach would be appropriate and why? How would such approach support or hinder the objectives of Section 342?

5) Would there be potential advantages or disadvantages of the proposed model approach to assessment? If so, what would they be?

V. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act (PRA) of 1995 (44 U.S.C. 3501 *et. seq*)., the Agencies have reviewed the proposed policy statement and determined that it contains no collections of information requiring approval by the Office of Management and Budget (OMB). As the Agencies consider the public comments received and finalize the policy statement, they will reevaluate this PRA determination.

[THIS SIGNATURE PAGE RELATES TO THE JOINT NOTICE ENTITLED "PROPOSED INTERAGENCY POLICY STATEMENT ESTABLISHING JOINT STANDARDS FOR ASSESSING THE DIVERSITY POLICIES AND PRACTICES OF ENTITIES REGULATED BY THE AGENCIES AND REQUEST FOR COMMENT"]

Dated: 10-2-13

Thomas J. Curry
Comptroller of the Currency

BILLING CODE: OCC4810-33-P

[THIS SIGNATURE PAGE RELATES TO THE JOINT NOTICE ENTITLED "PROPOSED INTERAGENCY POLICY STATEMENT ESTABLISHING STANDARDS FOR ASSESSING THE DIVERSITY POLICIES AND PRACTICES OF ENTITIES REGULATED BY THE AGENCIES AND REQUEST FOR COMMENT"]

By order of the Board of Governors of the Federal Reserve System, October 10, 2013.

Robert deV. Frierson

Robert deV. Frierson,
Secretary of the Board.

BILLING CODE: FRB 6210-01-P

[THIS SIGNATURE PAGE RELATES TO THE JOINT NOTICE ENTITLED "PROPOSED INTERAGENCY POLICY STATEMENT ESTABLISHING JOINT STANDARDS FOR ASSESSING THE DIVERSITY POLICIES AND PRACTICES OF ENTITIES REGULATED BY THE AGENCIES AND REQUEST FOR COMMENT"]

Dated at Washington, D.C., this 4th of October 2013.
Federal Deposit Insurance Corporation.

Robert E. Feldman,
Executive Secretary.

BILLING CODE: FDIC 6741-01-P

[THIS SIGNATURE PAGE RELATES TO THE NOTICE OF PROPOSED INTERAGENCY POLICY STATEMENT WITH REQUEST FOR PUBLIC COMMENT ENTITLED "PROPOSED INTERAGENCY POLICY STATEMENT ESTABLISHING JOINT STANDARDS TO ASSESS THE DIVERSITY POLICIES AND PRACTICES OF ALL ENTITIES REGULATED BY THE AGENCIES AND REQUEST FOR COMMENT"]

By the National Credit Union Administration Board on September 18, 2013

Gerard Poliquin

Secretary of the Board

BILLING CODE: NCUA 7590-01 P

[THIS SIGNATURE PAGE RELATES TO THE JOINT NOTICE ENTITLED "PROPOSED INTERAGENCY POLICY STATEMENT ESTABLISHING JOINT STANDARDS FOR ASSESSING THE DIVERSITY POLICIES AND PRACTICES OF ENTITIES REGULATED BY THE AGENCIES AND REQUEST FOR COMMENT"]

Dated: October 1, 2013.

Richard Cordray

Richard Cordray,
Director, Bureau of Consumer Financial Protection.

BILLING CODE: CFPB 4810-AMP

[THIS SIGNATURE PAGE RELATES TO THE JOINT NOTICE ENTITLED "PROPOSED INTERAGENCY POLICY STATEMENT ESTABLISHING JOINT STANDARDS FOR ASSESSING THE DIVERSITY POLICIES AND PRACTICES OF ENTITIES REGULATED BY THE AGENCIES AND REQUEST FOR COMMENT"]

By the Securities and Exchange Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary.

Date: October 22, 2013

BILLING CODE: SEC 8011-01p

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
October 22, 2013

In the Matter of **ARX Gold Corp.,** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission ("Commission") that there is a lack of current and accurate information concerning the securities of ARX Gold Corp. ("ARX Gold"), quoted under the ticker symbol DUCP, because of questions regarding the authorship of, and accuracy of information contained in, an exhibit, dated June 15, 2012 and entitled "Feasibility Study ARX Springs & ARX Pacific Properties For Mining Project Located in Wide Bay Burnett Region, Queensland, Australia," to ARX Gold's Form 10-K filed on September 4, 2013 and an exhibit, dated May 7, 2012 and entitled "Definitive Feasibility Study on the ARX Springs and ARX Pacific Properties located in Wide Bay Burnett Region, Queensland, Australia," to its Form 8-K filed on May 30, 2012. On October 3, 2013, ARX Gold filed an amended Form 10-K purporting "to delete an exhibit which was *erroneously filed*" with the 10-K filed on September 4, 2013 (emphasis added) without explicitly identifying or explaining that the Feasibility Study was the exhibit it sought to delete. ARX Gold has not amended its May 2012 Form 8-K and its October 2013 amendment to the Form 10-K does not disclaim the purported facts described in the earlier Feasibility Study filed with the Commission.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company.

Therefore, IT IS ORDERED, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on October 22, 2013, through 11:59 p.m. EST on November 4, 2013.

By the Commission.

Elizabeth M. Murphy
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70739 / October 22, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-14853

In the Matter of **OX Trading, LLC,** **optionsXpress, Inc., and** **Thomas E. Stern** **Respondents.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO OX TRADING, LLC AND OPTIONSXPRESS, INC.**

I.

On April 19, 2012, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and against OX Trading, LLC ("OX Trading") and optionsXpress, Inc. ("optionsXpress") (collectively, "Respondents").

II.

Respondents have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Exchange Act ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds[1] that:

[1] The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

A. SUMMARY

1. These proceedings arise out of registration violations relating to OX Trading, LLC ("OX Trading"), which, during the relevant period, was a subsidiary of optionsXpress Holdings, Inc. ("Holdings"). OX Trading was formed in 2007 to provide customers of optionsXpress, Inc. ("optionsXpress"), a registered broker-dealer that was also a subsidiary of Holdings, price improvement on their orders via internalization of options trades. OX Trading provided price improvement by becoming the counterparty to certain customer orders of optionsXpress. As a result of taking the customers' trades, OX Trading established positions which it then would try to hedge in such a way as to make a profit.

2. Stern, OX Trading's Chief Financial Officer and Chief Compliance Officer ("CFO") and optionsXpress' CFO, registered OX Trading with the Commission as a dealer effective February 1, 2008. At the time, OX Trading was a member of the Chicago Board Options Exchange ("CBOE"). As a member of CBOE, OX Trading was required to be audited on an annual basis. To avoid the cost of an audit, Stern instead terminated OX Trading's membership with CBOE effective March 2, 2009. After the Commission notified OX Trading a few months later that it could not be a registered dealer unless it was a member of an exchange or the Financial Industry Regulatory Authority ("FINRA"), Stern deregistered OX Trading. OX Trading's registration with the Commission ended on October 17, 2009. OX Trading, however, continued to operate in the same manner as it did when it was registered with the Commission and a member of CBOE, except that it conducted its trading through a customer portfolio margin account at optionsXpress.

3. During a portfolio margin examination in late 2009, CBOE discovered the account and told Stern, in April 2010, that OX Trading was required to register as a dealer. Stern, however, did not file OX Trading's registration application with the Commission until July 20, 2010. OX Trading's registration did not become effective until November 16, 2010, because OX Trading failed to become a member/permit holder of an exchange until that date.

4. Accordingly, as Chief Administrative Law Judge Brenda Murray found on September 5, 2012, from October 17, 2009 to November 16, 2010, OX Trading willfully violated Section 15(a) of the Exchange Act which makes it unlawful to induce or attempt to induce any purchase or sale of a security unless such a dealer is registered. Further, from March 2, 2009 to November 16, 2010, OX Trading willfully violated Section 15(b)(8) of the Exchange Act which makes it unlawful for a dealer to effect any transaction in any security (other than commercial paper, bankers' acceptances, or commercial bills) unless it is a member of a registered national securities association or effects transactions solely on a national exchange of which it is a member.

B. RESPONDENTS

5. OX Trading is currently an inactive Delaware limited liability company. OX Trading had its principal place of business in Chicago, IL. It was created to provide price improvement to customers of optionsXpress. It is a subsidiary of Holdings. On September 1, 2011, after the relevant time period, Holdings became a wholly-owned subsidiary of The Charles Schwab Corporation ("Schwab"). After being acquired by Schwab, OX Trading ceased doing business in any capacity in February 2012.

6. optionsXpress is a Delaware corporation with a principal place of business in Chicago, IL. optionsXpress is a self-clearing, retail, on-line broker specializing in options and futures. It is registered with the Commission, FINRA, CBOE, various stock exchanges, and 53 states and territories. optionsXpress is a subsidiary of Holdings. On September 1, 2011, Holdings became a wholly-owned subsidiary of Schwab.

C. OTHER RELEVANT PARTY

7. Stern, 67, of Chicago, IL, was the Chief Financial Officer, Secretary, Director, and Chief Compliance Officer of OX Trading; the Chief Financial Officer of optionsXpress; the Chief Administrative Officer of Holdings; the President and Chief Executive Officer, Chief Compliance Officer and Director of optionsXpress International, Inc.; and the Chief Financial Officer and Director of brokersXpress, LLC. At the time of the events herein, he was a board member of the Options Clearing Corporation and held Series 3, 4, 7, 24, 27, and 63 licenses.

D. FINDINGS

OX Trading Is Registered as a Broker-Dealer

8. OX Trading was formed in August 2007 with Stern as the Chief Financial Officer. Stern also served as OX Trading's Chief Compliance Officer, responsible for the entity's "regulatory functions," including its legal formation and ensuring its proper registration status.

9. OX Trading was created to provide price improvement on orders from optionsXpress' customers and to profit from those trades. The idea originated with the head of optionsXpress' order desk. He felt that price improvement would be beneficial for optionsXpress' customers and a way to generate profit for Holdings.

10. Price improvement generally means the execution of an order at a price better than the public quote at the time the market center received the order.

11. OX Trading was registered with the Commission as a broker-dealer as of February 1, 2008 and became a member of CBOE.

12. After becoming registered as a broker-dealer, OX Trading received electronic requests for quotes ("RFQs") from optionsXpress. These RFQs allowed OX Trading to determine whether it wanted to be the counterparty to an optionsXpress customer's order. Generally, the decision whether or not to be a counterparty to the optionsXpress customer trade was done automatically through a computerized system.

13. Although the decision whether or not to be a counterparty to the optionsXpress customer trade was generally done automatically, on at least one occasion, optionsXpress' head trader directed OX Trading to take the trade of an optionsXpress customer who he believed "deserved an execution" but who was "not getting executed in the marketplace."

14. If OX Trading wanted to act as the counterparty to an optionsXpress customer order, OX Trading would send a notice back to optionsXpress with an order identifying an exchange to which the paired orders should be sent. optionsXpress would then send a paired

trade to one of several price improvement auctions offered by various exchanges, such as CBOE's Automated Improvement Mechanism ("AIM"). If OX Trading chose not to be the counterparty on an order, optionsXpress would route the trade to an exchange. Although CBOE's AIM system was the first auction mechanism used by OX Trading, it later began using the NASDAQ Options Market system (no later than May 2009); International Stock Exchange's Price Improvement Mechanism (no later than early 2008); and BATS (no later than the fall of 2010).

15. OX Trading was not a member of FINRA during the relevant time period and was not, and has never been, a member of any exchange other than CBOE.

16. OX Trading earned revenue when it traded as a counterparty to optionsXpress customer orders and hedged the positions created by those trades. According to OX Trading's head trader: "The entity's desire is to make money, so after we price improve a customer order we end up having a position. And we manage those positions in such a way to . . . capture profit within those trades. . . . OX Trading makes money if it sells an option at one price and buys it at a lower price and sells it at a higher price."

17. Holdings' former CEO described OX Trading similarly: "[OX Trading] generates revenue by trading, by entering into primarily options positions and hedging those positions and either letting them expire or trading out of them and generating profit by buying low and selling high or selling high and buying low."

18. Stern described OX Trading as a liquidity provider.

19. Internal OX Trading documents described OX Trading as providing a "2 sided market."

OX Trading Deregisters

20. On December 31, 2008, an examiner in CBOE's Department of Member Firm Regulation ("DMFR") sent an email to Stern asking why OX Trading lost more than 15% of its excess net capital in November 2008. The CBOE examiner also asked OX Trading to complete a Member Questionnaire and inquired whether OX Trading only conducted proprietary trading or whether it also acted as a market maker.

21. Stern completed the questionnaire stating that OX Trading conducted only proprietary trading. The questionnaire did not list an outside auditor for the firm and stated that OX Trading facilitated "optionsXpress, Inc.'s customer in getting solicited by optionsXpress, Inc. for better than NBBO fill on CBOE AIM system. No other primary trades other than to hedge or liquidate the above." Stern did not respond to the examiner's inquiry about the November 2008 loss.

22. The CBOE examiner again asked Stern for a detailed explanation of OX Trading's November loss and told Stern that OX Trading was required to have an annual audit based on its CBOE membership status.

23. Stern responded that the loss was "due to the conversion from the inventory range to the customer range because of our desire for optionsXpress, Inc. the clearing firm, to be

able to classify its margin debit receivable from OX Trading as a 'good' asset." However, internal OX Trading emails indicate that at least part of the loss was due to poor trading performance.

24. In response to CBOE's admonition regarding the annual audit requirement and to avoid the cost of an audit, Stern decided to terminate OX Trading's CBOE membership.

25. On February 2, 2009, Stern notified CBOE that "OX Trading has given notice to its lessor to terminate its [CBOE membership] lease. Once the lease is terminated, OX Trading will cease to be a CBOE member and a broker-dealer." Then on February 25, 2009, Stern again notified CBOE that "[w]e will cease being a BD on Saturday."

26. OX Trading ceased being a member of CBOE on March 2, 2009. Despite terminating its CBOE membership, OX Trading continued to conduct the same trading, but through a customer portfolio margin account at optionsXpress. Stern did not inform CBOE that OX Trading would continue its operations as a customer of optionsXpress.

27. On May 11, 2009, the Commission's Division of Trading and Markets Office of Financial Responsibility ("OFR") notified OX Trading that "[b]roker-dealers who only transact business on an exchange must be a member of that exchange" and "[t]herefore, unless you can demonstrate within 35 days of receipt of this letter that you have applied for membership with an exchange or the FINRA, your registration with the Commission will be cancelled." OFR then cautioned: "Please note that you may not engage in the securities business unless you are a member of an exchange or the NASD and that merely having made application for membership will not satisfy the legal requirement." On June 17, 2009, OFR sent a second letter to OX Trading containing the same admonitions.

28. According to an email sent by Stern, OX Trading "stalled as long as we could," but finally on August 18, 2009, Stern filed a form with the Commission to deregister OX Trading as a broker-dealer. The deregistration became effective October 17, 2009.

29. OX Trading continued to trade through a customer portfolio margin account at optionsXpress.

OX Trading Reregisters as a Broker-Dealer

30. In late 2009, CBOE's DMFR was conducting a routine portfolio margin exam of optionsXpress when they identified an account that was engaged in a significant amount of trading. As part of the exam, a CBOE examiner asked if any subsidiary of Holdings traded with its own capital and cleared through optionsXpress. Stern replied: "No brokerage subsidiary of optionsXpress Holdings, Inc. does any proprietary trading or makes trades with its own capital."

31. On February 3, 2010, CBOE notified Stern that CBOE would like to discuss why OX Trading was being treated as a customer account.

32. On February 8, 2010, Stern and several others from optionsXpress met with CBOE to discuss the registration status of OX Trading.

33. On April 20, 2010, CBOE sent a letter to Stern asking for a written statement detailing the reasons why OX Trading was not registered as a broker-dealer, including a legal analysis on which the decision was based.

34. Stern responded in a letter dated April 23, 2010. Instead of providing an explanation as to OX Trading's registration status, the letter contained factual inaccuracies and no legal opinion or analysis.

35. CBOE responded to Stern's letter on April 27, 2010 and asked again for an explanation of why OX Trading believed it was not required to register as a broker-dealer and for a legal opinion to support its belief. Stern did not provide an explanation or a legal opinion.

36. On June 17, 2010, CBOE sent a letter to Stern stating that CBOE believed OX Trading was functioning as a dealer and was required to register as a broker-dealer. CBOE asked OX Trading to either cease operations or obtain a written opinion from the Commission confirming that OX Trading was not required to register. CBOE asked OX Trading to respond by June 22, 2010.

37. On June 29, 2010, OX Trading's outside counsel asked for an extension of time within which to respond.

38. On June 30, CBOE explained to optionsXpress' counsel that "[t]he characteristic that we see as primary in deeming OX Trading a 'dealer' is that it engages in a business of buying and selling securities for its own account. Moreover, this business is conducted entirely with optionsXpress, Inc. customer accounts."

39. In early July 2010, Stern contacted the Commission about reactivating OX Trading's registration noting that "we have no desire to apply for a no-action letter." At the same time, OX Trading's outside counsel sent a letter to CBOE offering to apply for dealer registration with the Commission and to obtain access/membership with an exchange.

40. On July 20, 2010, OX Trading filed an application for registration with the Commission and was granted conditional approval on August 26, 2010. For its SEC registration to become effective, OX Trading was required to be a member of FINRA or an exchange.

41. On October 6, 2010, OX Trading filed an application with CBOE. The application was approved on November 9, 2010 and the necessary access permits were issued on November 12, 2010. However, OX Trading requested an effective date of December 1 so "we don't get charged [for November]." Nevertheless at CBOE's insistence, the SEC registration and CBOE trading permit became effective on November 16, 2010.

42. From March 2, 2009 to November 16, 2010, OX Trading executed approximately 1.3 million trades. Its gross revenues from March 2009 to November 2010 were approximately $3.9 million.

43. On February 27, 2012, Schwab informed the Commission staff, pursuant to Rules 17a-5(h)(2) and 17a-11(e) and (g), that it had identified a material internal control inadequacy at OX Trading

E. VIOLATIONS

44. As a result of the conduct described above, OX Trading willfully violated Section 15(a) of the Exchange Act which makes it unlawful to induce or attempt to induce any purchase or sale of a security unless such a dealer is registered.

45. As a result of the conduct described above, OX Trading willfully violated Section 15(b)(8) of the Exchange Act which makes it unlawful for a broker-dealer to effect any transaction in any security (other than commercial paper, bankers' acceptances, or commercial bills) unless it is a member of a registered national securities association or effects transactions solely on a national exchange of which it is a member.

46. As a result of the conduct described above, optionsXpress caused OX Trading's violations of Sections 15(a) and 15(b)(8) of the Exchange Act.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, to impose the sanctions agreed to in Respondents' Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. OX Trading and optionsXpress cease and desist from committing or causing any violations and any future violations of Sections 15(a) and 15(b)(8) of the Exchange Act.

B. OX Trading is censured.

C. OX Trading shall, within fifteen days of the entry of this Order, pay disgorgement of $2,750,000 and prejudgment interest of $253,094.39 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

(1) OX Trading may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) OX Trading may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) OX Trading may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard

Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying OX Trading, LLC as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Daniel M. Hawke, Chief, Market Abuse Unit, Division of Enforcement, U.S. Securities and Exchange Commission, The Mellon Independence Center, 701 Market Street, Philadelphia, PA 19106-1532.

D. OX Trading shall, within fifteen days of the entry of this Order, pay a civil money penalty in the amount of $750,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) OX Trading may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) OX Trading may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) OX Trading may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying OX Trading, LLC as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Daniel M. Hawke, Chief, Market Abuse Unit, Division of Enforcement, U.S. Securities and Exchange Commission, The Mellon Independence Center, 701 Market Street, Philadelphia, PA 19106-1532.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chair White,
Commissioner Aguilar
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70737 / October 22, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3701 / October 22, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15582

In the Matter of ALEKSEY P. KOVAL a/k/a ALEXEI P. KOVAL, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Aleksey P. Koval a/k/a Alexei Koval ("Respondent" or "Koval").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of

1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Koval, age 39, is a resident of Bronxville, New York. He is a Russian citizen and has green card immigration status in the United States. From 2000 to 2006, Koval was a registered representative at Citigroup Global Markets Inc.

2. On January 7, 2011, Koval pleaded guilty to three counts of securities fraud in violation of 15 U.S.C. § 78j(b) and 18 U.S.C. § 2, and one count of conspiracy to commit securities fraud in violation of 18 U.S.C. § 371, before the United States District Court for the Southern District of New York, in United States v. Alexei P. Koval a/k/a Aleksey Koval, Crim. Information No. 1:10-CR-443. On May 24, 2011, a judgment in the criminal case was entered against Koval, finding him guilty of the aforesaid criminal violations. He was sentenced to a prison term of twenty-six months followed by two years of supervised release and ordered to pay forfeiture in the amount of $1,414,290.00.

3. The counts of the criminal information to which Koval pleaded guilty alleged that from at least July 2005 through February 2009, Koval engaged in a scheme to commit fraud in connection with the purchase and sale of securities by participating in an insider trading ring that yielded over $350,000 in illicit profits for Koval from trading in securities in advance of at least six mergers, acquisitions, and other business combinations based on material nonpublic information Koval received from a co-conspirator who was an investment banker at another securities firm that was involved as an adviser in each of the transactions.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Koval's Offer.

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, that Respondent Koval be, and hereby is, barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; and is barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any civil penalty ordered against the Respondent; (c) any arbitration award related to the conduct that served as the basis for the Commission order; (d) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; (e) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order; and (f) any criminal fine, restitution or forfeiture related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70740 / October 22, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30753 / October 22, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-14853

In the Matter of **OX Trading, LLC,** **optionsXpress, Inc., and** **Thomas E. Stern** **Respondents.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940 AS TO THOMAS E. STERN**

I.

On April 19, 2012, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist proceedings pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Thomas E. Stern ("Respondent" or "Stern").

II.

Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Exchange Act and Section 9(b) of the Investment Company Act ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

A. SUMMARY

1. These proceedings arise out of registration violations relating to OX Trading, LLC ("OX Trading"), which, during the relevant period, was a subsidiary of optionsXpress Holdings, Inc. ("Holdings"). OX Trading was formed in 2007 to provide customers of optionsXpress, Inc. ("optionsXpress"), a registered broker-dealer that was also a subsidiary of Holdings, price improvement on their orders via internalization of options trades. OX Trading provided price improvement by becoming the counterparty to certain customer orders of optionsXpress. As a result of taking the customers' trades, OX Trading established positions which it then would try to hedge in such a way as to make a profit.

2. Stern, OX Trading's Chief Financial Officer and Chief Compliance Officer ("CFO") and optionsXpress' CFO, registered OX Trading with the Commission as a dealer effective February 1, 2008. At the time, OX Trading was a member of the Chicago Board Options Exchange ("CBOE"). As a member of the CBOE, OX Trading was required to be audited on an annual basis. OX Trading, however, refused to pay for an audit and, instead, Stern terminated OX Trading's membership with the CBOE effective March 2, 2009. After the Commission notified OX Trading a few months later that it could not be a registered dealer unless it was a member of an exchange or FINRA, Stern deregistered OX Trading. OX Trading's registration with the Commission ended on October 17, 2009. OX Trading, however, continued to operate in the same manner as it did when it was registered with the Commission and a member of the CBOE, except that it conducted its trading through a customer portfolio margin account at optionsXpress.

3. During a portfolio margin examination in late 2009, CBOE discovered the account and told Stern, in April 2010, that OX Trading was required to register as a dealer. Stern, however, did not file OX Trading's registration application with the Commission until July 20, 2010. OX Trading's registration did not become effective until November 16, 2010, because OX Trading failed to become a member/permit holder of an exchange until that date.

4. Accordingly, as Chief Administrative Law Judge Brenda Murray found on September 5, 2012, from October 17, 2009 to November 16, 2010, OX Trading violated Section 15(a) of the Exchange Act which makes it unlawful to induce or attempt to induce any purchase or sale of a security unless such a dealer is registered. Further, from March 2, 2009 to November 16, 2010, OX Trading violated Section 15(b)(8) of the Exchange Act which makes it unlawful for a dealer to effect any transaction in any security (other than commercial paper, bankers' acceptances, or commercial bills) unless it is a member of a registered national securities association or effects transactions solely on a national exchange of which it is a member. Stern caused and aided and abetted OX Trading's violations of Sections 15(a) and 15(b)(8) of the Exchange Act as he knew or should have known that his acts or omissions as described above would contribute to these violations.

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

B. RESPONDENT

5. Stern, 68, of Chicago, IL, was the Chief Financial Officer, Secretary, Director, and Chief Compliance Officer of OX Trading; the Chief Financial Officer of optionsXpress; the Chief Administrative Officer of Holdings; the President and Chief Executive Officer, Chief Compliance Officer and Director of optionsXpress International, Inc.; and the Chief Financial Officer and Director of brokersXpress, LLC. At the time of the events herein, he was a board member of the Options Clearing Corporation. He holds Series 3, 4, 7, 24, 27, and 63 licenses.

C. OTHER RELEVANT ENTITIES

6. OX Trading is currently an inactive Delaware limited liability company. OX Trading had its principal place of business in Chicago, IL. It was created to provide price improvement to customers of optionsXpress. It is a subsidiary of Holdings. On September 1, 2011, after the relevant time period, Holdings became a wholly-owned subsidiary of The Charles Schwab Corporation ("Schwab"). After being acquired by Schwab, OX Trading ceased doing business in any capacity in February 2012.

7. optionsXpress is a Delaware corporation with a principal place of business in Chicago, IL. optionsXpress is a self-clearing, retail, on-line broker specializing in options and futures. It is registered with the Commission, the Financial Industry Regulatory Authority ("FINRA"), CBOE, various stock exchanges, and 53 states and territories. optionsXpress is a subsidiary of Holdings. On September 1, 2011, Holdings became a wholly-owned subsidiary of Schwab.

D. FINDINGS

OX Trading Is Registered as a Broker-Dealer

8. OX Trading was formed in August 2007 with Stern as the Chief Financial Officer. Stern also served as OX Trading's Chief Compliance Officer, responsible for the entity's "regulatory functions," including its legal formation and ensuring its proper registration status.

9. OX Trading was created to provide price improvement on orders from optionsXpress' customers and to profit from those trades. The idea originated with the head of optionsXpress' order desk. He felt that price improvement would be beneficial for optionsXpress' customers and a way to generate profit for Holdings.

10. Price improvement generally means the execution of an order at a price better than the public quote at the time the market center received the order.

11. OX Trading was registered with the Commission as a broker-dealer as of February 1, 2008 and became a member of CBOE. According to Stern, it was his decision to have OX Trading register.

12. After becoming registered as a broker-dealer, OX Trading received electronic requests for quotes ("RFQs") from optionsXpress. These RFQs allowed OX Trading to determine whether it wanted to be the counterparty to an optionsXpress customer's order. Generally, the decision whether or not to be a counterparty to the optionsXpress customer trade was done automatically through a computerized system.

13. Although the decision whether or not to be a counterparty to the optionsXpress customer trade was generally done automatically, on at least one occasion, optionsXpress' head trader directed OX Trading to take the trade of an optionsXpress customer who he believed "deserved an execution" but who was "not getting executed in the marketplace."

14. If OX Trading wanted to act as the counterparty to an optionsXpress customer order, OX Trading would send a notice back to optionsXpress with an order identifying an exchange to which the order should be sent. optionsXpress would then send a paired trade to one of several price improvement auctions offered by various exchanges, such as CBOE's Automated Improvement Mechanism ("AIM"). If OX Trading chose not to be the counterparty on an order, optionsXpress would route the trade to an exchange. Although CBOE's AIM system was the first auction mechanism used by OX Trading, it later began using the NASDAQ Options Market system (no later than May 2009); International Stock Exchange's Price Improvement Mechanism (no later than early 2008); and BATS (no later than the fall of 2010).

15. OX Trading was not a member of FINRA during the relevant time period and was not, and has never been, a member of any exchange other than CBOE.

16. OX Trading earned revenue when it traded as a counterparty to optionsXpress customer orders and hedges the positions created by those trades. According to OX Trading's head trader: "The entity's desire is to make money, so after we price improve a customer order we end up having a position. And we manage those positions in such a way to . . . capture profit within those trades. . . . OX Trading makes money if it sells an option at one price and buys it at a lower price and sells it at a higher price."

17. Holdings' former CEO described OX Trading similarly: "[OX Trading] generates revenue by trading, by entering into primarily options positions and hedging those positions and either letting them expire or trading out of them and generating profit by buying low and selling high or selling high and buying low."

18. Stern described OX Trading as a liquidity provider.

19. Internal OX Trading documents described OX Trading as providing a "2 sided market."

OX Trading Deregisters

20. On December 31, 2008, an examiner in CBOE's Department of Member Firm Regulation ("DMFR") sent an email to Stern asking why OX Trading lost more than 15% of its excess net capital in November 2008. The CBOE examiner also asked OX Trading to complete

a Member Questionnaire and inquired whether OX Trading only conducted proprietary trading or whether it also acted as a market maker.

21. Stern completed the questionnaire stating that OX Trading conducted only proprietary trading. The questionnaire did not list an outside auditor for the firm and stated that OX Trading facilitated "optionsXpress, Inc.'s customer in getting solicited by optionsXpress, Inc. for better than NBBO fill on CBOE AIM system. No other primary trades other than to hedge or liquidate the above." Stern did not respond to the examiner's inquiry about the November 2008 loss.

22. The CBOE examiner again asked Stern for a detailed explanation of OX Trading's November loss and told Stern that OX Trading was required to have an annual audit based on its CBOE membership status.

23. Stern responded that the loss was "due to the conversion from the inventory range to the customer range because of our desire for optionsXpress, Inc. the clearing firm, to be able to classify its margin debit receivable from OX Trading as a 'good' asset." However, internal OX Trading emails indicate that at least part of the loss was due to poor trading performance.

24. Despite CBOE's request, OX Trading refused to pay for an audit and Stern subsequently decided to terminate OX Trading's CBOE membership.

25. On February 2, 2009, Stern notified CBOE that "OX Trading has given notice to its lessor to terminate its [CBOE membership] lease. Once the lease is terminated, OX Trading will cease to be a CBOE member and a broker-dealer." Then on February 25, 2009, Stern again notified CBOE that "[w]e will cease being a BD on Saturday."

26. OX Trading ceased being a member of CBOE on March 2, 2009. Despite terminating its CBOE membership, OX Trading continued to conduct the same trading, but through a customer portfolio margin account at optionsXpress. Stern did not inform the CBOE that OX Trading would continue its operations as a customer of optionsXpress.

27. On May 11, 2009, the Commission's Division of Trading and Markets Office of Financial Responsibility ("OFR") notified OX Trading that "[b]roker-dealers who only transact business on an exchange must be a member of that exchange" and "[t]herefore, unless you can demonstrate within 35 days of receipt of this letter that you have applied for membership with an exchange or the FINRA, your registration with the Commission will be cancelled." OFR then cautioned: "Please note that you may not engage in the securities business unless you are a member of an exchange or the NASD and that merely having made application for membership will not satisfy the legal requirement." On June 17, 2009, OFR sent a second letter to OX Trading containing the same admonitions.

28. According to an email sent by Stern, OX Trading "stalled as long as we could," but finally on August 18, 2009, Stern filed a form with the Commission to deregister OX Trading as a broker-dealer. The deregistration became effective October 17, 2009.

29. OX Trading continued to trade through a customer portfolio margin account at optionsXpress.

OX Trading Reregisters as a Broker-Dealer

30. In late 2009, CBOE's DMFR was conducting a routine portfolio margin exam of optionsXpress when they identified an account that was engaged in a significant amount of trading. As part of the exam, a CBOE examiner asked if any subsidiary of Holdings traded with its own capital and cleared through optionsXpress. Stern replied: "No brokerage subsidiary of optionsXpress Holdings, Inc. does any proprietary trading or makes trades with its own capital."

31. On February 3, 2010, CBOE notified Stern that CBOE would like to discuss why OX Trading was being treated as a customer account.

32. On February 8, 2010, Stern and several others from optionsXpress met with CBOE to discuss the registration status of OX Trading.

33. On April 16, 2010, CBOE sent a letter to optionsXpress' Chief Compliance Officer asking for a written statement detailing the reasons why OX Trading was not registered as a broker-dealer, including a legal analysis on which the decision was based.

34. The Compliance Officer forwarded the letter to Stern who replied: "Ask him/them to direct it to OX Trading" adding that "I am happy to spin this however it needs to be." The Compliance Officer then asked CBOE to send the letter to Stern. On April 20, 2010, CBOE resent the same letter, but addressed it to Stern.

35. Stern responded in a letter dated April 23, 2010. Instead of providing an explanation as to OX Trading's registration status, the letter contained factual inaccuracies and no legal opinion or analysis.

36. CBOE responded to Stern's letter on April 27, 2010 and asked again for an explanation of why OX Trading believed it was not required to register as a broker-dealer and for a legal opinion to support its belief. Stern did not provide an explanation or a legal opinion.

37. On June 17, 2010, CBOE sent a letter to Stern stating that CBOE believed OX Trading was functioning as a dealer and was required to register as a broker-dealer. CBOE asked OX Trading to either cease operations or obtain a written opinion from the Commission confirming that OX Trading was not required to register. CBOE asked OX Trading to respond by June 22, 2010.

38. OX Trading did not respond until June 29, 2010, when its outside counsel asked for an extension of time within which to respond. Stern separately emailed the Director of CBOE's DMFR asking whether there was an "unofficial" way to resolve the matter and stating that it looked like OX Trading was "being penalized for trading only on AIM." OX Trading was not trading only on AIM.

39. On June 30, CBOE explained to optionsXpress' counsel that "[t]he characteristic that we see as primary in deeming OX Trading a 'dealer' is that it engages in a business of buying and selling securities for its own account. Moreover, this business is conducted entirely with optionsXpress, Inc. customer accounts."

40. In early July 2010, Stern contacted the Commission about reactivating OX Trading's registration noting that "we have no desire to apply for a no-action letter." At the same time, OX Trading's outside counsel sent a letter to CBOE offering to apply for dealer registration with the Commission and to obtain access/membership with an exchange.

41. On July 20, 2010, OX Trading filed an application for registration with the Commission and was granted conditional approval on August 26, 2010. For its SEC registration to become effective, OX Trading was required to be a member of FINRA or an exchange.

42. On October 6, 2010, OX Trading filed an application with CBOE. The application was approved on November 9, 2010 and the necessary access permits were issued on November 12, 2010. However, OX Trading requested an effective date of December 1 so "we don't get charged [for November]." Nevertheless at CBOE's insistence, the SEC registration and CBOE trading permit became effective on November 16, 2010.

43. From March 2, 2009 to November 16, 2010, OX Trading executed approximately 1.3 million trades. Its gross revenues from March 2009 to November 2010 were approximately $3.9 million.

E. VIOLATIONS

44. As a result of the conduct described above, Stern caused and willfully aided and abetted OX Trading's violation of Section 15(a) of the Exchange Act which makes it unlawful to induce or attempt to induce any purchase or sale of a security unless such a dealer is registered.

45. As a result of the conduct described above, Stern caused and willfully aided and abetted OX Trading's violation of Section 15(b)(8) of the Exchange Act which makes it unlawful for a broker-dealer to effect any transaction in any security (other than commercial paper, bankers' acceptances, or commercial bills) unless it is a member of a registered national securities association or effects transactions solely on a national exchange of which it is a member.

F. UNDERTAKING

46. Respondent undertakes to withdraw his Petition for Review of the Initial Decision issued on June 7, 2013 in the *Matter of optionsXpress, Inc., et al.*, Administrative Proceeding File No. 3-14848 ("Initial Decision") and acknowledges that upon this withdrawal the Commission may enter an order that the Initial Decision has become final as to him.

47. In determining whether to accept the Offer, the Commission has considered this undertaking and determined not to impose any additional sanctions against Stern beyond those set forth in Section IV, in view of the sanctions contained in the optionsXpress Initial Decision.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Sections 15(a) and 15(b)(8) of the Exchange Act.

B. Respondent shall, within fourteen days of the entry of this Order, pay a civil money penalty in the amount of $50,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Thomas E. Stern as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Daniel M. Hawke, Chief, Market Abuse Unit, Division of Enforcement, U.S. Securities and Exchange Commission, The Mellon Independence Center, 701 Market Street, Philadelphia, PA 19106-1532.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3702 / October 23, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15583

In the Matter of

Modern Portfolio Management, Inc.,
G. Thomas Damasco II,
and
Bryan F. Ohm

Respondents.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Modern Portfolio Management, Inc. ("MPM") and Sections 203(f) and 203(k) of the Advisers Act against G. Thomas Damasco II ("Damasco") and Bryan F. Ohm ("Ohm") (MPM, Damasco and Ohm referred to collectively as "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds[1] that:

Summary

These proceedings arise out of the failure of MPM, a registered investment adviser based in Ohio, and its principals, Damasco and Ohm, to correct ongoing violations at the advisory firm. At the time of an on-site examination of MPM in 2008 by the Office of Compliance Inspections and Examinations ("OCIE"), MPM had violated securities laws by failing to complete an annual compliance review in 2006, making misleading statements on MPM's website regarding MPM's exclusive access to Dimensional Fund Advisors ("DFA") funds, omitting disclosures in its performance information that were required by MPM's own policies and procedures, and making misleading statements in its performance information by providing model results that did not deduct MPM's advisory fees. Following the examination, OCIE staff sent MPM a letter concerning these violations. Despite assurances that it would take corrective action to remedy these violations, MPM continued to violate securities laws at the time of OCIE's 2011 examination by failing to complete an annual compliance review in 2009 and by continuing to make misleading statements regarding its access to DFA funds in its marketing materials. MPM also misleadingly represented in one location on its website that it had over $600 million in assets when it reported in its Form ADV that it had less than $325 million in assets under management as of September 2011. Based on these actions, MPM willfully violated, and Damasco and Ohm willfully aided and abetted and caused MPM's violations of, Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-1(a)(5) thereunder.

Respondents

1. **Modern Portfolio Management, Inc. ("MPM")** is a SEC-registered investment adviser located in Holland, Ohio that was founded in 1995 by Damasco and Ohm. Damasco and Ohm are the principal shareholders of MPM, with Damasco serving as Chief Executive Officer ("CEO") and Ohm serving as President. MPM reported in its Form ADV that it provides customized non-discretionary portfolio management services to approximately 2200 clients with assets under management ("AUM") of approximately $378 million.

2. **G. Thomas Damasco II**, age 55 and a resident of Swanton, Ohio, is MPM's co-owner and CEO and has been designated as its Chief Compliance Officer ("CCO") since November 2012. Damasco previously held Series 7, 24 and 31 licenses and currently has Series 63 and 65 licenses and a license for selling insurance in Ohio. Before founding MPM, Damasco

[1] The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding..

worked as a registered representative at various broker-dealers. Damasco has not been the subject of any Commission disciplinary action.

3. **Bryan F. Ohm**, age 57 and a resident of Maumee, Ohio, is the co-owner and President of MPM. Before founding MPM, Ohm worked as a registered representative at various broker-dealers. Ohm previously held a Series 7 license and currently has Series 63 and 65 licenses and a license for selling insurance in Ohio. Ohm has not been the subject of any Commission disciplinary action.

Facts

4. In 2001, Damasco and Ohm tasked an employee with less than three months of experience with overseeing compliance at MPM even though that employee had no Advisers Act compliance knowledge, experience or training. In 2006, MPM designated the employee as MPM's CCO without ensuring that the employee had adequate knowledge, training or resources to assess MPM's compliance with the Advisers Act.

5. MPM's policies and procedures required, among other things, that MPM's CCO complete annual compliance reviews each year, consistent with its obligations under the Advisers Act, and that Damasco and Ohm approve the annual compliance review.

6. MPM's policies and procedures also required that MPM's marketing materials be truthful and accurate and include all relevant disclosures and facts to ensure that the materials distributed to current and prospective clients were not misleading, fraudulent, deceptive or manipulative. Damasco and Ohm designated MPM's CCO to review and approve the marketing materials to ensure that they were consistent with MPM's policy and with regulatory requirements. Damasco and Ohm also had responsibility for, reviewed and approved MPM's marketing materials during the relevant period.

7. MPM's policies and procedures required that all performance information "be truthful and accurate, and prepared and presented in a manner consistent with applicable rules and regulatory guidelines," and that "all relevant disclosures and facts be made as necessary in marketing materials," including "making any and all disclosures required by the *Clover Capital Management* no-action letter." Damasco and Ohm were required to either review and approve the performance information or to designate another officer of the firm who was "familiar with the applicable rules and standards for performance advertising" to review and approve the performance information before it was disseminated to clients. Damasco and Ohm designated MPM's Chief Operating Officer ("COO") as the person responsible for "implementing and monitoring [MPM's] policy for the preparation, presentation, review and approval of any performance information to insure any materials are consistent with our policy and regulatory requirements." However, they were unaware, and took no steps to determine, whether the COO was familiar with the *Clover* guidelines or regulatory requirements for performance information before designating him to be responsible for MPM's performance information.

8. OCIE staff conducted an examination of MPM in September 2008. As of September 2008, MPM had failed to complete an annual compliance review in 2006, made misleading statements on its website and in its investor brochure regarding the exclusivity of its access to DFA funds, omitted from its performance information the disclosures set forth in the *Clover* no-action letter, and included disclosures that the *Clover* no-action letter stated were prohibited, in spite of its policy requiring compliance with *Clover*, and made misleading statements in its performance information by providing model results that did not deduct MPM's advisory fees.

9. Notwithstanding the requirements in MPM's policies and procedures, no annual compliance review was completed in 2006 and Damasco and Ohm did not approve an annual compliance review in 2006. They also did not designate an individual to review MPM's performance information who was knowledgeable about the guidelines for disclosures set forth in the *Clover* no-action letter despite an obligation to do so under MPM's policies and procedures. Damasco and Ohm also approved the misleading statements on MPM's website and investor brochure about MPM's purported exclusive access to DFA funds.

10. In February 2009, OCIE staff sent MPM a deficiency letter identifying all of these compliance failures. OCIE also cited its concern whether MPM's designated CCO was sufficiently knowledgeable regarding MPM's compliance operations relative to the Advisers Act to adequately administer MPM's compliance program as its CCO.

11. On April 30, 2009, Damasco and Ohm, on behalf of MPM, sent OCIE a response to the deficiency letter from its 2008 examination. In the response, Damasco and Ohm represented that MPM would take corrective action to remedy the deficiencies identified by OCIE staff. MPM specifically represented that it would complete annual compliance reviews, would add the *Clover* disclosures to its performance information, and would remove the statements about MPM's exclusive access to DFA funds.

12. MPM remedied a portion of the deficiencies and failed to address certain other deficiencies from the 2008 examination. Damasco and Ohm did not take any steps to ensure that all of the deficiencies identified by OCIE staff after the 2008 examination were corrected or to ensure that these compliance failures were not repeated going forward.

13. In 2009, MPM revised its website to indicate in one location that it had "over $600 million in assets" without qualifying that this number included assets under management and consultative assets. Ohm and Damasco participated in calculating the "$600 million in assets" and reviewed the website where the statement appeared. As of 2009 when this statement was added to MPM's website, MPM reported that its assets under management were less than $267 million on its Form ADV.

14. OCIE staff began another on-site examination of MPM in September 2011. At the time of the September 2011 examination, MPM had failed to complete an annual compliance review in 2009 and continued to refer to MPM's exclusive access to DFA funds on its website and in its investor brochure. In addition, the unqualified "$600 million in assets"

statement continued to appear on MPM's website even though MPM reported less than $325 million in assets under management as of September 2011 on its Form ADV.

15. Despite MPM's policy requiring Damasco and Ohm to approve its annual compliance reviews and Damasco's and Ohm's representation to OCIE in April 2009 that MPM would complete annual compliance reviews, MPM did not complete an annual compliance review in 2009 and Damasco and Ohm did not approve an annual compliance review in 2009. In addition, Damasco and Ohm did not take any steps to make sure that the statements about MPM's exclusive access to DFA funds were not repeated when MPM revised its website in 2009 or updated its investor brochure in 2010.

16. In February 2012, OCIE staff sent MPM another deficiency letter which identified MPM's failure to complete an annual compliance review in 2009, its continued misleading statement regarding exclusive access to DFA funds in its marketing materials, and its representation that it had "over $600 million in assets" on its website while it actually had less than $325 million in assets under management on its Form ADV.

17. In March 2012, in response to OCIE's second deficiency letter, MPM began taking steps to rectify the unresolved issues from the 2008 and 2011 examinations. Also, in June 2012, MPM confirmed that it had changed the reference on its website from over $600 million in assets to over $300 million in assets under management.

18. Damasco and Ohm were aware of the deficiencies identified by OCIE during the 2011 examination and did not take adequate corrective action to prevent the failures from the 2008 examination from being repeated during the 2011 examination.

19. In November 2012, MPM's CCO departed. MPM designated Damasco as its CCO despite his lack of compliance experience and unfamiliarity with compliance requirements under the Advisers Act.

Violations

20. As a result of its misleading statements in its marketing materials regarding MPM's exclusive access to DFA funds as described in paragraphs 8 and 14 above, its misleading statements in its performance information by providing model results that did not deduct MPM's advisory fees as described in paragraph 8 above, and its misleading representation on its website that it had over $600 million in assets as described in paragraphs 13 and 14 above, MPM willfully violated Section 206(2) of the Advisers Act, which prohibits registered investment advisers from, directly or indirectly, engaging in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client.

21. As a result of its failure to perform annual compliance reviews as described in paragraphs 5, 8 and 14 above and its failure to implement the requirements of its policies and procedures related to model performance disclosures as described in paragraphs 7 and 8 above, MPM willfully violated Section 206(4) of the Advisers Act, which prohibits fraudulent conduct by

an investment adviser, and Rule 206(4)-7 thereunder, which requires, among other things, that a registered investment adviser: (1) implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules; (2) review at least annually its written policies and procedures and the effectiveness of their implementation; and (3) designate a CCO.

22. As a result of its misleading statements in its marketing materials regarding MPM's exclusive access to DFA funds as described in paragraphs 8 and 14 above, its misleading statements in its performance information by providing model results that did not deduct MPM's advisory fees as described in paragraph 8 above, and its misleading representation on its website that it had over $600 million in assets as described in paragraphs 13 and 14 above, MPM willfully violated Section 206(4) of the Advisers Act, which prohibits fraudulent conduct by an investment adviser, and Rule 206(4)-1(a)(5) thereunder, which prohibits registered investment advisers from, directly or indirectly, publishing, circulating or distributing any advertisement which contains any untrue statement of a material fact, or which is otherwise false or misleading.

23. As a result of Damasco's and Ohm's conduct regarding MPM's statements in marketing materials about its exclusive access to DFA funds, its misleading statements in its performance information by providing model results that did not deduct MPM's advisory fees, and its misleading representation that MPM had "over $600 million in assets" as described in paragraphs 6-9, 11-15 and 18 above, Damasco and Ohm willfully aided and abetted and caused MPM's violation of Section 206(2) of the Advisers Act.

24. As a result of Damasco and Ohm's conduct related to the failure to complete annual compliance reviews and its failure to implement the requirements of its policies and procedures related to model performance disclosures as described in paragraphs 5, 7-9, 11, 12, 14, 15 and 18 above, Damasco and Ohm willfully aided and abetted and caused MPM's violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

25. As a result of Damasco's and Ohm's conduct regarding MPM's statements of its exclusive access to DFA funds, its misleading statements in its performance information by providing model results that did not deduct MPM's advisory fees, and its misleading representation that MPM had "over $600 million in assets" as described in paragraphs 6-9, 11-15 and 18 above, Damasco and Ohm willfully aided and abetted and caused MPM's violations of Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder.

Respondents' Remedial Efforts

26. In deciding to accept the Offer, the Commission considered the remedial acts promptly undertaken by MPM, Damasco and Ohm and the cooperation afforded the Commission staff. During the Commission's staff investigation, MPM engaged a compliance consultant to advise MPM on compliance issues.

Undertakings

Respondents have undertaken to:

27. Compliance Training. By November 1, 2014, Damasco and Ohm shall each complete thirty (30) hours of compliance training relating to the Adviser's Act.

28. Designation of CCO. Within sixty (60) days of entry of this Order, MPM shall designate someone other than Damasco or Ohm to be its CCO.

29. Continued Retention of Compliance Consultant. MPM currently retains a compliance consultant to render compliance services. MPM shall continue to retain, at its expense, either its current compliance consultant or an independent compliance consultant, to render compliance services for a period of at least three (3) years from the entry of this Order. The scope of the engagement of MPM's current compliance consultant or the independent compliance consultant must include at least the same responsibilities detailed in MPM's March 2013 contract with its current compliance consultant, including comprehensive annual compliance reviews. To the extent MPM's current compliance consultant has already made recommendations for changes in or improvements to MPM's policies and procedures and/or disclosures to clients, MPM shall adopt and implement all such recommendations.

30. Recordkeeping. MPM shall preserve for a period of no less than six (6) years from the end of the fiscal year last used, the first two (2) years in an easily accessible place, any record of MPM's compliance with the undertakings set forth in this Order.

31. Deadlines. For good cause shown, the Commission staff may extend any of the procedural dates relating to the undertakings. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

32. Certification of Compliance. MPM, Damasco and Ohm shall certify, in writing, compliance with the undertakings set forth above in paragraphs 27-29. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and MPM, Damasco and Ohm agree to provide such evidence. The certification and supporting material shall be submitted to James A. Davidson, Assistant Director, Securities and Exchange Commission, 175 West Jackson, Suite 900, Chicago, Illinois 60604, or such other address as the Commission staff may provide, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of each of the undertakings in paragraphs 27-29.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act against MPM, and Sections 203(f) and 203(k) of the Advisers Act against Damasco and Ohm, it is hereby ORDERED that:

A. Respondents MPM, Damasco and Ohm cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-1(a)(5) promulgated thereunder.

B. Respondents MPM, Damasco and Ohm are censured.

C. Respondent MPM shall pay a civil money penalty in the amount of $75,000 to the United States Treasury. Respondent MPM shall pay $37,500 within ten (10) days of entry of the order and the remaining $37,500 within one-hundred eighty (180) days of entry of the order. Respondent Damasco shall pay a civil money penalty in the amount of $50,000 to the United States Treasury. Respondent Damasco shall pay $25,000 within ten (10) days of entry of the order and the remaining $25,000 within one-hundred eighty (180) days of entry of the order. Respondent Ohm shall pay a civil money penalty in the amount of $50,000 to the United States Treasury. Respondent Ohm shall pay $25,000 within ten (10) days of entry of the order and the remaining $25,000 within one-hundred eighty (180) days of entry of the order.

If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(2) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying MPM, Damasco, and Ohm as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to James A. Davidson, Assistant Director, Chicago Regional Office, Securities and Exchange Commission, 175 West Jackson, Suite 900, Chicago, Illinois 60604.

D. Respondents shall comply with the undertakings enumerated in Section III, paragraphs 27-32 above.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70742 / October 23, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3703 / October 23, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15584

In the Matter of Stephen Derby Gisclair, Respondent.	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940 AND SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (the "Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 (the "Advisers Act") and Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") against Stephen Derby Gisclair ("Gisclair" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 and Section 15(b)(6) of the Exchange Act, Making Findings, and Imposing Remedial Sanctions and A Cease-and-Desist Order (the "Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

Summary

These proceedings concern violations of the advertising, compliance, and reporting provisions of the Advisers Act, and customer information protection provisions of Regulation S-P, committed or aided, abetted, and caused by Respondent Gisclair as an owner and officer of three registered investment advisers—Equitas Capital Advisors, LLC ("Equitas"), Equitas Partners, LLC ("Equitas Partners"), and Crescent Capital Consulting, LLC ("Crescent"). These violations arise from (1) Equitas' and Crescent's inadvertent over billing and under billing of certain clients; (2) Equitas' negligently making false and misleading disclosures to clients and potential clients in its advertising and Forms ADV about Equitas' compensation and conflicts of interest; (3) Equitas' and Crescent's failure to maintain written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules; (4) Equitas', Equitas Partners', and Crescent's failure to conduct annual compliance reviews as required by the Advisers Act's rules; and (5) Equitas' and Crescent's overstatement of Reported Assets Under Management. Many of these violations occurred despite warnings by the staff of the Commission's Office of Compliance Inspections and Examinations ("OCIE") in connection with its examinations of Equitas and Equitas Partners in 2005 and 2008. OCIE found some of the same deficiencies during its first examination of Crescent in 2012-13. Equitas Partners and Crescent also should have disclosed some of the examination deficiencies identified by OCIE to potential clients, but did not do so. As Equitas' Chief Operating Officer ("COO") and Equitas Partners' Chief Compliance Officer ("CCO") until he left those firms in September 2010, and then as Crescent's CCO until the end of 2012, Gisclair was at least in part responsible for these violations.

Respondent

1. **Stephen Derby Gisclair** (CRD No. 1040641), age 61, is a founder and minority owner of Crescent, a registered investment adviser, where he provides investment advice to clients. Gisclair served as Crescent's CCO from its creation in 2010 until January 1, 2013. Prior to Crescent, Gisclair served as COO of Equitas and CCO of Equitas Partners, two investment advisers Gisclair co-founded and co-owned. Gisclair holds, or previously held, Series 3, 7, and 63 securities licenses since the 1980s and a Series 65 license since 1993.

Registered Investment Advisers

2. **Equitas Capital Advisors, LLC,** is a Louisiana limited liability company based in New Orleans, Louisiana. Equitas (SEC File No. 801-61979) registered with the Commission as an investment adviser effective September 3, 2002. Its core business is recommending money managers to clients, as opposed to investing their assets directly. During Gisclair's tenure, Equitas managed approximately $2.6 billion in regulatory assets under management ("RAUM").

3. **Equitas Partners, LLC,** is a Louisiana limited liability company based in New Orleans, Louisiana. Equitas Partners (SEC File No. 801-64205) was registered with the Commission as an investment adviser from approximately 2005 until it withdrew in March 2012. During Gisclair's tenure, Equitas Partners' principal client was a fund of hedge funds called the Evergreen Fund with RAUM of as much as approximately $250 million and approximately $97 million when Gisclair left in late 2010.

4. **Crescent Capital Consulting, LLC,** is a Louisiana limited liability company based in New Orleans, LA. Crescent (File No. 801-71795) registered with the Commission as an investment adviser effective August 20, 2010. It is not affiliated with Equitas. According to its Forms ADV, Crescents' core business is recommending money managers to clients, as opposed to investing their assets directly. In its Form ADV filed on August 1, 2013, Crescent reported approximately $300 million in RAUM held in 289 discretionary and non-discretionary accounts.

Facts

Gisclair's Involvement in Commission Examinations of Equitas, Equitas Partners, and Crescent

5. In 2005 and 2008, OCIE staff examined Equitas and Equitas Partners. Following each examination, OCIE staff orally and in writing reported to the firms the deficiencies it had found with their compliance with certain provisions of the federal securities laws. Until his departure in September 2010, Gisclair was Equitas' COO, supervised Equitas' CCO, and was CCO of Equitas Partners. He was the firms' primary liaison with OCIE staff and the primary author of the firms' responses to the staff's deficiency letters.

6. Beginning early in 2012, OCIE staff examined Crescent. As Crescent's then-CCO, Gisclair again was the primary liaison with OCIE staff. OCIE staff orally communicated certain deficiencies to Crescent during its examination and issued a letter on March 5, 2013 detailing deficiencies it had found with Crescent's compliance with certain provisions of the federal securities laws, including inaccurate Forms ADV reporting, over- and under-billing of clients, misleading advertising, inadequate compliance and internal controls, inadequate review of employee trading, and certain missing required books and records.

Equitas and Crescent Inadvertently Overcharged Some Clients

7. From at least January 2008 until Gisclair left in September 2010, Equitas overcharged and undercharged clients for advisory fees. These billing errors were inadvertent and due primarily to back-office errors by Gisclair, Equitas' COO, who designed and controlled the firm's revenue tracking and fee billing system. Since Gisclair's departure, Equitas has refunded the overcharged amounts to clients, plus interest, and has decided not to pursue collections of any of the undercharges.

8. These billing errors occurred and persisted, at least in part, because Gisclair failed to adopt and implement sufficient policies, procedures, and checks reasonably designed to prevent billing errors despite warnings from OCIE staff in 2005 and 2008. Equitas'

revenue tracking and fee billing system was dependent upon the manual entry of client monthly and quarterly account values and fee offset amounts into an Excel spreadsheet from numerous paper and electronic sources that Equitas received. As explained below in paragraph 11, these fee offsets resulted from fee sharing arrangements clients had with Equitas and others, which led to Credit Balances. Despite the manual nature of this process, Gisclair alone manually populated the Excel spreadsheet that calculated the fees, with minimal, if any, review by others. As a result, and as OCIE staff repeatedly warned, Equitas' fee billing process was highly prone to errors. Recurring formula, formatting, and typographical errors in the Excel file used led to miscalculations of fee offsets and Credit Balances and resulted in billing errors. Despite OCIE staff repeatedly identifying these weaknesses and errors, Gisclair made no significant or effective changes to Equitas' fee billing process.

9. At Crescent, Gisclair continued the same problematic billing process, and OCIE staff found the same type of billing errors during its 2012-2013 examination of Crescent. Crescent began operations in 2010 and as of the end of 2011 outstanding overcharges for 31 clients totaled $24,301 (ranging from $0.33 to $5,439 per client), and outstanding undercharges for 40 clients totaled $19,182. The amounts varied by client and overcharges. Crescent has reimbursed the affected clients. Crescent has also instituted, as of April 1, 2013, a new more automated billing system that uses information fed directly from client account custodians, minimizing the need for manual entry.

Equitas Failed to Adequately Disclose Certain Fees and Conflicts of Interest

10. Equitas' core business is recommending money managers to clients, as opposed to investing their assets directly, and typically charges its clients a quarterly fee based on assets under management. Beginning in at least 2006, and despite prior warnings from OCIE staff, Equitas did not adequately disclose to its clients and potential clients material information about extra compensation it earned and could earn from recommending investments in certain hedge funds and through a particular wrap fee program, and about the conflicts of interest caused thereby. Until his departure in September 2010, Gisclair bore significant responsibility for these disclosures as Equitas' COO.

11. Beginning in at least 2006, for many of its clients, Equitas received or potentially could have received additional compensation for placing clients into: (i) a managed-account wrap-fee program that Equitas sponsored through an independent broker dealer ("IBD"); and (ii) a third party family of hedge funds. Participating clients owed separate fees to both Equitas and the IBD or hedge fund manager. The IBD and fund manager each agreed to share with Equitas a percentage of these fees paid by Equitas' clients. Subject to a significant limitation, Equitas in turn agreed with its clients to use those shared fees to offset, on a dollar-for-dollar basis, the particular client's fees separately due to Equitas. To the extent the offset was greater than the fee Equitas billed the client, Equitas rolled over that balance (the "Credit Balance") on a quarterly basis until the end of the calendar year. At year end, any Credit Balance reverted to zero and Equitas retained any unused balance as additional compensation. Although only some clients carried Credit Balances, this potential for extra compensation created a financial incentive for Equitas to recommend these investments over others and thus created a conflict of interest.

12. During its 2008 examination, OCIE staff warned Equitas that Equitas' disclosure about how these fee offsets and credit balances worked, and the conflicts they created, was inadequate and misleading. After OCIE's 2008 examination, Equitas added to client invoices and to certain sections of its Form ADV Part II/2A a disclosure that Credit Balances expired at year-end, and added to certain sections of its Form ADV Part II/2A a statement that expired Balances constituted extra compensation to Equitas. In other sections of its Form ADV Part II/2A, however, and in its client correspondence, fee reviews, client agreements, and other marketing material, Equitas stated simply that all revenues Equitas received in these fee-sharing arrangements were "credited on a dollar-for-dollar basis against our client's consulting fee." These statements failed to disclose that the Credit Balances expired at year-end and, when they did expire, Equitas kept this unused balance as extra compensation. During Gisclair's time at Equitas, the firm also did not expressly identify the conflict of interest attendant to these fee arrangements or describe how such conflicts were addressed.

13. During Gisclair's tenure, Equitas also never disclosed, in its Forms ADV or otherwise, the conflict of interest it had in recommending investment in the Evergreen Fund, which Equitas principals, including Gisclair, managed through Equitas Partners. Equitas also never described how it addressed such conflicts, as required by Form ADV.[1] Approximately 50 clients of Equitas were Evergreen investors from 2008 through 2010. Equitas Partners was paid a percentage of Evergreen's assets and a potential performance fee, providing Gisclair and other Equitas principals, through their control of Equitas Partners, a clear financial incentive to recommend that clients buy and remain in that fund. For instance, while disclosing in one section of its Forms ADV Part II/2A that Equitas Partners managed the Evergreen Fund and that both were under common control with Equitas, Equitas' Form ADV incorrectly stated elsewhere, "None of [Equitas'] principals or employees engages in any other business activity which would impede or conflict with their duties or responsibilities to the Company's clients." While at Equitas, Gisclair prepared and/or filed all of the firm's Forms ADV.

14. Despite requests by OCIE not to do so, Equitas also marketed itself as an "objective" consultant that used an "unbiased approach driven by process, not product." These and other claims of independence, that also appeared on Equitas' website and in other marketing materials prepared or approved by Gisclair and others, were misleading. In addition, Equitas claimed in responses to requests for proposals ("RFPs") from potential clients that, "[w]e are unaware of any potential conflicts of interest that may exist or which may develop as a result of our relationship with [potential client]," and "[o]ur policy is to avoid all actual and potential

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1 During the pertinent period, various provisions of Form ADV specifically required Equitas to disclose these types of conflicts. For instance, when supervised persons of advisers manage both accounts that charge a performance fee and accounts that charge another fee type, Item 6 of Part 2A requires disclosure of how the firm addresses the conflicts of interest caused by the incentive to favor the former account because of greater potential fees. If an adviser receives compensation directly from advisers it recommends, Item 10.D of Part 2A requires advisers to describe the conflicts created by such practices and how such conflicts are addressed. Before Form ADV was amended in 2011, where the adviser had an interest in a client transaction, such as recommending a security or product in which the adviser or its related person has some financial interest, Item 9 of Part II required advisers to disclose what restrictions, procedures or disclosures were used for the related conflicts of interest in these transactions.

conflicts of interest."[2] Gisclair either prepared or approved these responses.

Equitas and Crescent Overstated Reported Assets Under Management

15. Gisclair's responsibilities as Equitas COO and Crescent CCO included preparing and filing the firms' Forms ADV. Gisclair improperly included $1.5 billion in ineligible assets as Assets Under Management ("AUM") in the Forms ADV of both Equitas (since at least 2006 until he left to form Crescent in late 2010) and Crescent (since inception). These assets—mostly attributable to one particular client—were ineligible for inclusion because they were managed pursuant to *ad hoc*, one-time, limited engagements. Only securities portfolios for which an adviser provides "continuous and regular supervisory or management services" can be counted as an adviser's AUM, according to the Instructions for Item 5.F. of Form ADV Part 1A. By including these assets, Equitas' reported AUM was overstated by 25% and Crescent's AUM reported AUM was overstated by 60%.

16. Equitas used its overstated AUM to improperly describe itself, on its website, as "the largest independent investment management consulting practice in Louisiana." Crescent also used its overstated AUM to describe itself, on its website and in RFP responses, as "one of the largest" and "quickly becoming one of the largest independently owned investment management firms in the country." These descriptions were misleading, not only because the firms' AUM was significantly less than claimed, but also because the descriptions were unaccompanied by any caveats, disclaimers, or other clarifying explanations. Gisclair included or approved these and other statements in both firms' marketing materials despite having been warned about these types of statements by OCIE staff during its 2008 Equitas examination.

Equitas and Crescent Failed to Maintain Written Compliance Policies and Procedures and Equitas and Equitas Partners Failed to Conduct Annual Compliance Reviews that Satisfied the Advisers Act

17. During Gisclair's tenure from at least 2005 through September 2010, Equitas failed to comply with the mandate under Rule 206(4)-7 of the Advisers Act that every registered investment adviser adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules by the adviser and its supervised persons. While Equitas had a policy and procedures manual, it was based in part on a manual Gisclair used when employed at a broker dealer, and was not sufficiently tailored to Equitas' business of recommending other money managers. Further, despite repeated suggestions from OCIE staff, Equitas made only minor changes to its manual. Significantly, the manual was not reasonably designed to prevent and detect billing errors. The manual also did not address the conflicts of interest arising from Equitas' recommendation of investments with potential additional compensation to the firm, including the Evergreen Fund managed by Gisclair and

[2] An investment adviser is a fiduciary who owes his clients "an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' his clients." *SEC v. Capital Gains*, 375 U.S. 180, 194 (1963).

other Equitas principals through Equitas Partners. As Equitas' COO, Gisclair most directly supervised the firm's CCO and shared direct responsibility for its manual.

18. In addition, during Gisclair's tenure, Equitas and Equitas Partners failed to comply with the mandate in Rule 206(4)-7 that every registered investment adviser review at least annually the adequacy of its required policies and procedures and the effectiveness of their implementation. While there was some review of Equitas' manual during Gisclair's tenure, no one annually reviewed the adequacy of either Equitas' or Equitas Partners' policies and procedures and the effectiveness of their implementation as required by Rule 206(4)-7. In the case of Equitas Partners, it appears no separate review of any kind ever occurred. During its 2005 and 2008 examinations and in each deficiency letter sent to Equitas and Equitas Partners, OCIE staff noted these failures. As Equitas Partners' CCO, and as the most direct supervisor of Equitas' CCO, Gisclair bears responsibility for these failures.

19. For the first few months of Crescent's existence, and under Gisclair's leadership as founder and CCO, Crescent did not have any written compliance policies or procedures from August 2010 until December 31, 2010.

Gisclair Improperly Removed or Retained Nonpublic Personal Information about Equitas Customers

20. In violation of the privacy policies of both Equitas and Equitas Partners, Gisclair improperly removed or retained nonpublic personal information about both firms' clients. The information included electronic storage drives of account statements, values and numbers, money manager lists, investment portfolios, asset allocation studies, performance reports, invoices and billing information, and contact information. While Gisclair solicited Equitas clients to become Crescent clients, he claims the client information he removed or retained was only used after express permission from clients.

21. Gisclair did not provide advance notice to Equitas, Equitas Partners, or their clients of his removal or retention of this information. No client was given the opportunity to opt out of Gisclair's removal or retention of this information, as required by Rule 10 of Regulation S-P. To the contrary, Gisclair's removal and retention of this nonpublic personal information violated promises the firms made to their clients in privacy notices, wrap fee agreements, Evergreen Fund subscription agreements, and Equitas client engagement letters, many of which Gisclair signed personally. These same promises were memorialized in Equitas and Equitas Partners compliance manuals, which Gisclair had drafted and which he and other Equitas employees acknowledged annually.[3]

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[3] Based on his removal of Equitas client information and failure to disclose a related lawsuit Equitas filed against Gisclair and others, the Investment Management Consultants Association ("IMCA") found in October 2012 that Gisclair violated provisions of the IMCA's Standards of Practice, Code of Professional Responsibility, and Disciplinary Rules and Procedures. The IMCA, a professional organization to which Gisclair belongs, issued a letter of private censure to Gisclair and required him to fulfill five additional hours of continuing education in ethics. Subject to the fulfillment of the education requirement, Gisclair remains a member in good standing with the IMCA.

Equitas Partners Omitted Examination Deficiencies in Advertisements to Potential Clients

22. In connection with each of its examinations of Equitas and Equitas Partners in 2005 and 2008, OCIE staff notified the firms orally and in writing about numerous deficiencies, including those discussed in this Order. Equitas and Equitas Partners should have disclosed these deficiencies to potential clients in response to questions in certain due diligence questionnaires, but did not do so. For example, Gisclair assisted in preparing a 2008 year-end "due diligence questionnaire" for Equitas Partners to provide to potential investors in its Evergreen Fund. In response to a question Equitas Partners itself drafted about regulatory audits and what changes were made as a result thereof, Equitas Partners omitted any reference to OCIE's 26-page September 23, 2008, deficiency letter and falsely answered that it had "completed our first examination by the SEC and there were no exceptions noted or changes made to our operations."

Violations

23. As a result of the conduct described above, Gisclair willfully[4] aided and abetted and caused violations by Crescent and Equitas of Section 206(4) of the Advisers Act and Rules 206(4)-1(a)(5) thereunder, which prohibits publishing, circulating or distributing advertisements containing untrue statements of material facts, or that were otherwise false or misleading.

24. As a result of the conduct described above, Gisclair willfully aided and abetted and caused violations by Crescent, Equitas, and Equitas Partners of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require, among other things, that a registered investment adviser: (1) implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and the rules thereunder by the adviser and its supervised persons; and (2) conduct at least annual reviews of the adequacy of such policies and procedures and the effectiveness of their implementation.

25. As a result of the conduct described above, Gisclair willfully violated Section 207 of the Advisers Act, which makes it unlawful "for any person willfully to make any untrue statements of material fact in any registration application or report filed with the Commission under Section 203 or 204, or willfully to omit to state in any such application or report any material fact which is required to be stated therein."

26. As a result of the conduct described above, Gisclair willfully aided and abetted and caused violations by Equitas and Equitas Partners of Rule 10 of Regulation S-P [17 C.F.R. §248.10], which prohibits investment advisers registered with the Commission, either directly or through an affiliate, from disclosing nonpublic personal information about their

[4] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

customers to nonaffiliated third parties unless they have provided their customers with a privacy notice describing the nonpublic personal information they disclose, and notify their customers of their right to opt out of any disclosure and afford them a reasonable opportunity to opt out of the disclosure before it is made.[5]

Remedial Efforts

27. In determining to accept Respondent's Offer, the Commission considered and the following remedial acts undertaken by Respondent:

a. Respondent relinquished his chief compliance officer role and title at Crescent effective January 1, 2013;

b. Respondent caused Crescent to:

i. hire an independent consultant in 2012 to evaluate and improve its compliance practices and procedures, including matters related to the deficiencies found by OCIE during its 2012-2013 examination;

ii. reimburse 31 of its clients a total of $24,301 in improperly billed advisory fees; and

iii. on April 1, 2013, implement a new, more automated billing system expected to reduce, if not eliminate, the fee calculation errors caused by the previous system that required extensive manual entries.

Undertakings

Respondent shall comply with the following undertakings:

28. Notice to Advisory Clients. Within thirty (30) days of the entry of this Order, Respondent Gisclair shall provide a copy of the Order via mail, e-mail, or such other method as may be not unacceptable to the Commission staff, together with a cover letter in a form not unacceptable to the Commission staff, to each of the Crescent clients overcharged between 2010 and April 5, 2013 and each of Crescent's existing advisory clients as of the entry of this Order.

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[5] Nonpublic personal information is defined as personally identifiable financial information and includes "[a]ny list, description, or other grouping of consumers (and publicly available information pertaining to them) that is derived using any personally identifiable financial information that is not publicly available information." 17 C.F.R. § 248.3(t)(1). "Personally identifiable financial information" in turn is defined as information (i) a consumer provides to you to obtain a financial product or service from you; (ii) about a consumer resulting from any transaction involving a financial product or service between you and a consumer; or (iii) you otherwise obtain about a consumer in connection with providing a financial product or service to that consumer. *Id.* § 248.3(u)(1).

29. Certifications of Compliance by Respondent. Respondent Gisclair shall certify, in writing, compliance with his undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Jeffrey Finnell, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549-6010-A, or such other address as the Commission staff may provide, with a copy to the Office of Chief Counsel of the Enforcement Division (100 F St., N.E., Washington, DC 20549), no later than sixty (60) days from the date of the completion of the undertakings.

30. Deadlines. For good cause shown, the Commission's staff may extend any of the procedural dates relating to the undertakings. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, and for the protection of investors to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 203(f) and 203(k) of the Advisers Act and Section 15(b)(6) of the Exchange Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Sections 206(4) and 207 of the Advisers Act and Rules 206(4)-1, 206(4)-7 promulgated thereunder, and Rule 10 of Regulation S-P [17 C.F.R. § 248.10].

B. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $90,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

(a) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(b) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Stephen Derby Gisclair as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Jeffrey Finnell, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549-5010-A.

C. Respondents shall comply with his undertakings enumerated in Section III above.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70743 / October 23, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3704 / October 23, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15585

In the Matter of **Equitas Capital Advisors, LLC, Equitas Partners, LLC, David S. Thomas, Jr, and Susan Christina,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940 AND SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission (the "Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 (the "Advisers Act") against Equitas Capital Advisors, LLC, and Equitas Partners, LLC, and pursuant to Sections 203(f) and 203(k) of the Advisers Act and Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") against David S. Thomas, Jr. ("Thomas") and Susan Christina ("Christina") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over Respondents and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 and Section 15(b)(6) of the Exchange Act, Making Findings, and Imposing Remedial Sanctions and A Cease-and-Desist Order (the "Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds that:

Summary

These proceedings concern violations of the Advisers Act by Equitas Capital Advisors, LLC ("Equitas"), a registered investment adviser, arising from Equitas' inadvertent over billing and under billing of certain clients and its negligently making false and misleading disclosures to clients and potential clients about Equitas' historical performance, compensation, conflicts of interest, and prior examination deficiencies. Equitas also violated the compliance-related rules under the Advisers Act, as did Equitas Partners, LLC ("Equitas Partners"), a registered investment adviser under common control with Equitas, by failing to conduct the required annual compliance reviews, and, in the case of Equitas, by failing to maintain written compliance policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules. Their principal and chief executive officer ("CEO"), David Thomas, aided, abetted, and caused the advertising violations, while he and the firms' chief compliance officer ("CCO"), Susan Christina, aided, abetted, and caused the compliance-related violations. These violations occurred despite warnings by the staff of the Commission's Office of Compliance Inspections and Examinations ("OCIE") in connection with its examinations of Equitas and Equitas Partners in 2005, 2008, and 2011.

Respondents

1. **Equitas Capital Advisors, LLC,** is a Louisiana limited liability company based in New Orleans, Louisiana. Equitas (SEC File No. 801-61979) registered with the Commission as an investment adviser effective September 3, 2002. Its core business is recommending money managers to clients, as opposed to investing their assets directly. In its Form ADV filed on March 27, 2013, Equitas reported approximately $2.6 billion in regulatory assets under management ("RAUM") held in 436 accounts, all but four of which are non-discretionary. During the time period covered in this Order, Equitas managed as much as approximately $3 billion in RAUM and employed as many as ten investment professionals.

2. **Equitas Partners, LLC,** is a Louisiana limited liability company based in New Orleans, Louisiana. Equitas Partners (SEC File No. 801-64205) was registered with the Commission as an investment adviser from approximately 2005 until it withdrew in March 2012. Equitas Partners' sole client is a fund of hedge funds called the Evergreen Fund until Q2 2013 when Equitas Partners, as the fund's general partner, hired Equitas as the fund's investment adviser. The fund had RAUM of approximately $54.6 million as of March 31, 2013.

3. **David S. Thomas, Jr.** (CRD No. 717970), age 57, is the principal founder, CEO, and sole owner of Equitas. He is also Equitas Partners' sole owner and principal investment

adviser. Thomas has held general and/or principal securities licenses since at least 1980 and has been a registered representative of a broker-dealer since 2006.

4. **Susan Christina** (CRD No. 717632), age 56, has worked at Equitas since its founding in 2002. She has been a member of the compliance committee and CCO of Equitas since approximately 2004 and CCO of Equitas Partners since January 2011. Christina has also been a registered representative of a broker-dealer since 2006.

Facts

Commission Examinations of Equitas and Equitas Partners

5. In 2005, 2008, and 2011, OCIE staff examined Equitas and Equitas Partners. Following each examination, OCIE staff orally and in writing reported to the firms the deficiencies it had found with their compliance with certain provisions of the federal securities laws. Equitas' then-chief operating officer ("COO") and Equitas Partners' then-CCO, who left the firm in late 2010, was the primary liaison with OCIE staff and the primary author of the firms' responses to the staff's deficiency letters in 2005 and 2008. Starting in 2011, Christina, then-CCO of both Equitas and Equitas Partners, became the primary liaison with OCIE and Thomas became more active in writing both firms' responses to OCIE. While becoming more involved starting in 2011, Respondents Thomas and Christina participated in each of OCIE's previous examinations, including meeting with OCIE staff, reviewing the deficiency letters sent by OCIE staff, and preparing and/or reviewing the firms' letters in response.

Equitas Inadvertently Overcharged Some Clients

6. From at least January 2008 through 2010, Equitas overcharged at least 16 clients a total of approximately $70,826 for investment advisory services. The overcharged amounts varied by client and ranged from $4.37 to $15,895. During the same period, Equitas also undercharged 44 clients a total of approximately $411,855. These billing errors were inadvertent and due primarily to back-office errors by Equitas' COO, who designed and controlled the firm's revenue tracking and fee billing system. Equitas has refunded the overcharged amounts to clients, plus interest, and has decided not to pursue collections of any of the undercharges.

7. These billing errors occurred and persisted until the departure of Equitas' former COO in late 2010 because Equitas failed to adopt and implement sufficient policies, procedures, and checks reasonably designed to prevent billing errors despite warnings from OCIE staff in 2005 and 2008. Equitas' revenue tracking and fee billing system was dependent upon the manual entry of client monthly and quarterly account values and fee offset amounts from numerous paper and electronic sources that Equitas received. As explained below in paragraph 10, these fee offsets resulted from fee sharing arrangements clients had with Equitas and others, which led to Credit Balances. Until late 2010, and despite the manual nature of this billing process, only one person at the firm—Equitas' former COO and principal—manually populated the Excel spreadsheet that calculated the fees, with minimal, if any, review by others. As a result, and as OCIE staff repeatedly warned, Equitas' fee billing process was highly prone

to errors. Recurring formula, formatting, and typographical errors in the Excel file Equitas used led to miscalculations of fee offsets and Credit Balances, and resulted in billing errors.

8. Despite OCIE staff repeatedly identifying these weaknesses and errors, Equitas made no significant or effective changes to its fee billing process until its former COO and principal departed in late 2010. At that point, Equitas identified errors in the Excel file and attempted to prevent similar errors on a going-forward basis. It was not until 2012, however—after OCIE had identified potential billing errors for a third time as part of its 2011 exam—that Equitas began to correct historical overcharges and refund clients.

Equitas Failed to Adequately Disclose Certain Fees and Conflicts of Interest

9. Equitas' core business is recommending money managers to clients, as opposed to investing their assets directly, and typically charges its clients a quarterly fee based on assets under management. From at least 2006 through 2011, and despite prior warnings from OCIE staff, Equitas did not adequately disclose to its clients and potential clients material information about extra compensation it earned and could earn from recommending investments in certain hedge funds and through a particular wrap fee program, and about the conflicts of interest caused thereby.

10. From 2006 through 2011, for many of its clients, Equitas received or potentially could have received additional compensation for placing clients into: (i) a managed-account wrap-fee program that Equitas sponsored through an independent broker dealer ("IBD"); and (ii) a third party family of hedge funds. Participating clients owed separate fees to both Equitas and the IBD or hedge fund manager. The IBD and fund manager each agreed to share with Equitas a percentage of these fees paid by Equitas' clients. Subject to a significant limitation, Equitas in turn agreed with its clients to use those shared fees to offset, on a dollar-for-dollar basis, the particular client's fees separately due to Equitas. To the extent the offset was greater than the fee Equitas billed the client, Equitas rolled over that balance (the "Credit Balance") on a quarterly basis until the end of the calendar year. At year end, however, any Credit Balance reverted to zero and Equitas retained any unused balance as additional compensation. Although only some clients carried Credit Balances, this potential for extra compensation created a financial incentive for Equitas to recommend these investments over others and thus created a conflict of interest.

11. During its 2008 and 2011 examinations, OCIE staff warned Equitas that its disclosure about how these fee offsets and credit balances worked, and the conflicts they created, was inadequate and misleading. After OCIE's 2008 examination, Equitas added to client invoices and to certain sections of its Form ADV Part II/2A a disclosure that Credit Balances expired at year-end, and added to certain sections of its Form ADV Part II/2A a statement that expired Balances constituted extra compensation to Equitas. In other sections of its Form ADV Part II/2A, however, and in its client correspondence, fee reviews, client agreements, and its marketing material, Equitas stated simply that all revenues Equitas received in these fee-sharing arrangements were "credited on a dollar-for-dollar basis against our client's consulting fee." These statements failed to disclose that the Credit Balances expired at year-end and, when they did expire, that Equitas kept this unused balance as extra compensation. Equitas

also did not expressly identify the conflict of interest attendant to these fee arrangements or describe how such conflicts were addressed until its March 2012 Form ADV amendment.

12. Equitas also did not disclose until 2012, in its Forms ADV or otherwise, the conflict of interest it had in recommending investment in the Evergreen Fund, which Respondent Thomas and other now-former Equitas principals managed through Equitas Partners. Equitas also never described how it addressed such conflicts, as required by Form ADV.[1] At least 51 clients of Equitas were Evergreen investors from 2008 through 2011. Equitas Partners was paid a percentage of Evergreen's assets and a potential performance fee, providing Thomas and other then-principals of Equitas, through their control of Equitas Partners, a clear financial incentive to recommend that clients buy and remain in that fund. For instance, while disclosing in one section of its Forms ADV Part II/2A that Equitas Partners managed the Evergreen Fund and that both were under common control with Equitas, Equitas incorrectly stated elsewhere, "None of [Equitas'] principals or employees engages in any other business activity which would impede or conflict with their duties or responsibilities to the Company's clients."

13. Equitas also denied it had any conflicts in its responses to requests for proposals ("RFPs") from potential clients, claiming "[w]e are unaware of any potential conflicts of interest that may exist or which may develop as a result of our relationship with [potential client]," and "[o]ur policy is to avoid all actual and potential conflicts of interest."[2] Equitas also denied any conflicts in its responses to OCIE's 2008 and 2011 deficiency letters. To the contrary, and despite requests by OCIE not to do so, Equitas misleadingly marketed itself on its website and elsewhere as an "objective" consultant that used an "unbiased approach driven by process, not product." Finally, Equitas failed to heed repeated warnings by OCIE staff to adopt and implement policies and procedures to prevent a failure to disclose its conflicts.

Equitas Disseminated Misleading Advertisements about Its Historical Performance

14. In 2011, Equitas distributed two materially misleading marketing pieces about the firm's historical performance in managing its clients' investments. CEO Thomas

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[1] During the pertinent period, various provisions of Form ADV specifically required Equitas to disclose these types of conflicts. For instance, when supervised persons of advisers manage both accounts that charge a performance fee and accounts that charge another fee type, Item 6 of Part 2A requires disclosure of how the firm addresses the conflicts of interest caused by the incentive to favor the former account because of greater potential fees. If an adviser receives compensation directly from advisers it recommends, Item 10.D of Part 2A requires advisers to describe the conflicts created by such practices and how such conflicts are addressed. Before Form ADV was amended in 2011, where the adviser had an interest in a client transaction, such as recommending a security or product in which the adviser or its related person has some financial interest, Item 9 of Part II required advisers to disclose what restrictions, procedures or disclosures were used for the related conflicts of interest in these transactions.

[2] An investment adviser is a fiduciary who owes his clients "an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' his clients." *SEC v. Capital Gains*, 375 U.S. 180, 194 (1963).

directed the preparation of these marketing pieces, and allowed one to be distributed without the approval of CCO Christina, despite the concerns she had raised and despite the fact that Equitas' compliance policies and procedures required CCO approval of advertisements.

15. In February and March 2011, in response to a number of RFPs from potential clients, Equitas distributed a misleading and out-of-date marketing piece stating that it had averaged "108 basis points of additional performance net of all fees for our clients while reducing risk and inefficiency in their portfolios." The advertisement contained no explanation of how the number was calculated, what the 108 basis points of performance was in addition to, and did not reference any time period. In fact, the claimed "additional performance" was long out of date. As Equitas later acknowledged, the firm calculated this purported additional performance in late 2007 or early 2008 and did not update it. Equitas' improper use of this outdated advertisement in 2011 appears to have been inadvertent and the result of the firm's failure to properly date the performance and inadequate controls over the distribution of advertisements.

16. On or about September 23, 2011, Equitas distributed another misleading advertisement to its clients, stating that Equitas' Louisiana investment clients had made more than $1 billion since Equitas was founded in 2002. The advertisement stated Equitas calculated the $1 billion figure by totaling the profits and losses of all present and past clients since the firm's inception. The advertisement failed, however, to include important disclosures and caveats. For example, the undated advertisement failed to disclose the extent to which the performance results were attributable to Equitas' services, and that the results reflected investments and managers not recommended by Equitas. In fact, prior to Equitas distributing the advertisement, CCO Christina advocated for the inclusion of some of these same disclaimers. Without them, Equitas' characterization of its historical performance improperly suggested that the $1 billion in claimed client gains were solely the product of Equitas' investment advice. Thomas authorized publicizing this misleading $1 billion advertisement notwithstanding CCO Christina's concerns and without her approval.

Equitas Failed to Maintain Written Compliance Policies and Procedures and Equitas and Equitas Partners Failed to Conduct Annual Compliance Reviews that Satisfied the Advisers Act

17. From at least 2005 through 2011, Equitas failed to comply with the mandate under Rule 206(4)-7 of the Advisers Act that every registered investment adviser adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules by the adviser and its supervised persons. While Equitas had a policy and procedures manual, it was based in part on a manual Equitas employees had used when employed at a broker dealer, and was not sufficiently tailored to Equitas' business of recommending other money managers. Further, despite repeated suggestions from OCIE staff, Equitas made few changes to its manual. Significantly, the manual was not reasonably designed to detect and prevent billing errors. The manual also did not address the conflicts of interest arising from the firm's recommendation of investments with potential additional compensation to the firm, including the Evergreen Fund managed by Thomas and other then-principals of Equitas through Equitas Partners.

18. In addition, from at least 2006 through 2011, Equitas and Equitas Partners failed to comply with the mandate in Rule 206(4)-7 that every registered investment adviser review at least annually the adequacy of its required policies and procedures and the effectiveness of their implementation. While CCO Christina and Equitas' former COO reviewed Equitas' manuals at times, no one annually reviewed the adequacy of Equitas' policies and procedures and the effectiveness of their implementation as required by Rule 206(4)-7. In the case of Equitas Partners, it appears no separate review of any kind ever occurred. During its 2005, 2008, and 2011 examinations and in each deficiency letter, OCIE staff noted these failures.

19. As Equitas' CCO since 2004 and Equitas Partners' CCO since early 2011, Christina was at least partially responsible for these compliance failures and the failures to heed OCIE's warnings. She also did not take sufficient steps to make compliance improvements she herself identified. For example, in 2009, CCO Christina sent a memo to Equitas' compliance committee, which included Respondent Thomas and the then-CCO of Equitas, recommending various improvements to Equitas' compliance program similar to the changes OCIE had identified. Her recommendations included conducting a more robust annual compliance review, outlining the fee billing process, documenting the adviser due diligence process, and improving the process for advertising approvals. Equitas failed to implement these changes.

Misleading Statements about SEC Examination Deficiencies

20. In connection with each of its examinations in 2005, 2008, and 2011, OCIE staff notified Equitas and Thomas orally and in writing about numerous deficiencies, including those discussed in this Order. Equitas, Equitas Partners, and Thomas should have disclosed these deficiencies to potential clients in response to questions in certain RFPs and due diligence questionnaires, but did not do so.

21. For example, Thomas assisted in preparing a 2008 year-end "due diligence questionnaire" for Equitas Partners to provide to potential investors in the Evergreen Fund. In response to a question Equitas Partners itself drafted about regulatory audits and what changes were made as a result thereof, Equitas Partners omitted any reference to OCIE's 26-page September 23, 2008, deficiency letter and falsely answered that it had "completed our first examination by the SEC and there were no exceptions noted or changes made to our operations."

22. In another example, a potential client in October 2011 asked Equitas in an RFP to "describe any SEC or any other governmental, regulatory, or administrative formal investigations, audits, actions, fines, censures, litigation criminal charges or convictions involving your firm during the past 10 years." Equitas responded, "There have been no governmental or regulatory investigations or actions other than the normal SEC Examinations given to all RIAs in the history of our firm." This characterization—without describing the multiple OCIE exams since 2005 or the repeated deficiencies OCIE found—was misleading.

Violations

23. As a result of the negligent conduct described above, Equitas willfully[3] violated Section 206(2) of the Advisers Act, which prohibits an investment adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client. A violation of Section 206(2) may rest on a finding of simple negligence; scienter is not required. *See SEC v. Steadman*, 967 F.2d 636, 643, n.5 (D.C. Cir. 1992).

24. As a result of the conduct described above, Equitas willfully violated Section 206(4) of the Advisers Act and Rules 206(4)-1(a)(5) thereunder, which prohibits publishing, circulating or distributing advertisements containing untrue statements of material facts, or that were otherwise false or misleading. Proof of scienter is not required to establish a violation of Section 206(4) of the Advisers Act. *See id. at* 647. Thomas willfully aided and abetted and caused Equitas' violations.

25. As a result of the conduct described above, Equitas and Equitas Partners willfully violated, and Thomas and Christina willfully aided and abetted and caused Equitas' and Equitas Partners' violations of, Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require, among other things, that a registered investment adviser: (1) implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and the rules thereunder by the adviser and its supervised persons; and (2) conduct at least annual reviews of the adequacy of such policies and procedures and the effectiveness of their implementation.

26. As a result of the conduct described above, Equitas willfully violated Section 207 of the Advisers Act, which makes it unlawful "for any person willfully to make any untrue statements of material fact in any registration application or report filed with the Commission under Section 203 or 204, or willfully to omit to state in any such application or report any material fact which is required to be stated therein."

Undertakings

Respondents undertake to take the following actions, as applicable.

27. Independent Compliance Consultant. Equitas and Equitas Partners have and shall continue to retain, subject to these Undertakings, the services of an independent compliance consultant (the "Independent Consultant") that is not unacceptable to the Commission staff. The Independent Consultant's compensation and expenses shall be borne exclusively by Equitas and Equitas Partners.

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[3] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

a. Equitas and Equitas Partners shall require that the Independent Consultant conduct three (3) annual reviews of Equitas' and Equitas Partners' supervisory, compliance, and other policies and procedures reasonably designed to detect and prevent violations of the federal securities laws by Equitas and Equitas Partners and their employees (the "Reviews"), including the adequacy of: (1) Equitas' and Equitas Partners' assessment, mitigation, and disclosure of their fee practices and conflicts of interest; (2) Equitas' revenue tracking and fee billing processes; (3) Equitas' and Equitas Partners' marketing and advertising; and (4) Equitas' and Equitas Partners' policies and procedures required by Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

b. The three (3) year period for the Reviews shall begin on the date of entry of this Order.

c. Equitas and Equitas Partners have provided to the Commission's staff a copy of an engagement letter detailing the Independent Consultant's responsibilities, which includes the Reviews to be made by the Independent Consultant as described in this Order.

d. Equitas and Equitas Partners shall require that, within forty-five (45) days from the end of the applicable annual period, the Independent Consultant shall submit a written and detailed report of its findings to Equitas and Equitas Partners and to the Commission staff (the "Report"). Equitas and Equitas Partners shall require that each Report include a description of the review performed, the names of the individuals who performed the review, the conclusions reached, the Independent Consultant's recommendations for changes in or improvements to Equitas' and Equitas Partners' policies and procedures and/or disclosures to clients, and a procedure for implementing the recommended changes in or improvements to Equitas' and Equitas Partners' policies and procedures and/or disclosures.

e. Equitas and Equitas Partners shall adopt all recommendations contained in each Report within sixty (60) days of the applicable Report; provided, however, that within forty-five (45) days after the date of the applicable Report, Equitas or Equitas Partners shall in writing advise the Independent Consultant and the Commission staff of any recommendation that Equitas or Equitas Partners considers to be unduly burdensome, impractical, or inappropriate. With respect to any recommendation that Equitas or Equitas Partners considers unduly burdensome, impractical, or inappropriate, Equitas or Equitas Partners need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure, or system designed to achieve the same objective or purpose.

f. As to any recommendation with respect to Equitas' or Equitas Partners' policies and procedures on which Equitas or Equitas Partners and the Independent Consultant do not agree, Equitas or Equitas Partners and the Independent Consultant shall attempt in good faith to reach an agreement within sixty (60) days after the date of the applicable Report. Within fifteen (15) days after the conclusion of the discussion and evaluation by Equitas and the Independent Consultant, Equitas or Equitas Partners shall require that the Independent Consultant inform Equitas or Equitas Partners and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that Equitas or

Equitas Partners considers to be unduly burdensome, impractical, or inappropriate. Equitas and Equitas Partners shall abide by the determinations of the Independent Consultant and, within sixty (60) days after final agreement between Equitas or Equitas Partners and the Independent Consultant or final determination by the Independent Consultant, whichever occurs first, Equitas and Equitas Partners shall adopt and implement all of the recommendations that the Independent Consultant deems appropriate.

g. Within ninety (90) days of Equitas' and Equitas Partners' adoption of all of the recommendations in a Report that the Independent Consultant deems appropriate, as determined pursuant to the procedures set forth herein, Equitas and Equitas Partners shall certify in writing to the Independent Consultant and the Commission staff that Equitas and Equitas Partners have adopted and implemented all of the Independent Consultant's recommendations in the applicable Report. Unless otherwise directed by the Commission staff, all Reports, certifications, and other documents required to be provided to the Commission staff shall be sent to Jeffrey Finnell, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549-6010-A, or such other address as the Commission's staff may provide.

h. Equitas and Equitas Partners shall cooperate fully with the Independent Consultant and shall provide the Independent Consultant with access to such of their files, books, records, and personnel as are reasonably requested by the Independent Consultant for review.

i. To ensure the independence of the Independent Consultant, Equitas and Equitas Partners: (i) shall not have the authority to terminate the Independent Consultant or substitute another independent compliance consultant for the initial Independent Consultant, without the prior written approval of the Commission's staff; and (ii) shall compensate the Independent Consultant and persons engaged to assist the Independent Consultant for services rendered pursuant to this Order at their reasonable and customary rates.

j. Equitas and Equitas Partners shall require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two (2) years from completion of the engagement, the Independent Consultant shall not, without prior written consent of the Commission staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Equitas or Equitas Partners, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which the Independent Consultant is affiliated or of which the Independent Consultant is a member, and any person engaged to assist the Independent Consultant in the performance of the Independent Consultant's duties under this Order shall not, without prior written consent of the Commission staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Equitas or Equitas Partners, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two (2) years after the engagement.

28. Recordkeeping. Equitas and Equitas Partners shall preserve for a period of not less than six (6) years from the end of the fiscal year last used, the first two (2) years in an easily accessible place, any record of Equitas' compliance with the undertakings set forth in this Order.

29. Notice to Advisory Clients. Within ten (10) days of the entry of this Order, Equitas and Equitas Partners shall post prominently on their principal Web site(s) a summary of this Order in a form and location not unacceptable to the Commission's staff, with a hyperlink to the entire Order. Equitas and Equitas Partners shall maintain the posting and hyperlink on their Web site(s) for a period of twelve (12) months from the entry of this Order. Within thirty (30) days of the entry of this Order, Equitas shall provide a copy of the Order via mail, e-mail, or such other method as may be acceptable to the Commission staff, together with a cover letter in a form not unacceptable to the Commission staff, to each of the 16 Equitas clients overcharged between 2008 and 2010 and each of Equitas' existing advisory clients as of the entry of this Order.

30. Deadlines. For good cause shown, the Commission's staff may extend any of the procedural dates relating to the undertakings. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

31. Respondent Thomas undertakes to cause Equitas and Equitas Partners to comply with all of their undertakings in this Section III.

32. Certifications of Compliance by Respondents. Respondents Equitas, Equitas Partners, and Thomas shall certify, in writing, compliance with their undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Equitas agrees to provide such evidence. The certification and supporting material shall be submitted to Jeffrey Finnell, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549-6010-A, or such other address as the Commission staff may provide, with a copy to the Office of Chief Counsel of the Division of Enforcement (100 F St., N.E., Washington, DC 20549), no later than sixty (60) days from the date of the completion of the undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, and for the protection of investors to impose the sanctions agreed to in each of Respondents' Offers.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act with respect to Equitas and Equitas Partners, and pursuant to Sections 203(f) and 203(k) of the Advisers Act and Section 15(b)(6) of the Exchange Act with respect to Thomas and Christina, it is hereby ORDERED that:

A. Respondent Equitas cease and desist from committing or causing any violations and any future violations of Sections 206(2), 206(4), and 207 of the Advisers Act and Rules 206(4)-1 and 206(4)-7 promulgated thereunder.

B. Respondent Equitas Partners cease and desist from committing or causing any violations and any future violations of Sections 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder.

C. Respondent Thomas cease and desist from committing or causing any violations and any future violations of Sections 206(4) of the Advisers Act and Rules 206(4)-1 and 206(4)-7 promulgated thereunder.

D. Respondent Christina cease and desist from committing or causing any violations and any future violations of Sections 206(4) of the Advisers Act and Rules 206(4)-7 promulgated thereunder.

E. Respondents Equitas and Equitas Partners are censured.

F. Respondent Equitas shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $100,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

(a) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(b) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Equitas Capital Advisors LLC as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Jeffrey Finnell, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549-5010-A.

G. Respondent Thomas shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $35,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the ways described above in Section IV.F. Payments by check or money order must be accompanied by a cover letter identifying David S. Thomas, Jr. as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Jeffrey Finnell, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549-5010-A.

H. Respondents Equitas, Equitas Partners, and Thomas shall comply with their respective undertakings enumerated in Section III above.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70749 / October 23, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15586

In the Matter of **HUAKANG ZHOU (A/K/A DAVID ZHOU) and WARNER TECHNOLOGY AND INVESTMENT CORPORATION,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Huakang Zhou (a/k/a David Zhou) ("Zhou") and Warner Technology and Investment Corporation ("Warner Investment" or together with Zhou, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over Respondents and the subject matter of these proceedings and the findings contained in Section III.3. below, which are admitted, Respondents consent to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds that:

1. Zhou is the president of Warner Investment. Zhou does not have any securities licenses; however, for at least a portion of the time in which Zhou engaged in the conduct underlying the complaint described further below, Zhou acted as an unregistered broker. Further, Zhou participated in an offering of China Yingxia International, Inc. ("China Yingxia") stock, which was a penny stock. Zhou, 62 years old, is a resident of the state of New Jersey.

2. Warner Investment is a New Jersey-based consulting firm that works with private Chinese companies, assisting them in their reverse mergers, capital raises, and operations as publicly-traded companies, such as retaining independent auditors, officers and directors, and counsel, and filing reports with the Commission. Through Zhou, Warner Investment acted as a consultant to, and facilitated the reverse merger of, numerous Chinese companies. Warner Investment has never been registered with the Commission in any capacity; however, for at least a portion of the time in which Warner Investment engaged in the conduct underlying the complaint described further below, Warner Investment acted as an unregistered broker. Further, Warner Investment participated in an offering of China Yingxia stock, which was a penny stock.

3. On October 18, 2013 a final judgment was entered by consent against Zhou and Warner Investment in the civil action entitled Securities and Exchange Commission v. Huakang Zhou (a/k/a David Zhou) and Warner Technology and Investment Corporation, Civil Action Number 12-Civ-8987, in the United States District Court for the Southern District of New York, permanently enjoining Zhou and Warner Investment from violating Sections 5 and 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b), 13(d), 15(a), and 16(a) of the Exchange Act and Rules 10b-5, 13d-1, 13d-2, and 16a-3 thereunder. Under the final judgment, Zhou and Warner Investment are liable to pay disgorgement in the amount of $983,375, plus prejudgment interest thereon in the amount of $82,449, and Zhou is liable to pay civil penalties in the amount of $400,000.

4. The Commission's complaint alleged that Zhou and Warner Investment, consultants to numerous Chinese reverse merger companies, in connection with such work for various clients from 2007 through at least 2010, engaged in a scheme to list one client on a national securities exchange through manipulative trading and by facilitating in effect an artificial shareholder base sufficient for listing. Further, the complaint alleged that Zhou and Warner Investment made material misstatements and omissions in connection with an offering for another client through the misuse of proceeds. The complaint also alleged that Zhou and Warner Investment did not disclose certain holdings and transactions; sold unregistered securities; and acted as unregistered brokers and aided and abetted others' unregistered broker activity.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents Zhou and Warner Investment's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondents Zhou and Warner Investment be, and hereby are:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock, with the right to apply for reentry after five years to the appropriate self-regulatory organization, or if there is none, to the Commission.

Any reapplication for association by the Respondents will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondents, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 200, 227, 232, 239, 240 and 249

Release Nos. 33-9470; 34-70741; File No. S7-09-13

RIN 3235-AL37

CROWDFUNDING

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rules.

SUMMARY: The Securities and Exchange Commission is proposing for comment new Regulation Crowdfunding under the Securities Act of 1933 and the Securities Exchange Act of 1934 to implement the requirements of Title III of the Jumpstart Our Business Startups Act. Regulation Crowdfunding would prescribe rules governing the offer and sale of securities under new Section 4(a)(6) of the Securities Act of 1933. The proposal also would provide a framework for the regulation of registered funding portals and brokers that issuers are required to use as intermediaries in the offer and sale of securities in reliance on Section 4(a)(6). In addition, the proposal would exempt securities sold pursuant to Section 4(a)(6) from the registration requirements of Section 12(g) of the Securities Exchange Act of 1934.

DATES: Comments should be received on or before [insert date 90 days from publication in the Federal Register].

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/proposed.shtml*);

- Send an e-mail to *rule-comments@sec.gov*. Please include File Number S7-09-13 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-09-13. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (*http://sec.gov/rules/proposed.shtml*). Comments also are available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you would like to make publicly available.

FOR FURTHER INFORMATION CONTACT: With regard to requirements for issuers, Sebastian Gomez Abero or Jessica Dickerson, Division of Corporation Finance, at (202) 551-3500, and with regard to requirements for intermediaries, Joseph Furey, Joanne Rutkowski, Leila Bham, Timothy White or Carla Carriveau, Division of Trading and Markets, at (202) 551-5550, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

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I. Introduction and Background

A. Overview of Crowdfunding

Crowdfunding is a new and evolving method to raise money using the Internet. Crowdfunding serves as an alternative source of capital to support a wide range of ideas and ventures. An entity or individual raising funds through crowdfunding typically seeks small individual contributions from a large number of people.[1] A crowdfunding campaign generally has a specified target amount for funds to be raised, or goal, and an identified use of those funds. Individuals interested in the crowdfunding campaign – members of the "crowd" – may share information about the project, cause, idea or business with each other and use the information to decide whether or not to fund the campaign based on the collective "wisdom of the crowd."[2] Crowdfunding has been used to fund, for example, artistic endeavors, such as films and music recordings, where contributions or donations are rewarded with a token of value related to the project (*e.g.*, a person contributing to a film's production budget is rewarded with tickets to view the film and is identified in the film's credits) or where contributions reflect the pre-purchase of a finished product (*e.g.*, a music album). A number of entities operate websites that facilitate

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1 *See, e.g.*, C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 10 (2012) ("Bradford"). Crowdfunding has some similarities to "crowdsourcing," which is the concept that "the power of the many can be leveraged to accomplish feats that were once the province of the specialized few." *See* Jeff Howe, *The Rise of Crowdsourcing*, Wired (Jun. 2006) ("Howe"). Crowdsourcing is an approach for problem solving that employs the "wisdom of crowds," where "the very success of a solution is dependent on its emergence from a large body of solvers." Daren C. Brabham, *Crowdsourcing as a Model for Problem Solving*, 14 Convergence 75, 79-80 (2008) ("Brabham").

2 *See* Stephenson Letter; Richard Waters, *Startups seek the 'wisdom of crowds,'* FINANCIAL TIMES, Apr. 3, 2012, *available at* http://www.ft.com/intl/cms/s/0/c1f1695c-7da8-11e1-9adc-00144feab49a.html#axzz2b7QxIH5L ("[T]he backers of [crowdfunding] argue that the hard work of making investment decisions – filtering out the best investments and limiting fraud – can be solved by tapping the 'wisdom of crowds' over the internet.").

crowdfunding in its current form,[3] with some websites specializing in certain industries, such as computer-based gaming, music and the arts, and other websites focusing on particular types of entrepreneurs.[4]

The Jumpstart Our Business Startups Act (the "JOBS Act"),[5] enacted on April 5, 2012, establishes the foundation for a regulatory structure for startups and small businesses to raise capital through securities offerings using the Internet through crowdfunding.[6] The crowdfunding provisions of the JOBS Act were designed to help provide startups and small businesses with capital by making relatively low dollar offerings of securities less costly.[7] They also permit Internet-based platforms to facilitate the offer and sale of securities without having to register with the Commission as brokers.

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3 Examples of current crowdfunding websites include: www.indiegogo.com, www.kickstarter.com, www.kiva.com and www.rockethub.com.

4 *See* Bradford, note 1at 12-13 (citing "Unbound: Books Are Now in Your Hands" (http://unbound.co.uk/), specializing in book publishing, "My Major Company" (http://www.mymajorcompany.com/), specializing in music, "Spot.us: Community-funded Reporting" (http://spot.us/), specializing in journalism, and "Heifer International" (http://www.heifer.org/) specializing in agriculture and ranching). *See also* Liz Gannes, *Crowdfunding for a Cause: Nonprofits Can Now Hold Fundraisers on Crowdtilt*, AllThingsD (Nov. 21, 2012), *available at* http://allthingsd.com/20121121/crowdfunding-for-a-cause-non-profits-can-now-hold-fundraisers-on-crowdtilt/ (describing the use of crowdfunding for charitable purposes).

5 Pub. L. No. 112-106, 126 Stat. 306 (2012).

6 To facilitate public input on JOBS Act initiatives, the Commission solicited comment on each title of the JOBS Act through its website at http://www.sec.gov/spotlight/jobsactcomments.shtml. The public comments we received on Title III are available on our website at http://www.sec.gov/comments/jobs-title-iii/jobs-title-iii.shtml. Exhibit A of the release includes a citation key to the comment letters the Commission received on Title III.

7 *See, e.g.*, 158 CONG. REC. S1781 (daily ed. Mar. 19, 2012) (statement of Sen. Carl Levin) ("Right now, the rules generally prohibit a company from raising very small amounts from ordinary investors without significant costs."); 157 CONG. REC. S8458-02 (daily ed. Dec. 8, 2011) (statement of Sen. Jeff Merkley) ("Low-dollar investments from ordinary Americans may help fill the void, providing a new avenue of funding to the small businesses that are the engine of job creation. The CROWDFUND Act would provide startup companies and other small businesses with a new way to raise capital from ordinary investors in a more transparent and regulated marketplace."); 157 CONG. REC. H7295-01 (daily ed. Nov. 3, 2011) (statement of Rep. Patrick McHenry) ("[H]igh net worth individuals can invest in businesses before the average family can. And that small business is limited on the amount of equity stakes they can provide investors and limited in the number of investors they can get. So, clearly, something has to be done to open these capital markets to the average investor[.]").

In the United States, crowdfunding in its current form generally has not involved the offer of a share in any financial returns or profits that the fundraiser may expect to generate from business activities financed through crowdfunding.[8] Such a profit or revenue-sharing model – sometimes referred to as the "equity model" of crowdfunding[9] – could trigger the application of the federal securities laws because it likely would involve the offer and sale of a security.[10] Under the Securities Act of 1933 ("Securities Act"), the offer and sale of securities is required to be registered unless an exemption is available. At least one commenter has stated that registered offerings are not feasible for raising smaller amounts of capital, as is done in a typical crowdfunding transaction, because of the costs of conducting a registered offering and the resulting ongoing reporting obligations under the Securities Exchange Act of 1934 ("Exchange Act") that may arise as a result of the offering.[11] Limitations under existing regulations, including restrictions on general solicitation and general advertising and purchaser qualification requirements, have made private placement exemptions generally unavailable for crowdfunding

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8 *See* Bradford, note 1; Jenna Wortham, *Start-Ups Look to the Crowd*, N.Y. TIMES at B1 (Apr. 30, 2012); Joan MacLeod Heminway and Shelden Ryan Hoffman, *Proceed At Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879 (2011); Thomas Lee Hazen, *Crowdfunding or Fraudfunding? Social Networks and the Securities Laws – Why the Specially Tailored Exemption Must be Conditioned on Meaningful Disclosure*, 90 N.C.L. REV. 1735 (2012) ("Hazen"); C. Steven Bradford, *The New Federal Crowdfunding Exemption: Promise Unfulfilled*, 40 SEC. REG. L.J. 1 (2012).

9 *See* Bradford, note 1 at 33.

10 *See* Securities Act Section 2(a)(1) and Exchange Act Section 3(a)(10) (setting forth the definition of a "security" under the Securities Act and the Exchange Act, respectively). *See, e.g.*, *Reves v. Ernst & Young*, 494 U.S. 56 (1990) (outlining the requirements for a note to be considered a security); *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946) (setting forth the definition of an investment contract).

11 *See* Bradford, note 1 at 42.

transactions, which are intended to be made to a large number of potential investors and not limited to investors that meet specific qualifications.[12]

Moreover, a third party that operates a website to effect the purchase and sale of securities for the account of others generally would, under existing regulations, be required to register with the Commission as a broker-dealer and comply with the laws and regulations applicable to broker-dealers.[13] A person that operates such a website only for the purchase of securities of startups and small businesses, however, may find it impractical in view of the limited nature of that person's activities and business to register as a broker-dealer and operate under the full set of regulatory obligations that apply to broker-dealers.

B. Title III of the JOBS Act

Title III of the JOBS Act ("Title III") added new Securities Act Section 4(a)(6),[14] which provides an exemption from the registration requirements of Securities Act Section 5 for certain crowdfunding transactions. To qualify for the exemption under Section 4(a)(6), crowdfunding

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12 *But see Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings*, Release No. 33-9415 (July 10, 2013) [78 FR 44771 (July 24, 2013)] ("*General Solicitation Adopting Release*") (adopting rules to implement Title II of the JOBS Act). Title II of the JOBS Act directed the Commission to amend Rule 506 of Regulation D to permit general solicitation or general advertising in offerings made under Rule 506, provided that all purchasers of the securities are accredited investors. Accredited investors include natural persons who meet certain income or net worth thresholds. Although this rule facilitates the type of broad solicitation emblematic of crowdfunding, crowdfunding is premised on permitting sales of securities to any interested person, not just to investors who meet specific qualifications, such as accredited investors.

13 Exchange Act Section 15(a)(1) generally makes it unlawful for a broker or dealer to effect any transactions in, or induce the purchase or sale of, any security unless that broker or dealer is registered with the Commission pursuant to Exchange Act Section 15(b). 15 U.S.C. 78*o*(a). *See* discussion in Section II.D.2 below. Because brokers and dealers both register as broker-dealers (*i.e.*, there is no separate "broker" or "dealer" registration under Exchange Act Section 15(b)), we also use the term "broker-dealer" in this release.

14 Title III amended Securities Act Section 4 to add Section 4(6); however, Title II of the JOBS Act also amended Securities Act Section 4 and inserted subsections (a) and (b). The U.S. Code implemented the amendment by adding paragraph (6) at the end of subsection (a).

transactions by an issuer (including all entities controlled by or under common control with the issuer) must meet specified requirements, including the following:

- the amount raised must not exceed $1 million in a 12-month period (this amount is to be adjusted for inflation at least every five years);
- individual investments in a 12-month period are limited to:
  - the greater of $2,000 or 5 percent of annual income or net worth, if annual income or net worth of the investor is less than $100,000; and
  - 10 percent of annual income or net worth (not to exceed an amount sold of $100,000), if annual income or net worth of the investor is $100,000 or more (these amounts are to be adjusted for inflation at least every five years); and
- transactions must be conducted through an intermediary that either is registered as a broker or is registered as a new type of entity called a "funding portal."

In addition, Title III:

- adds Securities Act Section 4A, which requires, among other things, that issuers and intermediaries that facilitate transactions between issuers and investors in reliance on Section 4(a)(6) provide certain information to investors and potential investors, take certain other actions and provide notices and other information to the Commission;
- adds Exchange Act Section 3(h), which requires the Commission to adopt rules to exempt, either conditionally or unconditionally, "funding portals" from having to register as brokers or dealers pursuant to Exchange Act Section 15(a)(1);
- includes disqualification provisions under which an issuer would not be able to avail itself of the Section 4(a)(6) exemption if the issuer or other related parties, including an intermediary, was subject to a disqualifying event; and

- adds Exchange Act Section 12(g)(6), which requires the Commission to adopt rules to exempt from the registration requirements of Section 12(g), either conditionally or unconditionally, securities acquired pursuant to an offering made in reliance on Section 4(a)(6).

In this release, we are proposing new rules and forms to implement Securities Act Sections 4(a)(6) and 4A and Exchange Act Sections 3(h) and 12(g)(6). The proposed rules are described in detail below. Until we adopt rules relating to crowdfunding transactions and such rules become effective, issuers and intermediaries may not rely on the exemption provided under Section 4(a)(6).

C. Approach to Proposed Rules

We understand that Title III was designed to help alleviate the funding gap and accompanying regulatory concerns faced by startups and small businesses in connection with raising capital in relatively low dollar amounts.[15] The proposed rules are intended to align crowdfunding transactions under Section 4(a)(6) with the central tenets of the original concept of crowdfunding, in which the public – or the crowd – is presented with an opportunity to invest in an idea or business and individuals decide whether or not to invest after sharing information about the idea or business with, and learning from, other members of the crowd.[16] In this role,

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15 *See* note 7.

16 *See* notes 1 and 2. As discussed in Section II.C.5.c below, the proposed rules would require a person to open an account with an intermediary before posting comments on the intermediary's platform. However, as discussed in Section II.C.5.a below, a person would not need to open an account with the intermediary in order to view the issuer's disclosure materials.

members of the crowd are not only sharing information about the idea or business, but also are expected to help evaluate the idea or business before deciding whether or not to invest.[17]

At the same time, Congress provided important investor protections for crowdfunding transactions under Section 4(a)(6), including individual investment limits, required disclosures by issuers and the use of intermediaries. The proposed rules would require that all crowdfunding transactions under Section 4(a)(6) be conducted through a registered intermediary on an Internet website or other similar electronic medium to help ensure that the offering is accessible to the public and that members of the crowd can share information and opinions. Registered intermediaries are necessary to bring the issuer and potential investors together and to provide safeguards to potential investors.[18] The proposed rules also would require that intermediaries provide communication channels to facilitate the sharing of information that will allow the crowd to decide whether or not to fund the idea or business.[19] The proposed rules further provide intermediaries a means by which to facilitate the offer and sale of securities without registering as brokers. We are mindful of the timing and presentation of information required to be disclosed to investors pursuant to the terms of the statute. The proposed rules would require that this information be provided to investors at various points in time in connection with an offering and through various electronic means, such as through filings with the Commission and disclosures provided on the intermediary's platform. We believe this approach would be most practical and useful to investors in the crowdfunding context.

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17 *See* Hazen, note 8.

18 *See* 158 CONG. REC. S1829 (daily ed. Mar. 20, 2012) (statement of Sen. Jeff Merkley) ("The websites are subject to oversight by the SEC and security regulators of their principal States . . . This is a key predatory protection to prevent pump-and-dump schemes.").

19 *See* Mollick Letter (stating that allowing ongoing discussions between potential investors, community members and issuers is a vital aspect of avoiding fraud and improving proposed projects).

We understand that these proposed rules, if adopted, could significantly affect the viability of crowdfunding as a capital-raising method for startups and small businesses. Rules that are unduly burdensome could discourage participation in crowdfunding. Rules that are too permissive, however, may increase the risks for individual investors, thereby undermining the facilitation of capital raising for startups and small businesses.[20] We have directed the Commission staff, accordingly, to develop a comprehensive work plan to review and monitor the use of the crowdfunding exemption under Section 4(a)(6) and the rules the Commission adopts to implement crowdfunding. Upon adoption of final rules, the Commission staff will monitor the market for offerings made in reliance on Section 4(a)(6), focusing in particular on the types of issuers using the exemption, the level of compliance with Regulation Crowdfunding by issuers and intermediaries and whether the exemption is promoting new capital formation while at the same time providing key protections for investors. These efforts will assist the Commission in evaluating the development of market practices in offerings made in reliance on Section 4(a)(6). These efforts also will facilitate future Commission consideration of any potential amendments to the rules implementing crowdfunding that would be consistent with the Commission's mission

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20 One press article, for example, described non-securities-based crowdfunding campaigns that successfully raised funds but have had problems manufacturing and delivering the "perks" or products that were promised in exchange for contributions. *See* Matt Krantz, *Crowd-funding dark side: Sometimes investments go down drain*, USA TODAY at B1 (Aug. 15, 2012). Investor confidence in crowdfunding could be eroded if such delays occur with regularity in securities-based crowdfunding and compounded by any prevalence of fraud. *See, e.g., Laws Provide Con Artists with Personal Economic Growth Plan*, North American Securities Administrators Association (Aug. 21, 2012) (identifying crowdfunding and Internet-based offers of securities as a threat to investors), *available at* http://www.nasaa.org/14679/laws-provide-con-artists-with-personal-economic-growth-plan/. *See also* Adrianne Jeffries, *This is What a Kickstarter Scam Looks Like,* BetaBeat (Apr. 30, 2012), *available at* http://betabeat.com/2012/04/this-is-what-a-kickstarter-scam-looks-like/. *But see* Olga Khazan, *Kickstarter spies a sunglass start-up*, WASHINGTON POST at A14 (May 28, 2012) (discussing a successful sunglasses company that used crowdfunding for startup funds); *Crowdfunding: Invested Central raises $120,000*, WASHINGTON POST at A10 (Jul. 23, 2012) (mentioning a company that was able to raise capital through crowdfunding when it could not otherwise secure traditional financing for an expansion of its business).

of protecting investors, maintaining fair, orderly and efficient markets and facilitating capital formation. We urge commenters, as they review the proposed rules, to consider and address the role that our oversight, enforcement and regulation should play once a crowdfunding market under Section 4(a)(6) begins to develop.

II. Discussion of Proposed Regulation Crowdfunding

A. Crowdfunding Exemption

New Securities Act Section 4(a)(6) provides an exemption from the registration requirements of Securities Act Section 5 for certain crowdfunding transactions. To qualify for the exemption under Section 4(a)(6), crowdfunding transactions by an issuer must meet specified requirements, including requirements with regard to the dollar amount of the securities that may be sold by an issuer and the dollar amount that may be invested by an individual in a 12-month period. The crowdfunding transaction also must be conducted through a registered intermediary that complies with specified requirements.[21] Title III also provides limitations on who may rely on the exemption and establishes a liability scheme for improper use of the exemption. As discussed below, the rules we are proposing are designed to aid issuers and investors in determining the applicable limitations on capital raised and individual investments.

1. Limitation on Capital Raised

The exemption from registration provided by Section 4(a)(6) is available to a U.S. issuer provided that "the aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the exemption provided under [Section 4(a)(6)] during the 12-month period

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[21] *See* Section II.C below for a discussion of the requirements on intermediaries. *See also* Section II.D below for a discussion of the additional requirements on funding portals.

preceding the date of such transaction, is not more than \$1,000,000."[22] Under Section 4A(h), the Commission is required to adjust the dollar amounts in Section 4(a)(6) "not less frequently than once every five years, by notice published in the Federal Register, to reflect any change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics."

Several commenters indicated that the \$1 million maximum aggregate amount is too low.[23] Several commenters requested that the Commission state that the \$1 million aggregate limit pertains only to offerings under Section 4(a)(6) and does not include all exempt offerings.[24] Two commenters suggested, however, that the calculation of the \$1 million aggregate limit should include all issuer transactions that were exempt under Securities Act Section 4(a) during the preceding 12-month period.[25] Another commenter requested clarification that the limitations and requirements of the offering exemption under Section 4(a)(6) would not affect other methods of raising capital that do not involve the sale of securities, such as contributions from friends and family, donation crowdfunding, gifts, grants or loans.[26] Several commenters had concerns about the possible integration[27] of an offering under Section 4(a)(6) with other exempt offerings and

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22 Securities Act Section 4(a)(6)(A).

23 *See* High Tide Letter; TechnologyCrowdfund Letter 3 (stating that a minimum of \$5 million to \$10 million is necessary to start any business other than a software business); EnVironmental Letter (stating that the upper limit should be increased to \$5 million or higher); VTNGLOBAL Letter (stating that Rule 506 of Regulation D permits an unlimited capital raise from accredited investors and that the same should apply to crowdfunding).

24 *See* NSBA Letter (stating that the \$1 million limitation should pertain only to offerings made in reliance on Section 4(a)(6)); ABA Letter 1; NCA Letter.

25 *See* CommunityLeader Letter; Ohio Division of Securities Letter.

26 *See* Crowdfunding Offerings Ltd. Letter 6.

27 The integration doctrine seeks to prevent an issuer from improperly avoiding registration by artificially dividing a single offering into multiple offerings such that Securities Act exemptions would apply to multiple offerings that would not be available for the combined offering.

suggested that the Commission should allow for simultaneous or sequential offerings under Regulation D[28] and Section 4(a)(6) without integration.[29]

Section 4(a)(6) specifically provides for a maximum aggregate amount of $1 million sold in reliance on the exemption in any 12-month period. The only reference in the statute to changing that amount is the requirement that the Commission update the amount not less frequently than every five years based on the Consumer Price Index. Additionally, statements in the Congressional Record indicate that Congress believed that $1 million was a substantial amount for a small business.[30] We do not believe that Congress intended for us to modify the maximum aggregate amount permitted to be sold under the exemption when promulgating rules to implement the statute.[31] Therefore, we are not proposing to increase the limitation on the aggregate amount sold.

Title III provides that the $1 million limitation applies to the "aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the exemption provided under [Section 4(a)(6)]." Section 4A(g), however, provides that "[n]othing in the exemption

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28 17 CFR 230.501 through 230.508.

29 *See* ABA Letter 1; Lingam Letter 2 (stating that offerings under Regulation D and Section 4(a)(6) should not be integrated if: (1) no general solicitation takes place; (2) the Section 4(a)(6) offering closes prior to any general solicitation related to a Regulation D offering; or (3) the Regulation D and the Section 4(a)(6) offerings occur simultaneously and the offerings have the same economic terms, but the size of the Regulation D offering is greater than the size of the Section 4(a)(6) offering); CFIRA Letter 8 (stating that CFIRA's members have opposing views on whether the integration doctrine should be applied to crowdfunded offerings); Liles Letter 1; CFIRA Letter 2; CommunityLeader Letter. *See also* Final Report of the 2012 SEC Government-Business Forum on Small Business Capital Formation (April 2013) ("2012 SEC Government-Business Forum"), *available at* http://www.sec.gov/info/smallbus/sbforumreps.htm (recommending that we consider permitting concurrent offerings to be made to accredited investors in excess of the $1 million limit).

30 158 CONG. REC. S1829 (daily ed. Mar. 20, 2012) (statement of Sen. Jeff Merkley) ("[T]he amendment allows existing small businesses and startup companies to raise up to $1 million per year. That is a substantial amount for a small business.").

31 *Cf.* Securities Act Section 4A(b)(1)(D)(iii) (giving the Commission discretion to increase the aggregate target offering amount that requires audited financial statements).

shall be construed as preventing an issuer from raising capital through means other than [S]ection 4[(a)](6)." These two provisions create statutory ambiguity because the first provision could be read to provide for the aggregation of amounts raised in all exempt transactions, even those that do not involve crowdfunding, while the second provision could be read to provide that nothing in the Section 4(a)(6) exemption should limit an issuer's capital raising through other methods. We believe that the overall intent of providing the exemption under Section 4(a)(6) was to provide an additional mechanism for capital raising for startup and small businesses and not to affect the amount an issuer could raise outside of that exemption. Thus, we believe the capital raised in reliance on the exemption provided by Section 4(a)(6) should be counted toward the limitation. Capital raised through other means should not be counted in determining the aggregate amount sold in reliance on Section 4(a)(6). The opposite approach – requiring aggregation of amounts raised in any exempt transaction – would be inconsistent with the goal of alleviating the funding gap faced by startups and small businesses because it would place a cap on the amount of capital startups and small business could raise. An issuer that already sold $1 million in reliance on the exemption provided under Section 4(a)(6), for example, would be prevented from raising capital through other exempt methods and, conversely, an issuer that sold $1 million through other exempt methods would be prevented from raising capital under Section 4(a)(6).

In determining the amount that may be available to be offered and sold in reliance on Section 4(a)(6) in light of the $1 million aggregate amount limitation, an issuer would include amounts sold by the issuer (including amounts sold by entities controlled by the issuer or under common control with the issuer, as well as any amounts sold by any predecessor of the issuer) in reliance on Section 4(a)(6) during the preceding 12-month period. The issuer would aggregate any amounts previously sold with the amount the issuer intends to raise in reliance on the exemption, and under the proposed rules, the combined amount could not exceed $1 million. An issuer would not include amounts sold in other exempt offerings during the preceding 12-month period. For example, if an issuer sold $800,000 pursuant to the exemption provided in Regulation D during the preceding 12 months, this amount would not be aggregated in an issuer's calculation to determine whether it had reached the maximum amount for purposes of Section 4(a)(6).[32] In addition, in determining the amount sold in reliance on Section 4(a)(6) during the preceding 12-month period, an issuer would not need to consider amounts received through methods that do not involve the offer or sale of securities (such as donations it received from a separate non-securities-based crowdfunding effort, contributions from friends and family, gifts, grants or loans).

Further, in light of Section 4A(g) and the reasons discussed above, we believe that an offering made in reliance on Section 4(a)(6) should not be integrated with another exempt offering made by the issuer, provided that each offering complies with the requirements of the applicable exemption that is being relied upon for the particular offering. An issuer could complete an offering made in reliance on Section 4(a)(6) that occurs simultaneously with, or is preceded or followed by, another exempt offering. An issuer conducting a concurrent exempt offering for which general solicitation is not permitted, however, would need to be satisfied that purchasers in that offering were not solicited by means of the offering made in reliance on

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32 In contrast, if an issuer sold $800,000 in a crowdfunding transaction pursuant to Section 4(a)(6) during the preceding 12 months, the issuer would be required to count that amount toward the $1 million aggregate amount and, thus, could only offer and sell $200,000 more in reliance on Section 4(a)(6).

Section 4(a)(6).[33] Similarly, any concurrent exempt offering for which general solicitation is permitted could not include an advertisement of the terms of an offering made in reliance on Section 4(a)(6) that would not be permitted under Section 4(a)(6) and the proposed rules.[34]

Under Section 4(a)(6), the amount of securities sold in reliance on Section 4(a)(6) by entities controlled by or under common control with the issuer must be aggregated with the amount to be sold by the issuer in the current offering to determine the aggregate amount sold in reliance on Section 4(a)(6) during the preceding 12-month period. The statute does not define the term "controlled by or under common control with" the issuer; however, the term "control" is defined in Securities Act Rule 405.[35] For purposes of determining whether an entity is "controlled by or under common control with" the issuer, an issuer would be required to consider whether it has "control" based on this definition.[36]

Under the proposed rules, the amount of securities sold in reliance on Section 4(a)(6) also would include securities sold by any predecessor of the issuer in reliance on Section 4(a)(6)

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33 For example, if the prospective investor in a concurrent private placement for which general solicitation is not permitted became interested in that private placement through some means other than the offering made in reliance on Section 4(a)(6), such as through a substantive, pre-existing relationship with the issuer or direct contact by the issuer or its agents outside of the offering made in reliance on Section 4(a)(6), then the fact that the offering made in reliance on Section 4(a)(6) was posted publicly on the intermediary's platform would not affect the availability of the other private placement exemption. On the other hand, if an investor first discovers the issuer through a solicitation in a Section 4(a)(6) offering, that investor would likely not be eligible to participate in a concurrent private placement in which general solicitation is not permitted.

34 *See* proposed Rule 204 of Regulation Crowdfunding. *See also* discussion in Section II.B.4 below.

35 *See* 17 CFR 230.405 ("The term control (including the terms controlling, controlled by and under common control with) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."). Exchange Act Rule 12b-2 similarly defines the term "control." *See* 17 CFR 240.12b-2.

36 *See* proposed Instruction to paragraph (c) of proposed Rule 100 of Regulation Crowdfunding.

during the preceding 12-month period.[37] We believe this approach is necessary to prevent an issuer from exceeding the $1 million limit by reorganizing the issuer into a new entity that would otherwise not be limited by previous sales made by its predecessor. For example, if an issuer reaches the $1 million limit under Section 4(a)(6), we do not believe the reorganization of the issuer into a new entity should permit the successor to make additional offers and sales in reliance on Section 4(a)(6) during the relevant 12-month period.

Request for Comment

1. Should we propose that the $1 million limit be net of fees charged by the intermediary to host the offering on the intermediary's platform? Why or why not? If so, are there other fees that we should allow issuers to exclude when determining the amount to be raised and whether the issuer has reached the $1 million limit?

2. As described above, we believe that issuers should not have to consider the amounts raised in offerings made pursuant to other exemptions when determining the amount sold during the preceding 12-month period for purposes of the $1 million limit in Section 4(a)(6). Should we require that certain exempt offerings be included in the calculation of the $1 million limit? If so, which types of offerings and why? If not, why not? As noted above, at this time the Commission is not proposing to consider the amounts raised in non-securities-based crowdfunding efforts in calculating the $1 million limit in Section 4(a)(6). Should the Commission propose to require that amounts raised in non-

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37 *See* proposed Rule 100(c) of Regulation Crowdfunding (proposing to define issuer to include all entities controlled by or under common control with the issuer and any predecessor of the issuer).

securities-based crowdfunding efforts be included in the calculation of the $1 million limit? Why or why not?

3. As described above, we believe 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. How would an alternative interpretation affect the utility of crowdfunding as a capital raising mechanism? Are there circumstances under which other exempt offers should be integrated with an offer made in reliance on Section 4(a)(6)? If so, what are those circumstances? Should we prohibit an issuer from concurrently offering securities in reliance on Section 4(a)(6) and another exemption? Why or why not? Should we prohibit an issuer from offering securities in reliance on Section 4(a)(6) within a specified period of time after or concurrently with a Rule 506(c) offering under Regulation D involving general solicitation? Why or why not? Should we prohibit an issuer from using general solicitation or general advertising under Rule 506(c) in a manner that is intended, or could reasonably be expected, to condition the market for a Section 4(a)(6) offering or generate referrals to a crowdfunding intermediary? Why or why not? Should issuers that began an offering under Section 4(a)(6) be permitted to convert the offering to a Rule 506(c) offering? Why or why not?

4. Under the proposed rules, whether an entity is controlled by or under common control with the issuer would be determined based on whether the issuer possesses, directly or indirectly, the power to direct or cause the direction of the management and policies of the entity, whether through the ownership of voting

securities, by contract or otherwise. This standard is based on the definition of "control" in Securities Act Rule 405. Is this approach appropriate? Why or why not? Should we define control differently? If so, how?

5. Under the proposed rules, the definition of issuer would include any predecessor of the issuer. Is this approach appropriate? Why or why not? Should an issuer aggregate amounts sold by an affiliate of the issuer when determining the aggregate amount sold in reliance on Section 4(a)(6) during the preceding 12-month period? Why or why not? If so, how should we define affiliate?

2. Investment Limitation

Under Section 4(a)(6)(B), the aggregate amount sold to any investor by an issuer, including any amount sold in reliance on the exemption during the 12-month period preceding the date of such transaction, cannot exceed: "(i) the greater of $2,000 or 5 percent of the annual income or net worth of such investor, as applicable, if either the annual income or the net worth of the investor is less than $100,000; and (ii) 10 percent of the annual income or net worth of such investor, as applicable, not to exceed a maximum aggregate amount sold of $100,000, if either the annual income or net worth of the investor is equal to or more than $100,000." Section 4A(h) further provides that these dollar amounts shall be adjusted by the Commission not less frequently than once every five years based on the Consumer Price Index. As discussed in more detail below, Section 4A(h) also provides that the income and net worth of a natural person who is investing in a crowdfunding transaction pursuant to Section 4(a)(6) shall be calculated in accordance with the Commission's rules regarding the calculation of income and net worth of an accredited investor.[38]

Several commenters noted that Sections 4(a)(6)(B)(i) and (ii) technically subject some investors to two potential investment limits.[39] The language of the statute may be read to create potential conflicts or ambiguity between the two investment limits because paragraph (i) applies if "either" annual income or net worth is less than $100,000 and paragraph (ii) applies if "either" annual income or net worth is equal to or more than $100,000. Accordingly, in any situation in which annual income is less than $100,000 and net worth is equal to or more than $100,000 (or vice versa), the language of the statute may be read to cause both paragraphs to apply. Paragraph (i) also fixes the maximum annual investment by an investor at 5 percent of "the annual income or net worth of such investor, as applicable" and paragraph (ii) fixes the maximum annual

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38 The definition of the term "accredited investor" is set forth in Rule 501(a) of Regulation D [17 CFR 230.501(a)] and includes any person who comes within one of the definition's enumerated categories of persons, or whom the issuer "reasonably believes" comes within any of the enumerated categories, at the time of the sale of the securities to that person. For natural persons, Rule 501(a) defines an accredited investor as a person: (1) whose individual net worth, or joint net worth with that person's spouse, exceeds $1 million, excluding the value of the person's primary residence (the "net worth test"); or (2) who had an individual income in excess of $200,000 in each of the two most recent years, or joint income with that person's spouse in excess of $300,000 in each of those years, and has a reasonable expectation of reaching the same income level in the current year (the "income test"). Although the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1577 (July 21, 2010), (the "Dodd-Frank Act") did not change the amount of the $1 million net worth test, it did change how that amount is calculated – by excluding the value of a person's primary residence. This change took effect upon the enactment of the Dodd-Frank Act. In December 2011, we amended Rule 501 to incorporate this change into the definition of accredited investor. See *Net Worth Standard for Accredited Investors*, Release No. 33-9287 (Dec. 21, 2011) [76 FR 81793 (Dec. 29, 2011)]. In addition, Section 413(b) of the Dodd-Frank Act specifically authorizes us to undertake a review of the definition of the term "accredited investor" as it applies to natural persons, it and requires us to undertake a review of the definition in its entirety every four years, beginning four years after enactment of the Dodd-Frank Act. Release No. 33-9416 (July 10, 2013) requests public comments on the definition of "accredited investor."

39 *See* RocketHub Letter 1 (stating that the Commission should clarify that the greater of income or net worth will be used to determine the investment limit); NASAA Letter (stating that the Commission should resolve the ambiguity by requiring the lesser of the two investment limits); Ohio Division of Securities Letter (stating that the Commission should apply the stricter investment limitation); ABA Letter 1; Friedman Letter.

investment by an investor at 10 percent of "the annual income or net worth of such investor, as applicable", but neither paragraph (i) nor paragraph (ii) explicitly states when that percentage should be applied against the investor's annual income and when the percentage should be applied against the investor's net worth. Finally, paragraph (i) sets a floor for the investment limit of $2,000 per year and paragraph (ii) sets a ceiling for the investment limit of $100,000 per year, but the statutory language does not explicitly state whether the floor applies if the maximum is calculated under paragraph (ii) or whether the ceiling applies if the maximum is calculated under paragraph (i). Accordingly, discretion is required in interpreting and applying this provision of the statute.

We believe that the appropriate approach to the investment limit provision is to provide for an overall investment limit of $100,000, but within that overall limit, to provide for a "greater of" limitation based on annual income and net worth. Under the proposed rules, therefore, if *both* annual income *and* net worth are less than $100,000, then a limit of $2,000 or 5 percent of annual income or net worth, whichever is greater, would apply. If either annual income or net worth exceeds $100,000, then a limit of 10 percent of annual income or net worth, whichever is greater, but not to exceed $100,000, would apply. We believe that this clarification would give effect to the provision and would be consistent with Congressional intent in providing investment limitations; however, we request comment below on whether to calculate the investment limit based on the lesser of annual income or net worth.

As required by Section 4A(h), the proposed rules would require a natural person's annual income and net worth to be calculated in accordance with the Commission's rules for determining accredited investor status.[40] Securities Act Rule 501 specifies the manner in which annual income and net worth are calculated for purposes of determining accredited investor status.[41] One commenter stated that Section 4(a)(6)(B) is unclear in regard to how to address the joint net worth of spouses.[42] The proposed rules would clarify that an investor's annual income and net worth may be calculated jointly with the income and net worth of the investor's spouse.[43] We believe that this approach is consistent with the rules for determining accredited investor status because the accredited investor definition contemplates both individual and joint income and net worth with a spouse as methods of calculating annual income and net worth.

We also are proposing to allow an issuer to rely on efforts that an intermediary takes in order to determine that the aggregate amount of securities purchased by an investor will not cause the investor to exceed the investor limits,[44] provided that the issuer does not have knowledge that the investor had exceeded, or would exceed, the investor limits as a result of purchasing securities in the issuer's offering.[45]

In discussing the investment limitations, one commenter requested that the Commission distinguish between retail investors and institutional or accredited investors and allow institutional and accredited investors to invest in excess of the investment limitations included in

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40 *See* proposed Instruction 1 to paragraph (a)(2) of proposed Rule 100 of Regulation Crowdfunding. *See also* note 9.

41 *See* Securities Act Rule 501(a)(5) [17 CFR 230.501(a)(5)] (net worth) and Securities Act Rule 501(a)(6) [17 CFR 230.501(a)(6)] (income). Consistent with these rules, the calculation of a natural person's net worth for purposes of the investment limit would exclude the value of the primary residence of such person. A natural person's income for purposes of the investment limit calculation would be the lower of such person's income for each of the two most recent years as long as such person has a reasonable expectation of the same income level in the current year.

42 *See* Friedman Letter.

43 *See* proposed Instruction 2 to paragraph (a)(2) of proposed Rule 100 of Regulation Crowdfunding.

44 *See* discussion in Section II.C.5.b.i below.

45 *See* proposed Instruction 3 to paragraph (a)(2) of proposed Rule 100 of Regulation Crowdfunding.

the statute.[46] Another commenter asked that the Commission clarify whether non-U.S. citizens or non-U.S. residents are bound by the same investment limits.[47] Three commenters proposed that the Commission create a two-tier regulatory system based on different investment limits to reduce the regulatory burden for small, local offerings.[48] One of the commenters suggested that one of the tiers could consist of a "small local offering" in which investment limits would be up to $250 per investor.[49] The commenter asserted that smaller investments could be subject to significantly reduced regulation because a $250 investment is unlikely to pose significant risk to an investor. The second commenter suggested reducing the anticipated personal disclosure requirements for investors who invest less than $500 through an intermediary that is a community development financial institution.[50]

The limitations in Section 4(a)(6)(B) apply to any investor seeking to participate in a crowdfunding transaction. We believe that Congress intended for investment opportunities through crowdfunding transactions relying on Section 4(a)(6) to be available to all types of investors and established the investment limitations accordingly.[51] The statute provides specific investment limits, and the only reference in the statute regarding changing those investment limits is the requirement that the Commission update the investment limits not less frequently

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46 *See* CFIRA Letter 2.

47 *See* TechnologyCrowdFund Letter 5.

48 *See* ASBC Letter; City First Letter. *See also* Spinrad Letter 1 (supporting the two-tier approach described in the ASBC Letter).

49 *See* ASBC Letter.

50 *See* City First Letter.

51 *See* 158 CONG. REC. S1689 (daily ed. Mar. 15, 2012) (statement of Sen. Mark Warner) ("There is now the ability to use the Internet as a way for small investors to get the same kind of deals that up to this point only select investors have gotten that have been customers of some of the best known investment banking firms, where we can now use the power of the Internet, through a term called crowdfunding.").

than every five years based on the Consumer Price Index. Therefore, we do not believe it would be appropriate to alter those limits for any particular type of investor or, at this time, to create a different exemption based on different investment limits. Issuers can rely on other exemptions to offer and sell securities to accredited investors and institutional investors (and, in some cases, investors that do not meet the definition of accredited investor). As discussed above, concurrent offerings to these types of investors are possible if the conditions of the applicable exemption are met. Therefore, as proposed, the limitations would apply to all investors, including retail, institutional or accredited investors and both U.S. and non-U.S. citizens or residents.

Request for Comment

6. While we acknowledge that there is ambiguity in the statutory language and there is some comment regarding a contrary reading, we believe that the appropriate approach to the investment limitations in Section 4(a)(6)(B) is to provide for an overall investment limit of $100,000 and, within that limit, to provide for a "greater of" limitation based on an investor's annual income or net worth. In light of ambiguity in the statutory language, we are specifically asking for comment as to the question of whether we should instead require investors to calculate the investment limitation based on the investor's annual income or net worth at the five percent threshold of Section 4(a)(6)(B)(i) if either annual income or net worth is less than $100,000? Similarly, for those investors falling within the Section 4(a)(6)(B)(i) framework, should we require them to calculate the five percent investment limit based on the lower of annual income or net worth? Should we require the same for the calculation of the 10 percent investment limit within the Section 4(a)(6)(B)(ii) framework? If we were to

pursue any of these calculations, would we unnecessarily impede capital formation?

7. The statute does not address how joint annual income or joint net worth should be treated for purposes of the investment limit calculation. The proposed rules clarify that annual income and net worth may be calculated jointly with the annual income and net worth of the investor's spouse. Is this approach appropriate? Should we distinguish between annual income and net worth and allow only one or the other to be calculated jointly for purposes of calculating the investment limit? Why or why not? Should the investment limit be calculated differently if it is based on the spouses' joint income, rather than each spouse's annual income? Why or why not?

8. We are proposing to permit an issuer to rely on the efforts that an intermediary takes in order to determine that the aggregate amount of securities purchased by an investor will not cause the investor to exceed the investor limits, provided that the issuer does not have knowledge that the investor had exceeded, or would exceed, the investor limits as a result of purchasing securities in the issuer's offering. Is this approach appropriate? Why or why not? Should an issuer be required to obtain a written representation from the investor that the investor has not and will not exceed the limit by purchasing from the issuer? Why or why not?

9. Should institutional and accredited investors be subject to the investment limits, as proposed? Why or why not? Should we adopt rules providing for another crowdfunding exemption with a higher investment limit for institutional and

accredited investors? If so, how high should the limit be? Are there categories of persons that should not be subject to the investment limits? If yes, please identify those categories of persons. If the offering amount for an offering made in reliance on Section 4(a)(6) is not aggregated with the offering amount for a concurrent offering made pursuant to another exemption, as proposed, is it necessary to exclude institutional and accredited investors from the investment limits since they would be able to invest pursuant to another exemption in excess of the investment limits in Section 4(a)(6)?

10. Should we adopt rules providing for another crowdfunding exemption with different investment limits (*e.g.*, an exemption with a $250 investment limit and fewer issuer requirements), as one commenter suggested,[52] or apply different requirements with respect to individual investments under a certain amount, such as $500, as another commenter suggested?[53] Why or why not? If so, should the requirements for issuers and intermediaries also change? What investment limits and requirements would be appropriate? Would adopting such an exemption be consistent with the purposes of Section 4(a)(6)?

11. Should we consider additional investment limits on transactions made in reliance on Section 4(a)(6) where the purchaser's annual income and net worth are both below a particular threshold? If so, what should such threshold be and why?

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52 *See* ASBC Letter.

53 *See* City First Letter.

3. Transaction Conducted Through an Intermediary

Under Section 4(a)(6)(C), a transaction in reliance on Section 4(a)(6) must be "conducted through a broker or funding portal that complies with the requirements of [S]ection 4A(a)." We believe that requiring an issuer to use only one intermediary, rather than allowing the issuer to use multiple intermediaries, to conduct an offering or concurrent offerings in reliance on Section 4(a)(6) would help foster the creation of a crowd and better accomplish the purpose of the statute. As discussed above, a central tenet of the concept of crowdfunding is presenting members of the crowd with an idea or business so members of the crowd can share information and evaluate the idea or business. Allowing an issuer to conduct a single offering or simultaneous offerings in reliance on Section 4(a)(6) through more than one intermediary would diminish the ability of the members of the crowd to effectively share information, because essentially, there would be multiple "crowds." Also, because practices among intermediaries may differ, were multiple intermediaries to conduct a single offering or simultaneous offerings, this could result in significant differences among such offerings. Finally, allowing an issuer to conduct an offering using more than one intermediary would make it more difficult for intermediaries to determine whether an issuer is exceeding the $1 million aggregate offering limit. Therefore, in addition to requiring the use of an intermediary in connection with an offering made in reliance on Section 4(a)(6), the proposed rules would prohibit an issuer from using more than one intermediary to conduct an offering or concurrent offerings made in reliance on Section 4(a)(6).[54]

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[54] *See* proposed Instruction 1 to paragraph (a)(3) of proposed Rule 100 of Regulation Crowdfunding.

Although the statute does not expressly require it, we also believe that in enacting Section 4(a)(6)(C), Congress contemplated that crowdfunding transactions made in reliance on Section 4(a)(6) and activities associated with these transactions would occur over the Internet or other similar electronic medium that is accessible to the public.[55] We believe that an "online-only" requirement enables the public to access offering information and share information publicly 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.[56] We believe that other mechanisms would not offer this opportunity. The proposed rules would require that an intermediary, in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6), effect such transactions exclusively through an intermediary's platform.[57] We propose to define the term "platform" to mean an Internet website or other similar electronic medium through which a registered broker or a registered funding portal acts as an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6).[58] The requirement that a transaction be conducted exclusively through a platform does not preclude an intermediary from performing back office and other administrative functions offline. Therefore, we propose to state that intermediaries

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55 In this regard, we note that Section 301 of the JOBS Act states that "[Title III] may be cited as the 'Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012'". *See* Section 301 of the JOBS Act. *See also* 158 CONG. REC. S1689 (daily ed. March 15, 2012) (statement of Sen. Mark Warner) ("There is now the ability to use the Internet as a way for small investors to get the same kind of deals that up to this point only select investors have gotten . . . , where we can now use the power of the Internet, through a term called crowdfunding."); *id.* at S1717 (Statement of Sen. Mary Landrieu) ("this crowdfunding bill – which is, in essence, a way for the Internet to be used to raise capital . . . .").

56 *See* note 2 and accompanying text. The Internet is considered to be a "perfect technology capable of aggregating millions of disparate, independent ideas in the way markets and intelligent voting systems do, without the dangers of 'too much communication' and compromise." Brabham, note 1 (citing James Surowiecki, *The Wisdom of Crowds* xix (2004)).

57 *See* proposed Rule 100(a)(3) of Regulation Crowdfunding.

58 *See* proposed Rule 100(d) of Regulation Crowdfunding.

may engage in back office and other administrative functions other than on their platforms.[59] Examples of such functions include document maintenance, preparation of notices and confirmations, preparing internal policies and procedures, defining and approving business security requirements and policies for information technology, and preparing information required to be filed or otherwise provided to regulators.

The proposed rules would accommodate other electronic media that currently exist or may develop in the future. For instance, applications for mobile communication devices, such as cell phones or smart phones, could be used to display offerings and to permit investors to make investment commitments. In our releases concerning the use of electronic media for delivery purposes, we discussed so-called "electronic-only" offerings as those in which investors are permitted to participate only if they agree to accept electronic delivery of all documents and other information in connection with the offering.[60] As discussed below, the proposed rules would require that an intermediary, in its standard account opening materials, obtain from investors consent for such electronic delivery.[61]

Some commenters appear to assume that all offers and sales made in reliance on Section 4(a)(6) would be conducted online.[62] One commenter recommended that the Commission

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59 *See* proposed Instruction 2 to paragraph (a)(3) of proposed Rule 100 of Regulation Crowdfunding.

60 *See, e.g.*, *Use of Electronic Media by Broker-Dealers, Transfer Agents and Investment Advisers for Delivery of Information,* Release No. 34-37182 (May 9, 1996) [61 FR 24644 (May 15, 1996)]; *Use of Electronic Media,* Release No. 34-42728 (Apr. 28, 2000) [65 FR 25843 (May 4, 2000)] ("*Use of Electronic Media*").

61 *See* proposed Rule 302(a) of Regulation Crowdfunding. The proposed rules would require consent to electronic delivery because we believe Congress contemplated that crowdfunding would, by its very nature, occur exclusively through electronic media.

62 *See, e.g.*, MacDonald Letter (stating that readily-available information on the Internet already provides a safeguard for crowdfunding investors); NAASA Letter (stating that NASAA is considering whether open Internet access to funding portals would provide sufficient and updated information to state regulators).

expressly require that all disclosure and affirmations required for crowdfunding transactions take place online.[63] In contrast, another commenter requested that we permit some crowdfunding elements to take place offline to encourage local community investments through entities such as community banks, community development companies and business development companies.[64] This commenter stated that permitting crowdfunding to take place offline also will help persons without Internet access to invest. The proposed rules would, subject to certain conditions, separately permit outreach by third parties and a third party's promotion of an issuer's offering through communication channels provided by an intermediary.[65] In addition, an issuer may provide a notice, subject to the conditions in the proposed rules, that directs potential investors to the intermediary's platform through which the issuer will conduct its offering.[66] Finally, we are not proposing to permit offerings to be conducted through means other than the Internet or similar electronic medium because we believe that allowing other non-electronic means would be inconsistent with the underlying principles of crowdfunding and the statute. Offerings made by other means would not be widely accessible by the public, which would defeat the benefit of the collective wisdom of the members of the crowd. We also believe that Internet access may be available to the public, such as through local public libraries, alleviating one commenter's concern about some persons not being able to invest unless the offerings also take place offline.

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63 *See* Cera Technology Letter.

64 *See* Tally Letter.

65 *See* proposed Rule 205 of Regulation Crowdfunding (promoter compensation), proposed Rule 305 of Regulation Crowdfunding (payments to third parties) and proposed Rule 402(b)(6) of Regulation Crowdfunding (conditional safe harbor), discussed below in Sections II.B.5, II.C.7 and II.D.3, respectively.

66 *See* proposed Rule 204 of Regulation Crowdfunding (advertising) discussed below in Section II.B.4.

12. The proposed rules 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? Why or why not? If issuers were permitted to use more than one intermediary, what requirements and other safeguards should or could be employed?

13. Should we define the term "platform" in a way that limits crowdfunding in reliance on Section 4(a)(6) to transactions conducted through an Internet website or other similar electronic medium? Why or why not?

14. Should we permit crowdfunding transactions made in reliance on Section 4(a)(6) to be conducted through means other than an intermediary's electronic platform? If so, what other means should we permit? For example, should we permit community-based funding in reliance on Section 4(a)(6) to occur other than on an electronic platform?[67] To foster the creation and development of a crowd, to what extent would such other means need to provide members of the crowd with the ability to observe and comment (*e.g.*, through discussion boards or similar functionalities) on the issuer, its business or statements made in the offering materials?

15. Should we allow intermediaries to restrict who can access their platforms? For example, should we permit intermediaries to provide access by invitation only or only to certain categories of investors? Why or why not? Would restrictions such as these negatively impact the ability of investors to get the benefit of the

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[67] *See* City First Letter and note 355.

crowd and its assessment of an issuer, business or potential investment? Would these kinds of restrictions affect the ability of small investors to access the capital markets? If so, how?

16. As noted above, the proposed rules would not require intermediaries' back office or other administrative functions to be conducted exclusively on their platforms. Do the proposed rules require any clarification? Are there other activities in which an intermediary may engage that would not be considered back office or administrative functions and that should be permitted to occur other than on a platform? If so, what activities are they, and why should they be permitted to occur other than on a platform?

4. Exclusion of Certain Issuers from Eligibility under Section 4(a)(6)

Section 4A(f) excludes certain categories of issuers from eligibility to rely on Section 4(a)(6) to engage in crowdfunding transactions. These issuers are: (1) issuers that are not organized under the laws of a state or territory of the United States or the District of Columbia; (2) issuers that are subject to Exchange Act reporting requirements;[68] (3) investment companies as defined in the Investment Company Act of 1940 (the "Investment Company Act")[69] or companies that are excluded from the definition of investment company under Section 3(b) or 3(c) of the Investment Company Act;[70] and (4) any other issuer that the Commission, by rule or regulation, determines appropriate.

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68 These are issuers who are required to file reports with the Commission pursuant to Exchange Act Sections 13(a) (15 U.S.C. 78m(a)) or 15(d) (15 U.S.C. 78*o*(d)).

69 15 U.S.C 80a-1 *et seq.*

70 15 U.S.C. 80a-3(b) or (c).

One commenter suggested that the Commission's rules should specify that the crowdfunding exemption under Section 4(a)(6) is not available for blank check companies or hedge funds and noted that "permitting these kinds of high-risk and often complex entities to use the exemption is not consistent with the statutory goal of deterring fraud and unethical non-disclosure in crowdfunding offerings."[71]

The proposed rules would exclude the categories of issuers identified in the statute,[72] as well as issuers that are disqualified from relying on Section 4(a)(6) pursuant to the disqualification provisions of Section 302(d) of the JOBS Act.[73] The proposed rules also would exclude an issuer that has sold securities in reliance on Section 4(a)(6) if the issuer has not filed with the Commission and provided to investors, to the extent required, the ongoing annual reports required by Regulation Crowdfunding[74] during the two years immediately preceding the filing of the required new offering statement.[75] We believe that the ongoing reporting requirement should benefit investors by enabling them to consider updated information about the issuer, thereby allowing them to make more informed investment decisions. If issuers fail to comply with this requirement, we do not believe that they should have the benefit of relying on the exemption under Section 4(a)(6) again until they file, to the extent required, the two most recent annual reports.

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71 Commonwealth of Massachusetts Letter.

72 *See* proposed Rules 100(b)(1)-(3) of Regulation Crowdfunding.

73 *See* proposed Rule 100(b)(4) of Regulation Crowdfunding. *See also* proposed Rule 503 of Regulation Crowdfunding and Section II.E.6 below for a discussion of the disqualification provisions.

74 *See* proposed Rules 202 and 203(b) of Regulation Crowdfunding and Section II.B.2 below for a discussion of the ongoing reporting requirements.

75 *See* proposed Rule 100(b)(5) of Regulation Crowdfunding.

The proposed rules also would exclude an issuer that has no specific business plan or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies. As described above, crowdfunding is a new and evolving method to raise money that serves as an alternative source of capital to support a wide range of ideas and ventures. We believe that the exemption under Section 4(a)(6) is intended to provide an issuer with an early stage project, idea or business an opportunity to share it publicly with a wider range of potential investors. Those potential investors may then share information with each other about the early stage proposal and use that information to decide whether or not to provide funding based on the "wisdom of the crowd." Under such circumstances, this mechanism requires the public to have sufficient information about the issuer's proposal to discuss its merit and flaws.[76]

At the same time, an early stage proposal may not allow the crowdfunding mechanism to work appropriately if the issuer does not describe a specific project, idea, or business, or is seeking funding for unspecified corporate transactions. In such cases, individuals reviewing the proposal may not have sufficient information to formulate a considered view of the proposal, or the proposal may be less likely to attract enough perspectives to inform a crowd decision. Investors who nonetheless choose to participate may therefore be more likely to be participating in an issuance that has not been reviewed by the crowd in the manner contemplated by the exemption under Section 4(a)(6).

We are cognizant of the challenges associated with distinguishing between early stage proposals that should provide information sufficient to support the crowdfunding mechanism and

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76 *See, e.g.*, Section 4A(b)(1)(C) (requiring a description of the business of the issuer and the anticipated business plan of the issuer).

those that cannot by their terms do so. We preliminarily believe that an appropriate balance can be struck by excluding an issuer that has no specific business plan or that has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies. As described below, we do not expect that a specific "business plan" requires a formal document prepared by management or used for marketing to investors.[77] We understand that issuers engaging in crowdfunding transactions may have businesses at various stages of development in differing industries, and therefore, we believe that a specific "business plan" could encompass a wide range of project descriptions, articulated ideas, and business models. In particular, we recognize that the business plan for startups or small businesses seeking to rely on Section 4(a)(6) may not be fully developed or highly specific and that for many it may be less defined or detailed than the plan associated with larger issuers.

With respect to hedge funds, we believe that under Section 4A(f)(3), hedge funds would be excluded from eligibility to rely on Section 4(a)(6) because hedge funds and other private funds typically rely on one of the exclusions from the definition of investment company under Section 3(c) of the Investment Company Act.[78]

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77 *See* discussion below in Section II.B.1.a.i.(b) below.

78 Investment Advisers Act ("Advisers Act") Form PF defines a "hedge fund" generally as any "private fund" (other than a securitized asset fund) that: (1) pays a performance fee or allocation calculated by taking into account unrealized gains (other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses); (2) may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital); or (3) may sell securities or other assets short or enter into similar transactions (other than for the purpose of hedging currency exposure or managing duration). *See* Form PF: Glossary of Terms at 4, *available at* http://www.sec.gov/rules/final/2011/ia-3308-formpf.pdf. A "private fund" is defined as any issuer that would be an investment company as defined in Section 3 of the Investment Company Act but for Section 3(c)(1) or 3(c)(7) of that Act. *Id.* at 7.

17. Section 4A(b)(4) requires that, "not less than annually, [the issuer] file with the Commission and provide to investors reports of the results of operations and financial statements of the issuer . . . ." Should an issuer be excluded from engaging in a crowdfunding transaction in reliance on Section 4(a)(6), as proposed, if it has not filed with the Commission and provided to investors, to the extent required, the ongoing annual reports required by proposed Regulation Crowdfunding during the two years immediately preceding the filing of the required offering statement? Why or why not? Should an issuer be eligible to engage in a crowdfunding transaction in reliance on Section 4(a)(6) if it is delinquent in other reporting requirements (*e.g.*, updates regarding the progress of the issuer in meeting the target offering amount)?[79] Why or why not? Should the exclusion be limited to a different timeframe (*e.g.*, filings required during the five years or one year immediately preceding the filing of the required offering statement)?

18. Is the proposed exclusion of issuers who fail to comply with certain ongoing annual reporting requirements too broad? If so, how should it be narrowed and why? Should the exclusion cover issuers whose affiliates have sold securities in reliance on Section 4(a)(6) if the affiliates have not complied with the ongoing annual reporting requirements? If so, should this encompass all affiliates? If not, which affiliates should it cover? Should we exclude any issuer with an

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79 *See* Section II.B.1.b below for a discussion of progress updates.

officer, director or controlling shareholder who served in a similar capacity with another issuer that failed to file its annual reports? Why or why not?

19. What specific risks do investors face with "idea-only" companies and ventures? Please explain. Do the proposed rules provide sufficient protection against the inherent risks of such ventures? Why or why not?

20. Does the exclusion of issuers that do not have a specific idea or business plan from eligibility to rely on Section 4(a)(6) strike the appropriate balance between the funding needs of small issuers and the information requirements of the crowd? Why or why not? Are there other approaches that would strike a better balance among those considerations? If the proposed approach is appropriate, should we define "specific business plan" or what criteria could be used to identify them? How would any such criteria comport with the disclosure obligations described in Section II.B.1.a.i.(b) (description of the business) below?

21. Are there other categories of issuers that should be precluded from relying on Section 4(a)(6)? If so, what categories of issuers and why?

B. Requirements on Issuers

1. Disclosure Requirements

Section 4A(b)(1) provides that an issuer offering or selling securities in reliance on Section 4(a)(6) must file specified disclosures, including financial disclosures, with the Commission, provide these disclosures to investors and the relevant broker or funding portal and make these disclosures available to potential investors. These disclosures include:

- the name, legal status, physical address and website address of the issuer;[80]
- the names of the directors and officers (and any persons occupying a similar status or performing a similar function), and each person holding more than 20 percent of the shares of the issuer;[81]
- a description of the business of the issuer and the anticipated business plan of the issuer;[82]
- a description of the financial condition of the issuer;[83]
- a description of the stated purpose and intended use of the proceeds of the offering sought by the issuer with respect to the target offering amount;[84]
- the target offering amount, the deadline to reach the target offering amount and regular updates regarding the progress of the issuer in meeting the target offering amount;[85]
- the price to the public of the securities or the method for determining the price;[86] and

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80 Section 4A(b)(1)(A).

81 Section 4A(b)(1)(B).

82 Section 4A(b)(1)(C).

83 Section 4A(b)(1)(D). This provision also establishes a framework of tiered financial disclosure requirements based on aggregate offering amounts for offerings under Section 4(a)(6) within the preceding 12-month period.

84 Section 4A(b)(1)(E).

85 Section 4A(b)(1)(F).

86 Section 4A(b)(1)(G). This provision also requires that "prior to sale, each investor shall be provided in writing the final price and all required disclosures, with a reasonable opportunity to rescind the commitment to purchase the securities." This provision is addressed in Sections II.C.5 and II.C.6 below.

- a description of the ownership and capital structure of the issuer.[87]

In addition, Section 4A(b)(1)(I) specifies that the Commission may require additional disclosures for the protection of investors and in the public interest.

Commenters expressed concerns about the extent of the disclosure requirements and stated that overly burdensome rules would make offers and sales in reliance on Section 4(a)(6) prohibitively expensive.[88] We recognize these concerns and have considered them in determining the disclosure requirements that we should propose in this release.

The proposed rules generally describe the type of information that issuers would be required to disclose. We expect, however, that an issuer, along with the intermediary, would determine the format that best conveys the required disclosures and any other information the issuer determines is material to investors.[89] We recognize that there are numerous ways to achieve that goal and, as such, we are not proposing to mandate a specific disclosure format.[90]

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87 Section 4A(b)(1)(H). Specifically, Section 4A(b)(1)(H) requires a description of: "(i) terms of the securities of the issuer being offered and each other class of security of the issuer…; (ii) a description of how the exercise of the rights held by the principal shareholders of the issuer could negatively impact the purchasers of the securities being offered; (iii) the name and ownership level of each existing shareholder who owns more than 20 percent of any class of the securities of the issuer; (iv) how the securities being offered are being valued…; and (v) 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."

88 *See* Vim Funding Letter; ExpertBeacon Letter; CrowdFund Connect Letter.

89 Section II.B.3 below further discusses the proposed format of Form C and requests comments on the format and presentation of the information.

90 While the proposed rules do not mandate a specific disclosure format, Rule 306 of Regulation S-T (17 CFR 232.306) requires that all electronic filings made with the Commission, including the filings that would be required under the proposed rules, be in English. The proposed rules would not, however, prevent an issuer from providing to the relevant intermediary both an English and a foreign language version of the information for the intermediary to make publicly available through its platform. The anti-fraud and civil liability provisions of the Securities Act would apply equally to both the English and the foreign language version of the information.

Similarly, to the extent some of the required disclosures overlap, issuers would not be required to duplicate disclosures.

As discussed further in Section II.B.3, we are proposing to require issuers to file the disclosures with the Commission on Form C.[91] As proposed, Form C would be filed in the standard format of eXtensible Markup Language (XML). An XML-based fillable form would enable issuers to provide information in a convenient medium without requiring the issuer to purchase or maintain additional software or technology. This would provide the Commission with data about offerings made in reliance on Section 4(a)(6). Information not required to be provided in text boxes would be filed as attachments to Form C.

Request for Comment

22. Rule 306 of Regulation S-T requires that all electronic filings made with the Commission, including the filings that would be required under the proposed rules, be in English. Some startups and small businesses, and their potential investors, may principally communicate in a language other than English. Should we amend Rule 306 to permit filings by issuers under the proposed rules to be filed in the other language? Why or why not? If we retain the requirement to make filings only in English, will this impose a disproportionate burden on issuers and potential investors who principally communicate in a language other than English? What will be the impact on capital formation for such issuers?

a. Offering Statement Disclosure Requirements

i. Information about the Issuer and the Offering

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91 Issuers would use Form C to provide the required disclosures about the crowdfunding transaction and the information required to be filed annually. *See* Section II.B.3 below.

(a) General Information about the Issuer, Officers and Directors

Consistent with Sections 4A(b)(1)(A) and (B), we are proposing to require an issuer to disclose information about its legal status, directors, officers and certain shareholders and how interested parties may contact the issuer. Specifically, an issuer would be required to disclose:

- its name and legal status, including its form of organization, jurisdiction in which it is organized and date of organization;[92]
- its physical address and its website address;[93] and
- the names of the directors and officers, including any persons occupying a similar status or performing a similar function, all positions and offices with the issuer held by such persons, the period of time in which such person served in the position or office and their business experience during the past three years,[94] including:
    - each person's principal occupation and employment, including whether any officer is employed by another employer; and
    - the name and principal business of any corporation or other organization in which such occupation and employment took place.

Although the statute does not define "officer," the term is defined in Securities Act Rule 405[95] and in Exchange Act Rule 3b-2.[96] We are proposing to define "officer" consistent with

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92 *See* proposed Rule 201(a) of Regulation Crowdfunding.

93 *Id.*

94 *See* proposed Rule 201(b) of Regulation Crowdfunding.

95 17 CFR 230.405.

96 17 CFR 240.3b-2.

these existing rules. Thus, an issuer would be required to disclose information regarding its president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer and any person routinely performing corresponding functions with respect to any organization, whether incorporated or unincorporated, to the extent it has individuals serving in these capacities.

We are proposing to require disclosure of the business experience of directors and officers of the issuer during the past three years. A three-year period is less than the five-year period that applies to issuers conducting registered offerings[97] or exempt offerings pursuant to Regulation A.[98] We believe that startups and small businesses that may seek to raise capital in reliance on Section 4(a)(6) generally would be smaller than the issuers conducting registered offerings or exempt offerings pursuant to Regulation A;[99] thus, we believe that the less burdensome three-year period would reduce the compliance cost for issuers while still providing potential investors with sufficient information about the business experience of directors and officers of the issuer to make an informed investment decision.

Section 4A(b)(1)(B) requires disclosure of "the names of . . . each person holding more than 20 percent of the shares of the issuer." In contrast, Section 4A(b)(1)(H)(iii) requires disclosure of the "name and ownership level of each existing shareholder who owns more than 20 percent *of any class* of the securities of the issuer" (emphasis added). The proposed rules would require disclosure of the names of persons, as of the most recent practicable date, who are the beneficial owners of 20 percent or more of the issuer's outstanding voting equity securities,

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97 *See* Item 401(e) of Regulation S-K [17 CFR 229.401(e)].

98 *See* Item 8(c) of Form 1-A [17 CFR 239.90].

99 There is no cap on the amount of proceeds that may be raised in a registered offering, and Regulation A limits offerings to $5 million.

calculated on the basis of voting power.[100] We refer to this group of persons as "20 Percent Beneficial Owners." We believe that the universe of 20 Percent Beneficial Owners should be the same for the disclosure requirements and the disqualification provisions[101] because this would ease the burden on issuers by requiring issuers to only identify one set of persons who would be the subject of these rules. We believe that assessing beneficial ownership based on total outstanding voting securities is consistent with Section 4A(b)(1)(B). Section 4A(b)(1)(B) is not limited to voting equity securities, but we believe the limitation would be necessary to clarify how beneficial ownership would be required to be calculated since issuers could potentially have multiple classes of securities with different voting powers. Assessing beneficial ownership based on ownership of total outstanding voting securities, rather than based on ownership of any class of securities as potentially contemplated by Section 4A(b)(1)(H)(iii), also should ease the burden of compliance because there would be fewer 20 Percent Beneficial Owners to track.

Neither Section 4A(b)(1)(B) nor Section 4A(b)(1)(H)(iii) states as of what date the beneficial ownership should be calculated. The proposed rules would require issuers to calculate beneficial ownership as of the most recent practicable date.[102] This is the same requirement that applies to issuers conducting registered offerings or Exchange Act reporting companies.[103] We believe that it is appropriate to provide issuers relying on Section 4(a)(6) the flexibility to calculate beneficial ownership as of the most recent practicable date, otherwise such issuers

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100 *See* proposed Rule 201(c) of Regulation Crowdfunding.

101 *See* proposed Rule 503 of Regulation Crowdfunding and Section II.E.6 below for a discussion of the proposed disqualification provisions. This approach also would be consistent with how beneficial ownership is calculated for the Rule 506 disqualification rules. *See Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings*, Release No. 33-9414 (July 10, 2013) [78 FR 44729 (July 24, 2013)] ("*Disqualification Adopting Release*").

102 *See* proposed Rule 201(c) of Regulation Crowdfunding.

103 *See* Item 403 of Regulation S-K [17 CFR 229.403].

would be subject to a more burdensome standard than the one that applies to issuers conducting registered offerings or Exchange Act reporting companies.

Request for Comment

23. Under the proposed rules the definition of the term "officer" is consistent with how that term is defined in Securities Act Rule 405[104] and in Exchange Act Rule 3b-2.[105] Should we instead define "officer" consistent with the definition of "executive officer" in Securities Act Rule 405[106] and in Exchange Act Rule 3b-7[107]? Why or why not? Which definition would be more appropriate for the types of issuers that would be relying on the exemption?

24. Are these proposed disclosure requirements relating to the issuer and its officers and directors appropriate? Why or why not? Should we only require the disclosures specifically called for by statute or otherwise modify or eliminate any of the proposed requirements? Should we require any additional disclosures (*e.g.*, disclosure about significant employees)? Is there other general information about the issuer or its officers and directors that we should require to be disclosed? If so, what information and why? For example, should we require disclosure of any court orders, judgments or civil litigation involving any directors and officers, including any persons occupying a similar status or

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[104] 17 CFR 230.405.

[105] 17 CFR 240.3b-2.

[106] 17 CFR 230.405.

[107] 17 CFR 240.3b-7.

performing a similar function? Why or why not? If so, what time period should this disclosure cover and why?

25. The proposed rules would require disclosure of the business experience of directors and officers of the issuer during the past three years. Is the three-year period an appropriate amount of time? Why or why not? If not, please discuss what would be an appropriate amount of time and why. 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? Why or why not?

26. The proposed rules would require disclosure of the names of persons who are beneficial owners of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power. Is this approach appropriate? Why or why not? Should the proposed rules require disclosure of the names of beneficial owners of 20 percent or more of any class of the issuer's voting securities, even if such beneficial ownership does not exceed 20 percent of all of the issuer's outstanding voting equity securities? Why or why not? Should the proposed disclosure requirement apply to the names of beneficial owners of 20 percent or more, as proposed, or to more than 20 percent of the issuer's outstanding voting equity securities? Why or why not?

27. The proposed rules would require that beneficial ownership be calculated as of the most recent practicable date. Is this approach appropriate? Why or why not? Should beneficial ownership be calculated as of a different date? For

example, should the reported beneficial ownership only reflect information as of the end of a well-known historical period, such as the end of a fiscal year? Please explain. Should there be a maximum amount of time from this calculation date to the filing to ensure that the information is current? If so, what maximum amount of time would be appropriate?

28. Should we provide additional guidance on how to calculate beneficial ownership on the basis of voting power? If so, what should that guidance include? Should the proposed rules require disclosure of the name of a person who has investment power over, an economic exposure to or a direct pecuniary interest in the issuer's securities even if that person is not a 20 Percent Beneficial Owner? Why or why not?

(b) Description of the Business

Consistent with Section 4A(b)(1)(C), we are proposing to require an issuer to disclose information about its business and business plan.[108] One commenter noted that the term "business plan" traditionally referred to a document prepared by management for internal use only and more recently has been used to refer to a marketing document used to solicit investors.[109] We do not expect issuers to provide those types of documents in response to this requirement.[110] Although two commenters suggested that the Commission clarify the term

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108 *See* proposed Rule 201(d) of Regulation Crowdfunding.

109 *See* Ohio Division of Securities Letter.

110 Companies filing a registration statement or other filings that require a description of the business include a description of the business without providing a formal business plan. *See* Item 101 of Regulation S-K [17 CFR 229.101]. Our approach under proposed Rule 201(d) of Regulation Crowdfunding is consistent with that practice.

"business plan,"[111] the proposed rules would not specify the disclosures that an issuer must include in the description of the business and the business plan. We understand that issuers engaging in crowdfunding transactions may have businesses at various stages of development in differing industries, and therefore, we believe that the proposed rules should provide flexibility for issuers to disclose the information about their businesses.

Request for Comment

29. Are these proposed disclosure requirements appropriate? Why or why not? Should we require any additional disclosures? Should we prescribe specific disclosure requirements about the business of the issuer and the anticipated business plan of the issuer or provide a non-exclusive list of the types of information an issuer should consider disclosing? Why or why not? If so, what specific disclosures about the issuer's business or business plans should we require or include in a non-exclusive list? For example, should we explicitly require issuers to describe any material contracts of the issuer, any material litigation or any outstanding court order or judgment affecting the issuer or its property? Why or why not?

30. Would more specific line item disclosures be more workable for issuers relying on Section 4A or provide more useful guidance for such issuers? Would such disclosures be more useful to investors? Why or why not? For example, should we require issuers to provide a business description incorporating the information that a smaller reporting company would be required to provide in a

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111 *See* Cones Letter; Ohio Division of Securities Letter.

registered offering pursuant to Item 101(h) of Regulation S-K?[112] Why or why not? Should we require issuers to provide information regarding their plan of operations, similar to that required by Item 101(a)(2) of Regulation S-K[113] in registered offerings by companies with limited operating histories? Why or why not?

(c) Use of Proceeds

The proposed rules, consistent with Section 4A(b)(1)(E), would require an issuer to provide a description of the purpose and intended use of the offering proceeds.[114] One commenter suggested that we require issuers to be specific and detailed when making this disclosure.[115] We expect that such disclosure would provide a sufficiently detailed description of the intended use of proceeds to permit potential investors to evaluate the investment. For example, an issuer may, among other uses, intend to use the proceeds of an offering to acquire assets or businesses, compensate the intermediary or its own employees or repurchase outstanding securities of the issuer. In its description, an issuer should use its judgment regarding the level of detail in its disclosures regarding the assets or businesses that the issuer anticipates acquiring, if applicable. If the proceeds will be used to compensate the intermediary, the issuer should disclose the amount to be used for such compensation. If the proceeds will be used to compensate existing employees and/or to hire new employees, the issuer should consider

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112 17 CFR 229.101(h).

113 17 CFR 229.101(a)(2).

114 *See* proposed Rule 201(i) of Regulation Crowdfunding.

115 *See* Williams Letter (stating that an issuer should disclose how the issuer arrived at the offering target, an itemization of expected expenses within the intended use of the proceeds, a contingency plan for the use of the proceeds should circumstances change and what will be done with any leftover proceeds upon completing the intended use).

disclosing whether the proceeds will be used for salaries or bonuses and how many employees it plans to hire, as applicable. If the issuer will repurchase outstanding issuer securities, it should consider disclosing its plans, terms and purpose for repurchasing the securities. An issuer also should consider disclosing how long the proceeds will satisfy the operational needs of the business. If an issuer does not have definitive plans for the proceeds, but instead has identified a range of possible uses, then the issuer should identify and describe each probable use and factors impacting the selection of each particular use.[116] If an issuer indicates that it will accept proceeds in excess of the target offering amount,[117] the issuer would be required to provide a separate, reasonably detailed description of the purpose and intended use of any excess proceeds with similar specificity.[118]

Request for Comment

31. Are these proposed disclosure requirements appropriate? Why or why not? Should we require any additional disclosures, including specifying items required to be disclosed? Is the proposed standard sufficiently clear such that it would result in investors being provided with an adequate amount of information? If not, how should we change the disclosure requirement? Should the rules include a non-exclusive list of examples that issuers should consider when providing disclosure, similar to the examples discussed above?

32. Under what circumstances, if any, should an issuer be required to update the use of proceeds disclosures?

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116 *See* proposed Instruction to paragraph (i) of proposed Rule 201 of Regulation Crowdfunding.

117 *See* Section II.B.1.a.i(d) below.

118 *See* proposed Instruction to paragraph (i) of proposed Rule 201 of Regulation Crowdfunding.

33. Is there other information regarding the purpose of the offering and use of proceeds that we should require to be disclosed? If so, what information? Should any of the examples above be included as requirements in the rules? Why or why not?

(d) Target Offering Amount and Deadline

Consistent with Section 4A(b)(1)(F), the proposed rules would require issuers to disclose the target offering amount and the deadline to reach the target offering amount.[119] In addition, an issuer would be required to disclose whether it will accept investments in excess of the target offering amount and, if it will, the issuer would be required to disclose, at the commencement of the offering, the maximum amount it will accept.[120] For example, if the issuer sets a target offering amount of $200,000 but is willing to accept up to $750,000, the issuer would be required to disclose both the $200,000 target offering amount and the $750,000 maximum offering amount that it will accept.[121] In addition, the issuer would be required to disclose, at the commencement of the offering, how shares in oversubscribed offerings would be allocated.[122] If this disclosure is made, we do not believe it would be necessary for us to prescribe how oversubscribed offerings would be allocated because this approach would allow issuers the

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119 *See* proposed Rule 201(g) of Regulation Crowdfunding.

120 *See* proposed Rule 201(h) of Regulation Crowdfunding.

121 The issuer in this case also would need to disclose the intended use of the additional proceeds. *See* proposed Instruction to paragraph (i) of proposed Rule 201 of Regulation Crowdfunding. *See also* Section II.B.1.a.i(c) above. In addition, the issuer in this case would need to provide audited financial statements at the commencement of the offering, rather than financial statements reviewed by an independent public accountant as would be required for the lower target amount. *See* Section II.B.1.a.ii below for a discussion of the financial statements requirements. As another example, an issuer that sets a target offering amount of $80,000 and a maximum offering amount of $105,000 would be required to provide financial statements reviewed by an independent public accountant (rather than tax returns for the most recently completed fiscal year and financial statements certified by the principal executive officer).

122 *See* proposed Rule 201(h) of Regulation Crowdfunding.

flexibility to structure the offering as they believe appropriate. At the same time, this approach would provide investors with the disclosure they need to make an informed investment decision.

We believe that investors in a crowdfunding transaction would benefit from clear disclosure about their right to cancel, the circumstances under which an issuer may close an offering early and the need to reconfirm the investment commitment under certain circumstances, so investors are more aware of their rights to rescind an investment commitment.[123] As such, we propose to require issuers to describe the process to cancel an investment commitment or to complete the transaction once the target amount is met,[124] including a statement that:

- investors may cancel an investment commitment until 48 hours prior to the deadline identified in the issuer's offering materials;[125]
- the intermediary will notify investors when the target offering amount has been met;
- if an issuer reaches the target offering amount prior to the deadline identified in its offering materials, it may close the offering early if it provides notice about the new offering deadline at least five business days prior to that new deadline (absent another material change that would require an extension of the offering and reconfirmation of the investment commitment);[126] and

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123 Although not specifically required by Title III, Securities Act Section 4A(b)(1)(I) provides us with discretion to require issuers engaged in transactions in reliance on Section 4(a)(6) to provide additional information for the protection of investors and in the public interest.

124 *See* proposed Rule 201(j) of Regulation Crowdfunding.

125 Section II.C.6 below further discusses the proposed cancelation provisions and requests comments on the proposed approach.

126 *Id.*

- if an investor does not cancel an investment commitment before the 48-hour period prior to the offering deadline, the funds will be released to the issuer upon closing of the offering and the investor will receive securities in exchange for his or her investment.

We also propose to require issuers to disclose that if an investor does not reconfirm his or her investment commitment after a material change is made to the offering, the investor's investment commitment will be cancelled and committed funds will be returned.[127] The proposed rules also would require issuers to disclose that if the sum of the investment commitments does not equal or exceed the target offering amount at the time of the offering deadline, no securities will be sold in the offering, investment commitments will be cancelled and committed funds will be returned.[128]

Request for Comment

34. Are these proposed disclosure requirements appropriate? Why or why not? Should we modify or eliminate any of the proposed requirements? Should we require any additional disclosures?

35. The proposed rules would require an issuer willing to accept investments in excess of the target offering amount to provide, at the commencement of the offering, the disclosure that would be required in the event the offer is oversubscribed. Is this approach appropriate? Why or why not?

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127 *See* proposed Rule 201(k) of Regulation Crowdfunding.

128 *See* proposed Rule 201(g) of Regulation Crowdfunding. *See also* Section 4A(a)(7) (requiring intermediaries to "ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount . . . .") and discussion in Section II.C.6 below.

(e) Offering Price

Consistent with Section 4A(b)(1)(G), the proposed rules would require an issuer to disclose the offering price of the securities or the method for determining the price, provided that prior to the sale, each investor is provided in writing the final price and all required disclosures.[129]

Request for Comment

36. Are these proposed disclosure requirements appropriate? Why or why not? Should we modify or eliminate any of the proposed requirements? Should we require any additional disclosures? Please explain.

(f) Ownership and Capital Structure

Consistent with Section 4A(b)(1)(H), the proposed rules would require an issuer to provide a description of its ownership and capital structure.[130] This disclosure would include:

- the terms of the securities being offered and each other class of security of the issuer, including the number of securities being offered and/or outstanding, whether or not such securities have voting rights, any limitations on such voting rights, how the terms of the securities being offered may be modified and a summary of the differences between such securities and each other class of security of the issuer, and how the rights of the securities being offered may be materially limited, diluted or qualified by the rights of any other class of security of the issuer;

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[129] *See* proposed Rule 201*(l)* of Regulation Crowdfunding. *See also* Sections II.C.5 and II.C.6 below for a discussion of information that issuers would be required to provide to investors.

[130] *See* proposed Rule 201(m) of Regulation Crowdfunding.

- a description of how the exercise of the rights held by the principal shareholders of the issuer could affect the purchasers of the securities;
- the name and ownership level of persons who are 20 Percent Beneficial Owners;
- how the securities being offered are being valued, and examples of methods for how such securities may be valued by the issuer in the future, including during subsequent corporate actions;
- the risks to purchasers of the securities relating to minority ownership in the issuer and the risks associated with corporate actions including additional issuances of securities, issuer repurchases of securities, a sale of the issuer or of assets of the issuer or transactions with related parties; and
- a description of the restrictions on the transfer of the securities.

We believe that investors in crowdfunding transactions would benefit from clear disclosure about the terms of the securities being offered and each other class of security of the issuer. The proposed rules would require disclosure of the number of securities being offered and/or outstanding, whether or not such securities have voting rights, any limitations on such voting rights and a description of the restrictions on the transfer of the securities.[131] Although Section 4A(b)(1)(H) does not specifically call for this disclosure, we believe that such disclosure would be necessary to provide investors with a more complete picture of the issuer's capital structure than would be obtained solely pursuant to the statutory requirements. We believe this would help investors better evaluate the terms of the offer before making an investment decision.

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131 *See* proposed Rule 501 of Regulation Crowdfunding and Section II.E.2 below for a discussion of restrictions on resales.

Request for Comment

37. Are these proposed disclosure requirements appropriate? Why or why not? Should we modify or eliminate any of the proposed requirements? Should we require any additional disclosures? Please explain.

(g) Additional Disclosure Requirements

In addition to the statutory disclosure requirements,[132] we propose to require:

- disclosure of the name, Commission file number and Central Registration Depository number ("CRD number")[133] (as applicable) of the intermediary through which the offering is being conducted;[134]
- disclosure of the amount of compensation paid to the intermediary for conducting the offering, including the amount of any referral or other fees associated with the offering;[135]
- disclosure of certain legends to be included in the offering statement;[136]
- disclosure of the current number of employees of the issuer;[137]
- a discussion of the material factors that make an investment in the issuer speculative or risky;[138]

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132 Section 4A(b)(1)(I) provides us with discretion to require crowdfunding issuers to provide additional information for the protection of investors and in the public interest.

133 The Financial Industry Regulatory Authority, Inc. ("FINRA") will issue the CRD number.

134 *See* proposed Rule 201(n) of Regulation Crowdfunding.

135 *See* proposed Rule 201(o) of Regulation Crowdfunding.

136 *See* Item 2 of General Instruction III to proposed Form C.

137 *See* proposed Rule 201(e) of Regulation Crowdfunding.

138 *See* proposed Rule 201(f) of Regulation Crowdfunding.

- a description of the material terms of any indebtedness of the issuer, including the amount, interest rate, maturity date and any other material terms;[139]
- disclosure of exempt offerings conducted within the past three years;[140] and
- disclosure of certain related-party transactions.[141]

Requiring an issuer to identify the name, Commission file number and CRD number (as applicable) of the intermediary through which the offering is being conducted should assist investors and regulators in obtaining information about the offering and facilitate monitoring the use of the exemption. It also could help investors obtain background information on the intermediary, for instance through filings made by the intermediary with the Commission as well as through the Financial Industry Regulatory Authority's ("FINRA") BrokerCheck system for brokers[142] or a similar system, if created, for funding portals.

In addition, requiring an issuer to disclose the amount of compensation paid to the intermediary for conducting the offering, including the amount of referral or other fees associated with the offering, would permit investors and regulators to determine how much of the proceeds of the offering are used to compensate the intermediary and to facilitate the monitoring of compensation paid to intermediaries.

The requirement for an issuer to include in the offering statement certain specified legends about the risks of investing in a crowdfunding transaction is intended to help investors understand the general risks of investing in a crowdfunding transaction. In addition, the

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139 *See* proposed Rule 201(p) of Regulation Crowdfunding.

140 *See* proposed Rule 201(q) of Regulation Crowdfunding.

141 *See* proposed Rule 201(r) of Regulation Crowdfunding.

142 *See* FINRA, FINRA BrokerCheck, *available at* http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/P015175.

requirement that an issuer include in the offering statement certain legends about the required ongoing reports, including how those reports would be made available to investors and how an issuer may terminate its ongoing reporting obligations, is intended to help investors understand an issuer's ongoing reporting obligations and inform investors of how they will be able to access those reports.

The proposed rules also would require disclosure of the material factors that make an investment in the issuer speculative or risky.[143] We believe that this risk factor information should help investors to better understand the risks of investing in a specific issuer's offering.

The proposed rules also would require disclosure of certain related-party transactions between the issuer and any director or officer of the issuer, any person who is a 20 Percent Beneficial Owner, any promoter of the issuer (if the issuer was incorporated or organized within the past three years), or immediate family members of the foregoing persons.[144] For purposes of this related-party transactions disclosure, "immediate family member" would have the same meaning that it has in Item 404 of Regulation S-K,[145] which relates to the disclosure of related-party transactions for Exchange Act reporting companies. This related-party transactions disclosure should assist investors in obtaining a more complete picture of the financial relationships between certain related parties and the issuer.

Several commenters suggested that we should model the disclosure form after Securities Act Form 1-A[146] or the North American Securities Administrators Association's ("NASAA")

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143 *See* proposed Rule 201(f) of Regulation Crowdfunding.

144 *See* proposed Rule 201(r) of Regulation Crowdfunding.

145 17 CFR 229.404. *See* proposed Rule 201(r)(4) of Regulation Crowdfunding.

146 17 CFR 239.90. Form 1-A is the form used for securities offerings made pursuant to Regulation A.

uniform Small Company Offering Registration Form (U-7).[147] The proposed disclosure requirements regarding risk factors and related-party transactions are similar to those in Form 1-A except that, with respect to the disclosure about related-party transactions, the proposed rules would require disclosure about transactions since the beginning of the issuer's last full fiscal year, rather than the two fiscal years required in Form 1-A. Given the early stage of development of the small businesses and startups that we expect would seek to raise capital pursuant to Section 4(a)(6), as well as the investment limitations prescribed by the proposed rules, we believe that limiting the disclosure to related-party transactions since the beginning of the issuer's last full fiscal year will reduce the burden on issuers while still providing investors with sufficient information to evaluate the relationship between related parties and the issuer. Also, the proposed rules only would require disclosure of related-party transactions in excess of five percent of the aggregate amount of capital raised by the issuer in reliance on Section 4(a)(6) during the preceding 12-month period, inclusive of the amount the issuer seeks to raise in the current offering under Section 4(a)(6). For example, an issuer seeking to raise $1 million would be required to disclose related-party transactions in excess of $50,000, which is the same threshold required in Form 1-A. We believe that, in light of the sizes and varieties of issuers that may make offerings in reliance on Section 4(a)(6), this scaled approach is more appropriate than the fixed amount approach used in Form 1-A, which might be disproportionate to the size of certain offerings and issuers.

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147 *See* Commonwealth of Massachusetts Letter; Coan Letter; Liles Letter 1; Vim Funding Letter; NASAA Letter.

Two commenters suggested that the Commission require the issuer to disclose the total number of employees.[148] The proposed rules would require disclosure of the issuer's current number of employees.[149] This information should assist investors and regulators in obtaining information about the size of the businesses using the exemption. This information would make data available that could be used to evaluate whether the businesses using the exemption are creating additional jobs.[150]

The proposed rules also would require disclosure of the material terms of any indebtedness of the issuer, including, among other items, the amount, interest rate and maturity date.[151] We believe this information would be important to investors because servicing debt could place additional pressures on an issuer in the early stages of development.

In addition, the proposed rules would require disclosure of exempt offerings conducted within the past three years.[152] For each exempt offering within the past three years, the proposed rules would require a description of the date of the offering, the offering exemption relied upon, the type of securities offered and the amount of securities sold and the use of proceeds.[153] We believe that it would be important to investors to know of prior offerings of securities. This information would better inform investors about the capital structure of the issuer and would provide information about how prior offerings were valued.

Request for Comment

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148 *See* NASAA Letter; Ohio Division of Securities Letter.

149 *See* proposed Rule 201(e) of Regulation Crowdfunding.

150 Issuers would be required to disclose the current number of employees in the offering document and the ongoing reports, which should permit comparison of the number of employees over different time periods.

151 *See* proposed Rule 201(p) of Regulation Crowdfunding.

152 *See* proposed Rule 201(q) Regulation Crowdfunding.

153 *See* proposed Instruction to paragraph (q) of proposed Rule 201 of Regulation Crowdfunding.

38. Are these proposed disclosure requirements appropriate? Why or why not? Should we modify or eliminate any of the proposed requirements? If so, how and why?

39. To assist investors and regulators in obtaining information about the offering and to facilitate monitoring the use of the exemption, the proposed rules would require an issuer to identify the name, Commission file number and CRD number (as applicable) of the intermediary through which the offering is being conducted. Is there a better approach? What other information should be provided? If so, please describe it.

40. Should we require disclosure of the amount of compensation paid to the intermediary, as proposed? Why or why not? Should we require issuers to separately disclose the amounts paid for conducting the offering and the amounts paid for other services? Why or why not?

41. Should we require the issuer to include certain specified legends about the risks of investing in a crowdfunding transaction and disclosure of the material factors that make an investment in the issuer speculative or risky, as proposed? Why or why not? Should we provide examples in our rules of the types of material risk factors an issuer should consider disclosing? Why or why not? If so, what should those examples be?

42. Should we require disclosure of certain related-party transactions, as proposed? Why or why not? The proposed rules would require disclosures of certain transactions between the issuer and directors or officers of the issuer, 20 Percent Beneficial Owners, any promoter of the issuer, or relatives of the foregoing

persons. Is this the appropriate group of persons? Should we limit or expand the list of persons? If so, how and why?

43. As proposed, immediate family member, for purposes of related-party transactions disclosure, would have the same meaning that it has in Item 404 of Regulation S-K.[154] Is this the appropriate approach? Why or why not? If not, what would be a more appropriate definition and why? For purposes of restrictions on resales of securities issued in transactions made in reliance on Section 4(a)(6), "member of the family of the purchaser or the equivalent" would, as proposed, expressly include spousal equivalents.[155] Should the definition of immediate family member for purposes of related-party transactions disclosure also expressly include spousal equivalents, or would including spousal equivalents create confusion in light of the fact that the definition for purposes of related-party transactions already includes any persons (other than a tenant or employee) sharing the same household? Please explain.

44. Is it appropriate to limit the disclosure about related-party transactions to transactions since the beginning of the issuer's last full fiscal year? Why or why not? Is it appropriate to limit disclosure to those related-party transactions that exceed five percent of the aggregate amount of capital raised by the issuer in reliance on Section 4(a)(6)? Should we instead require disclosure of all related-party transactions or all transactions in excess of an absolute threshold amount?

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[154] 17 CFR 229.404. *See* proposed Rule 201(r)(4) of Regulation Crowdfunding.

[155] *See* proposed Rule 501(c) of Regulation Crowdfunding and the related instruction thereto. *See also* Section II.E.2 below for a discussion of spousal equivalent.

45. Is it appropriate to require a description of any prior exempt offerings conducted within the past three years, as proposed? Why or why not? Would another time period (*e.g.*, one year, five years, etc.) or no time limit be more appropriate?

46. Should we require any additional disclosures (*e.g.*, should we require disclosure about executive compensation and, if so, what level of detail should be required in such disclosure)? If so, what disclosures and why?

ii. Financial Disclosure

Section 4A(b)(1)(D) requires "a description of the financial condition of the issuer." It also establishes a framework of tiered financial disclosure requirements based on aggregate target offering amounts of the offering and all other offerings made in reliance on Section 4(a)(6) within the preceding 12-month period:

- issuers offering $100,000 or less are required to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors income tax returns filed by the issuer for the most recently completed year (if any) and financial statements that are certified by the principal executive officer to be true and complete in all material respects;
- issuers offering more than $100,000, but not more than $500,000, are required to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors financial statements reviewed by a public accountant that is independent of the issuer; and
- issuers offering more than $500,000 (or such other amount as the Commission may establish) are required to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors audited financial statements.

Section 4A(h) further provides that these dollar amounts shall be adjusted by the Commission not less frequently than once every five years, by notice published in the Federal Register, to reflect any change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics.

(a) Financial Condition Discussion

Consistent with Section 4A(b)(1)(D), the proposed rules would require an issuer to provide a narrative discussion of its financial condition.[156] This discussion should address, to the extent material, the issuer's historical results of operations in addition to its liquidity and capital resources. If an issuer does not have a prior operating history, the discussion should focus on financial milestones and operational, liquidity and other challenges. If an issuer has a prior operating history, the discussion should focus on whether historical earnings and cash flows are representative of what investors should expect in the future. An issuer's discussion of its financial condition should take into account the proceeds of the offering and any other known or pending sources of capital. Issuers also should discuss how the proceeds from the offering will affect their liquidity and whether these funds and any other additional funds are necessary to the viability of the business. In addition, issuers should describe the other available sources of capital to the business, such as lines of credit or required contributions by principal shareholders.

We expect that the discussion required by the proposed rule and instruction would inform investors about the financial condition of the issuer in a manner similar to the management's discussion and analysis of financial condition and results of operations ("MD&A") required by

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156 *See* proposed Rule 201(s) of Regulation Crowdfunding.

Item 303 of Regulation S-K[157] for registered offerings. Because issuers seeking to engage in crowdfunding transactions would likely be smaller, less complex and at an early stage of development compared to issuers conducting registered offerings or Exchange Act reporting companies, we expect that the discussion would not generally need to be as lengthy or detailed as the MD&A of Exchange Act reporting companies. We are not proposing to prescribe content or format for this information, but rather to set forth principles of disclosure. To the extent these items of disclosure overlap with the issuer's discussion of its business or business plan, issuers are not required to make duplicate disclosures. While we are not proposing to mandate a specific presentation, we expect issuers to present the required disclosures, including any other information that would be material to an investor, in a clear and understandable manner.

Request for Comment

47. Are these proposed requirements for the discussion of the financial condition of the issuer appropriate? Why or why not? Should we modify or eliminate any of the requirements in the proposed rule or instruction? If so, which ones and why? Should we require any additional disclosures? If so, what disclosures and why? Should we prescribe a specific format or presentation for the disclosure? Please explain.

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157 17 CFR 229.303.

48. Should we exempt issuers with no operating history from the requirement to provide a discussion of their financial condition? If so, why? Should we require such issuers to specifically state that they do not have an operating history, as proposed? Why or why not?

49. In the discussion of the issuer's financial condition, should we require issuers to provide specific disclosure about prior capital raising transactions? Why or why not? Should we require specific disclosure relating to prior transactions made pursuant to Section 4(a)(6), including crowdfunding transactions in which the target amount was not reached? Why or why not?

(b) Financial Disclosures

As noted above, Section 4A(b)(1)(D) establishes tiered financial statement disclosure requirements that are based on aggregate target offering amounts within the preceding 12-month period. We received a range of comments on this requirement.

In response to the requirement for issuers offering $100,000 or less to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors their income tax returns for the most recently completed year, one commenter suggested that, even if redacted, income tax returns should not be made public.[158] One commenter suggested that financial statements should cover the most recently completed fiscal year.[159] Other commenters suggested that issuers offering $100,000 or less should provide financial statements prepared in accordance with generally accepted accounting principles

158 *See* RocketHub Letter 1 (stating that information can be taken from the issuer's tax return and entered digitally, by the issuer, for inclusion in the offering materials).

159 *See* CompTIA Letter.

("GAAP"), including explanatory notes, even though those financial statements would not be subject to an independent accountant's review or audit.[160]

For issuers offering more than $100,000, but not more than $500,000, one commenter suggested that the Commission require the financial statement review to be done by accountants in good standing for at least five years.[161] Another commenter stated that issuers in existence for less than 12 months should not be required to provide independently reviewed financial statements.[162]

Several commenters objected to the requirement for issuers to provide audited financial statements when offering more than $500,000 and suggested alternatives.[163] One commenter suggested that an issuer should not be required to provide audited financial statements if: (1) the target offering amount is not greater than $100,000 (notwithstanding any other transactions made in reliance on Section 4(a)(6) within the preceding 12-month period); and (2) the issuer has not

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160 *See* Commonwealth of Massachusetts Letter; NASAA Letter.

161 *See* Philipose Letter 1.

162 *See* CFIRA Letter 2.

163 *See* CFIRA Letter 2 (stating that the requirement to provide audited financial statements should apply solely to issuers that have been engaged in their current business for more than 12 months and which are seeking to raise at least $1,000,000); Vim Funding Letter (stating that the statute gives the Commission the discretion to raise the threshold at which audits are required, "in theory all the way up to the $1,000,000 level" and asking that the Commission exercise its discretion); RocketHub Letter 1 (stating that the threshold for the audit requirement should be raised to an amount in excess of $1,000,000 and audited financial statements should only be required for issuers that have been in operation for more than two years); Parker Letter (stating that the audit requirement is an unnecessary expense); Cera Technology Letter (stating that the audit requirement should be raised to $1,000,000); ABA Letter 1 (stating that the Commission should consider a higher threshold, such as $750,000, or identify additional criteria, such as revenue levels, that would require audited financial statements); Loofbourrow Letter (stating that the Commission should not impose an audit requirement); InitialCrowdOffering Letter (stating that the requirement for audited financial statements should be eliminated); Genedyne Letter 1 (stating that the Commission should not impose an audit requirement for offerings under $1,000,000); BrainThrob Laboratories Letter (stating that the Commission should defer imposing an audit requirement until further study can determine whether it is economically beneficial to the investment community); Vogele Letter (stating that obtaining audited financial statements takes time and new businesses do not have a lot of time). *See also* 2012 SEC Government-Business Forum, note 29 (recommending that the Commission consider raising the offering amount at which audited financial statements are required).

conducted a transaction in reliance on Section 4(a)(6) within the preceding six months.[164] Another commenter suggested that issuers should be required to identify the accountant used to certify or audit the financial statements.[165]

Under the proposed rules, in determining the financial statements that would be required, an issuer would need to aggregate the amounts offered and sold in reliance on Section 4(a)(6) within the preceding 12-month period with the target offering amount (or the maximum offering amount, including the aggregate amount of any possible oversubscriptions if the issuer will accept oversubscriptions) of the offering for which disclosure is being provided.[166] The statute refers to aggregate "offering amounts" within the preceding 12-month period. We are proposing to require issuers to aggregate only amounts offered and sold (rather than all offered amounts, including those not sold) within the preceding 12-month period with the amount the issuer is seeking to raise in the transaction.[167] We do not believe that this provision should require an issuer to aggregate amounts offered in prior offerings but not sold (for example, because the target offering amount was not met). Otherwise, an issuer that initially sought to raise $400,000, did not complete the crowdfunding transaction because the target offering amount was not met, and would like to raise $200,000 in a second attempt would be required to provide audited financial statements rather than financial statements reviewed by a public accountant in

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164 *See* ABA Letter 1.

165 *See* RocketHub Letter 1 (stating that disclosure of the identity of the accountant used to review or audit the financial statements would allow investors to conduct diligence on the accountant and permit the intermediary to track accountant activities and block issuers on their platform from using accountants who produce poor quality or fraudulent work).

166 *See* proposed Instruction 1 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

167 *See also* Hutchens Letter (suggesting that the Commission "devise a rule that creates a relationship between the amount of capital actually raised by an issuer in a crowdfunding offering and the degree of financial disclosure the issuer must provide").

connection with that $200,000 offering. We believe that this result would increase costs to issuers when those issuers were unsuccessful in prior offerings within the preceding 12-month period. Requiring issuers to aggregate amounts offered and sold should still prevent issuers from circumventing the framework of tiered financial disclosure requirements by structuring a larger offering as a series of smaller offerings.[168] We do not propose to prohibit issuers from providing financial statements that meet the requirements for a higher aggregate target offering amount than the proposed rules would require.[169]

The proposed rules would require all issuers to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors a complete set of their financial statements (a balance sheet, income statement, statement of cash flows and statement of changes in owners' equity), prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"), covering the shorter of the two most recently completed fiscal years or the period since inception of the business.[170] In proposing this requirement we considered commenters' suggestions that we require financial statements prepared in accordance with U.S. GAAP,[171] as well as the fact that the same requirement applies to offerings under Regulation A.[172]

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168 For example, we believe aggregating completed offerings within the preceding 12-month period is necessary to avoid having an issuer who seeks to raise more than $500,000, which requires audited financial statements, structure the offering as a series of smaller offerings to circumvent this requirement.

169 *See* proposed Instruction 10 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

170 *See* proposed Instruction 2 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding. Financial statements prepared in accordance with U.S. GAAP are generally self-scaling to the size and complexity of the issuer, which should reduce the burden of preparing financial statements for many issuers.

171 *See* Commonwealth of Massachusetts Letter; NASAA Letter.

172 *See* Part F/S of Form 1-A. [17 CFR 239.90].

We considered proposing to require financial statements covering only the most recently completed fiscal year, as one commenter suggested,[173] rather than the two most recently completed fiscal years; however, we believe that requiring a second year will provide investors with a basis for comparison against the most recently completed period, without substantially increasing the burden for the issuer.[174] We also considered proposing to require a third year of financial statements, but we are concerned that this could be overly burdensome for the types of issuers that likely would engage in crowdfunding transactions.[175]

During the first 120 days of the issuer's fiscal year, an issuer would be able to conduct an offering in reliance on Section 4(a)(6) and the related rules using financial statements for the fiscal year prior to the most recently completed fiscal year if the financial statements for the most recently completed fiscal year are not otherwise available or required to be filed.[176] We believe this accommodation is needed because otherwise issuers would not be able to conduct offerings in reliance on Section 4(a)(6) for a period of time between the end of their fiscal year and the date when the financial statements for that period are available.[177] The issuer could not do this,

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173 *See* CompTIA Letter.

174 *See Smaller Reporting Company Regulatory Relief and Simplification*, Release No. 33-8876 (Dec. 19, 2007) [73 FR 934 (Jan. 4, 2008)] (in the context of requiring two years, rather than just one year, of audited balance sheet data for smaller reporting companies, the Commission noted that comparative balance sheets will provide a much more meaningful presentation for investors without a significant additional burden on smaller reporting companies, since the earlier year data should be readily available for the purposes of preparing the other financial statements). *See also SEC Advisory Committee on Smaller Public Companies, Final Report* (Apr. 23, 2006), *available at* http://www.sec.gov/info/smallbus/acspc.shtml.

175 Requiring a third year of financial statements also would place a greater burden on issuers relying on Section 4(a)(6) than on emerging growth companies conducting registered offerings. *See* Section 102(b) of the JOBS Act.

176 *See* proposed Instruction 8 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

177 Issuers conducting a registered offering after the end of their fiscal year also are permitted to use financial statements for their prior period until the 90th day after their fiscal-year end for non-accelerated filers (or 75th day for accelerated filers and 60th day for large accelerated filers) if certain conditions are satisfied. *See* Rule 3-01(c) of Regulation S-X [17 CFR 210.3-01(c)].

however, if it was otherwise required to provide updated financial statements by the ongoing reporting requirements[178] or financial statements are otherwise available.[179] For example, if an issuer that has a calendar fiscal year end conducts an offering in April 2014, it would be permitted to include financial statements for the fiscal year ended December 31, 2012 if the financial statements for the fiscal year ended December 31, 2013 are not yet available. Once more than 120 days have passed since the end of the issuer's most recent fiscal year, the issuer would be required to include financial statements for its most recent fiscal year.[180] Regardless of the age of the financial statements, an issuer would be required to include a discussion of any material changes in the financial condition of the issuer during any time period subsequent to the period for which financial statements are provided, including changes in reported revenue or net income, to inform investors of changes to the financial condition of the issuer.[181]

Section 4A(b)(1)(D)(i) requires issuers to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors income tax returns and financial statements. As specified in the statute, we are proposing to require an issuer that is conducting an offering of $100,000 or less in reliance on Section 4(a)(6) to provide its filed income tax returns for the most recently completed fiscal year, if any, and its financial statements certified by its principal executive officer.[182] Although one commenter suggested the

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178 *See* Section II.B.2 below for a discussion of ongoing reporting requirements.

179 Additionally, if the offering period remains open beyond 120 days after the end of the issuer's fiscal year (resulting in financial statements older than 485 days at the time the offering closes), then the issuer would be required to update the disclosure in the offering statement to include financial statements for the most recently completed fiscal year. *See* proposed Instruction 8 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

180 *Id.*

181 *See* proposed Instruction 9 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

182 *See* proposed Rule 201(t)(1) of Regulation Crowdfunding.

Commission should provide otherwise,[183] the statute specifically calls for the Commission to require the filing of income tax returns. To address the privacy concerns raised by commenters with regard to the requirement to provide tax returns, we are proposing to require issuers to redact personally identifiable information, such as social security numbers, from their tax returns before filing. Issuers that offer securities in reliance on Section 4(a)(6) before filing their tax returns for the most recently completed fiscal year would be allowed to use the tax return filed for the prior year, provided that the issuer discloses any material changes since that prior year. In addition, the issuer would be required to provide the tax return for the most recent fiscal year when filed with the U.S. Internal Revenue Service (if filed during the offering period). With regard to the requirement to provide financial statements that are certified to be true and complete in all material respects, we are proposing a form of the certification that would be provided by the issuer's principal executive officer.[184]

For offerings of more than $100,000, but not more than $500,000, Section 4A(b)(1)(D)(ii) requires issuers to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors financial statements reviewed by a public accountant who is "independent" of the issuer, using professional standards and procedures or standards and procedures established by the Commission for this purpose. The statute does not define the term "independent." We propose that to qualify as an independent public accountant for purposes of this requirement, the accountant would need to comply with

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183 *See* RocketHub Letter 1.

184 *See* proposed Instruction 4 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

the Commission's independence rules, which are set forth in Rule 2-01 of Regulation S-X.[185] We believe that accounting professionals could benefit from the guidance the Commission and staff have provided about these independence rules. We also believe that financial statement reviews under these standards could provide investors with more confidence regarding the reliability of the financial statements.[186] An issuer subject to this requirement that seeks to eventually become an Exchange Act reporting company may have an easier transition because the issuer would already be complying with our independence rules.[187]

The statute also gives the Commission discretion to determine the professional standards and procedures used for the review of the financial statements. To implement this requirement, the proposed rules would require issuers to provide financial statements reviewed in accordance with the Statements on Standards for Accounting and Review Services ("SSARS") issued by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants ("AICPA").[188] We are not proposing new review standards for purposes of these

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185 17 CFR 210.2-01. Rule 2-01 of Regulation S-X is designed to ensure that auditors are qualified and independent both in fact and in appearance. The rule sets forth restrictions on, including but not limited to, financial, employment, and business relationships between an accountant and a client and restrictions on an accountant providing certain non-audit services to a client. The general standard of independence is set forth in Rule 2-01(b). The rule does not purport to, and the Commission could not, consider all the circumstances that raise independence concerns, and these are subject to the general standard in paragraph (b) of Rule 2-01. In considering this standard, the Commission looks in the first instance to whether a relationship or the provision of a service: (a) creates a mutual or conflicting interest between the accountant and the client; (b) places the accountant in the position of auditing his or her own work; (c) results in the accountant acting as management or an employee of the client; or (d) places the accountant in a position of being an advocate for the client.

186 For example, under the Commission's independence rules, an auditor cannot provide bookkeeping services to an audit client, so investors would be able to rely on the benefits that accompany the prohibition against an auditor auditing its own work. *See* Rule 2-01(c)(4) of Regulation S-X [17 CFR 210.2-01(c)(4)].

187 Using an accountant that is not independent in accordance with our independence rules could result in increased expense and delay to the extent that an issuer seeking to become an Exchange Act reporting company would need to obtain an audit of the financial statements by an accountant complying with the Commission's independence standards.

188 *See* proposed Rule 201(t)(2) of Regulation Crowdfunding.

rules at this time because we do not believe it is necessary. The AICPA's review standard is widely utilized, and we are not aware of any other widely utilized standards for reviews. Many accountants reviewing financial statements of crowdfunding issuers should be familiar with the AICPA's standards and procedures for review, which could make it less burdensome for issuers.

The issuer would be required to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors a copy of the public accountant's review report.[189] This should benefit investors by giving them the ability to consider any modification that may have been made to the review report. It also would serve as a way to identify the accounting firm used to review the financial statements. As one commenter suggested,[190] investors then could conduct due diligence on the accounting firm by, for example, researching the other offerings made in reliance on Section 4(a)(6) in which the accounting firm was involved or reviewing the accounting firm's licensure status and any publicly-available disciplinary proceedings.

For offerings of more than $500,000, consistent with the threshold identified in Section 4A(b)(1)(D)(iii), the proposed rules would require issuers to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors audited financial statements. While Congress authorized the Commission to establish a different threshold, we are not proposing at this time to raise the threshold at which an issuer would be required to provide audited financial statements, as some commenters suggested.[191] We note that Congress specifically selected $500,000 as the threshold at which to require audited financial

189 *See* proposed Instruction 5 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

190 *See* RocketHub Letter 1.

191 *See* CFIRA Letter 2; Vim Funding Letter; RocketHub Letter 1; Cera Technology Letter; Genedyne Letter 1; Schwartz Letter.

statements. If we were to raise the threshold to $1 million, as suggested by some commenters,[192] it would eliminate the requirement for issuers ever to provide audited financial statements because the maximum offering amount under Section 4(a)(6) is $1 million. Leaving the $500,000 threshold unchanged also would provide the Commission, investors and issuers an opportunity to become familiar with the new offering exemption before considering possible changes to the threshold.

Under the proposed rules, the auditor conducting the audit of the financial statements would be required to be independent of the issuer and the audit would have to be conducted in accordance with the auditing standards issued by either the AICPA or the Public Company Accounting Oversight Board ("PCAOB").[193] The proposed instructions to the rules would provide that the auditor would be required to be independent of the issuer based on the Commission's independence standard in Rule 2-01 of Regulation S-X.[194] Providing issuers with a choice of auditing standards could provide a benefit in a number of ways. If an issuer currently has audited financial statements using one of the specified standards, the issuer would not need to obtain a new audit or engage a different auditor to conduct an audit in order to engage in a crowdfunding transaction in reliance on Section 4(a)(6). If an issuer chooses to have an audit conducted in accordance with PCAOB auditing standards, it generally would not need to obtain a new audit in order to file a registration statement with the Commission for a registered offering or to register a class of securities under the Exchange Act and become an Exchange Act reporting company. The proposed rules would not require the audit to be conducted by a

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192 *See* CFIRA Letter 2; Vim Funding Letter; Cera Technology Letter; Genedyne Letter 1.

193 *See* proposed Rule 201(t)(3) of Regulation Crowdfunding.

194 17 CFR 210.2-01.

PCAOB-registered firm. This should mean that a greater number of accountants would be eligible to audit the issuers' financial statements, which may reduce issuers' costs.

An issuer would be required to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors a copy of the audit report.[195] This should benefit investors by serving as a way to identify the accounting firm used to audit the financial statements. Investors then could conduct due diligence by, for example, researching other offerings made in reliance on Section 4(a)(6) in which the accounting firm was involved or reviewing the accounting firm's licensure status and any publicly-available disciplinary proceedings.

An issuer that received an unqualified or a qualified audit opinion would be in compliance with the audited financial statement requirements.[196] An issuer that received an adverse opinion or a disclaimer of opinion, however, would not be in compliance with the audited financial statement requirements,[197] because the auditor determined that the financial statements of the issuer do not present fairly its financial position, results of operations or cash flows in conformity with U.S. GAAP, or that the auditor does not express an opinion on the financial statements.

Under Rule 2-01 of Regulation S-X, the Commission does not recognize as a public accountant any person who: (1) is not duly registered and in good standing as a certified public accountant under the laws of the place of his residence or principal office; or (2) is not in good standing and entitled to practice as a public accountant under the laws of the place of his

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195 *See* proposed Instruction 6 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

196 *Id.*

197 *Id.*

residence or principal office.[198] We believe that this rule promotes the use of qualified accountants that are in compliance with the requirements for their profession for the review or audit of the financial statements with respect to all offerings, including offerings in reliance on Section 4(a)(6).[199] We are not proposing to require that the public accountant be in good standing for at least five years, as one commenter suggested,[200] because that could unnecessarily restrict the pool of available public accountants by, for example, excluding accountants who are in good standing but who have been in business for fewer than five years.

We believe that many issuers engaging in crowdfunding transactions in reliance on Section 4(a)(6) are likely to be at a very early stage of their business development and may not have an operating history. In many instances, these issuers will have no more than a business plan for which they are seeking investors to help fund. We are not proposing to exempt these issuers (or issuers that have been in existence for less than 12 months, as one commenter suggested)[201] from the requirement to provide financial statements based on the tiered offering amounts. Financial statements prepared in accordance with U.S. GAAP are generally self-scaling to the size and complexity of the issuer, which reduces the burden of preparing financial statements for many early stage issuers. We would not expect that the required financial statements would be long or complicated for issuers that are recently formed and have limited

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198 *See* 17 CFR 210.2-01(a).

199 Accountants also would be subject to Rule 102(e) of the Rules of Practice and Investigations. *See* 17 CFR 201.102(e). Under Rule 102(e), the Commission can censure, suspend or bar professionals who appear or practice before it if it finds such professionals, after notice and an opportunity for hearing: (1) not to possess the requisite qualifications to represent others; or (2) to be lacking in character or integrity or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the Federal securities laws or the rules and regulations thereunder. *See* 17 CFR 201.102(e)(1)(i), (ii) and (iii).

200 *See* Philipose Letter 1.

201 *See* CFIRA Letter 2.

operating histories. We preliminarily believe, nevertheless, that financial statements for such issuers would be useful for investors, particularly when presented along with a description of the issuer's financial condition. This would give investors a more complete picture of the issuer and would highlight its early stage of development.

Request for Comment

50. Under the statute and the proposed rules, issuers are required to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors financial statements. The proposed rules would require all issuers to provide a complete set of financial statements (a balance sheet, income statement, statement of cash flows and statement of changes in owner's equity) prepared in accordance with U.S. GAAP. Should we define financial statements differently than under U.S. GAAP? If so, what changes would be appropriate and why? What costs or challenges would be associated with the use of a model other than U.S. GAAP (*e.g.*, lack of comparability)? What would be the benefits? Please explain.

51. Should we exempt issuers with no operating history or issuers that have been in existence for fewer than 12 months from the requirement to provide financial statements, as one commenter suggested?[202] Why or why not? Specifically, what difficulties would issuers with no operating history or issuers that have been in existence for fewer than 12 months have in providing financial statements? Please explain.

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202 *Id.*

52. If we were to exempt issuers with little or no operating history from the requirement to provide financial statements, should we require additional discussion of the fact that the issuer does not have an operating history? If so, what additional discussion should we require?

53. Section 4A(b)(1)(D) establishes tiered financial statement requirements based on aggregate target offering amounts within the preceding 12-month period. Under the proposed rules, issuers would not be prohibited from *voluntarily* providing financial statements that meet the requirements for a higher aggregate target offering amount (*e.g.*, an issuer seeking to raise $80,000 provides financial statements reviewed by a public accountant who is independent of the issuer, rather than the required income tax returns and a certification by the principal executive officer). Is this approach appropriate? Why or why not?

54. Should we allow issuers to prepare financial statements using a comprehensive basis of accounting other than U.S. GAAP? For example, should issuers be allowed to provide financial statements prepared on an income tax basis, a cash basis or a modified cash basis of accounting? Why or why not? If so, should we allow all issuers to use a comprehensive basis of accounting other than U.S. GAAP, or only issuers seeking to raise $100,000 or less, or $500,000 or less? Why or why not?

55. Should we require issuers to provide two years of financial statements, as proposed? Should this time period be one year, as one commenter suggested,[203] or three years? Please explain.

56. Should we require some or all issuers also to provide financial statements for interim periods, such as quarterly or semi-annually? Why or why not? If so, which issuers and why? Should we require these financial statements to be subject to public accountant or auditor involvement? If so, what level of involvement is appropriate?

57. As proposed, subject to certain conditions, issuers would be able to conduct an offering during the first 120 days of the issuer's fiscal year if the financial statements for the most recently completed fiscal year are not yet available. For example, an issuer could raise capital in April 2014 by providing financial statements from December 2012, instead of a more recent period. Is this an appropriate approach? If the issuer is a high growth company subject to significant change, would this approach result in financial statements that are too stale? Should the period be shorter or longer (*e.g.*, 90 days, 150 days, etc.)? What quantitative and qualitative factors should we consider in setting the period? Should issuers be required to describe any material changes in their financial condition for any period subsequent to the period for which financial statements are provided, as proposed? Please explain if you do not believe this description should be required.

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203 *See* CompTIA Letter.

58. The proposed rules would require issuers offering $100,000 or less to provide financial statements that are certified by the principal executive officer to be true and complete in all material respects. Should we require issuers offering more than $100,000, but not more than $500,000, and/or issuers offering more than $500,000 to provide financial statements that are certified by the principal executive officer to be true and complete in all material respects? Why or why not?

59. Have we adequately addressed the privacy concerns raised by the requirement to provide income tax returns? Should we require issuers to redact personally identifiable information from any tax returns, as proposed? Is there additional information that issuers should be required or allowed to redact? In responding, please specify each item of information that issuers should be required or allowed to redact and why. Under the statute and proposed rules, an issuer must be a business organization, rather than an individual. Does this requirement alleviate some of the potential privacy concerns? Please explain.

60. If an issuer has not yet filed its tax return for the most recently completed fiscal year, should we allow the issuer to use the tax return filed for the prior year and require the issuer to update the information after filing the tax return for the most recently completed fiscal year, as proposed? Should the same apply to an issuer that has not yet filed its tax return for the most recently completed fiscal year and has requested an extension of the time to file? Should issuers be required, as proposed, to describe any material changes that are expected in the tax returns for the most recently completed fiscal year? Please explain.

61. As proposed, the accountant reviewing or auditing the financial statements would have to be independent, as set forth in Rule 2-01 of Regulation S-X. Should we require compliance with the independence standards of the AICPA instead? Why or why not? If so, similar to the requirement in Rule 2-01 of Regulation S-X, should we also require an accountant to be: (1) duly registered and in good standing as a certified public accountant under the laws of the place of his or her residence or principal office; or (2) in good standing and entitled to practice as a public accountant under the laws of his or her place of residence or principal office? Is there another independence standard that would be appropriate? If so, please identify the standard and explain why. Alternatively, should we create a new independence standard for purposes of Section 4(a)(6)? If so, what would be an appropriate standard? Please explain.

62. As proposed, the accountant reviewing or auditing the financial statements must be independent based on the independence standard in Rule 2-01 of Regulation S-X. Are there any requirements under Rule 2-01 that should not apply to the accountant reviewing or auditing the financial statements that are filed pursuant to the proposed rules? Why or why not? Are there any that would not apply, but should? For example, should the accountant reviewing or auditing the financial statements of issuers in transactions made in reliance on Section 4(a)(6) be subject to the partner rotation requirements of Rule 2-01(c)(6)? Why or why not?

63. As proposed, an issuer with a target offering amount greater than $100,000, but not more than $500,000, would be required to file with the Commission, provide

to investors and the relevant intermediary and make available to potential investors financial statements reviewed by an independent public accountant in accordance with the review standards issued by the AICPA. Is this standard appropriate, or should we use a different standard? Why or why not? If so, what standard and why? Alternatively, should we create a new review standard for purposes of Section 4(a)(6)? If so, what would be an appropriate standard and why would it be more appropriate than the one proposed? What costs would be involved for companies and accountants in complying with a new review standard? How should the Commission administer and enforce a different standard?

64. Section 4A(b)(1)(D)(iii) requires audited financial statements for offerings of more than $500,000 "or such other amount as the Commission may establish, by rule." Should we increase the offering amount for which audited financial statements would be required? If so, to what amount (*e.g.*, $600,000, $750,000, etc.)? Please provide a basis for any amount suggested. Should we identify additional criteria other than the offering amount, as one commenter suggested,[204] that could be used to determine when to require an issuer to provide audited financial statements? If so, what should those criteria be?

65. Should financial statements be required to be dated within 120 days of the start of the offering? If so, what standard should apply? Should those financial statements be reviewed or audited? Why or why not?

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204 *See* ABA Letter 1 (stating that revenue could be a criteria for determining when audited financial statements would be required).

66. Under Rule 502(b)(2)(B)(1)-(2) of Regulation D, if an issuer, other than a limited partnership, cannot obtain audited financial statements without unreasonable effort or expense, then only the issuer's balance sheet must be audited. Should we include a similar provision in the proposed rules? Why or why not? Should we provide any guidance as to what would constitute unreasonable effort or expense in this context? If so, please describe what should be considered to be an unreasonable effort or expense. If we were to require an issuer's balance sheet to be dated within 120 days of the start of the offering, should we allow the balance sheet to be unaudited? Why or why not?

67. As proposed, an issuer with a target offering amount greater than $500,000 could select between the auditing standards issued by the AICPA or the PCAOB. Should we instead mandate one of the two standards? If so, which standard and why? Alternatively, should we create a new audit standard for purposes of Section 4(a)(6)? If so, what would be an appropriate standard? What costs would be involved for companies and auditors in complying with a new audit standard?

68. Should we require that all audits be conducted by PCAOB-registered firms? Why or why not?

69. Should we consider the requirement to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors financial statements subject to a review to be satisfied if the review report includes modifications? Why or why not? Would your response differ depending on the nature of the modification? Please explain.

70. As proposed, an issuer receiving an adverse audit opinion or disclaimer of opinion would not satisfy its requirement to file with the Commission, provide to investors and the relevant intermediary and make available to potential investors audited financial statements. Should an issuer receiving a qualified audit opinion be deemed to have satisfied this requirement? Should certain qualifications (*e.g.*, non-compliance with U.S. GAAP) result in the financial statements not satisfying the requirement to provide audited financial statements while other types of qualifications would be acceptable? If so, which qualifications would be acceptable and why?

71. Should we require that the certified public accountant reviewing or auditing the financial statements be in good standing for at least five years, as one commenter suggested?[205] Why or why not? Should we require that the public accountant be in good standing for a lesser period of time? If so, for how long? Would such a requirement restrict the pool of available public accountants? If so, by how much? Would such a requirement reduce investor protections? If so, how?

b. Progress Updates

Consistent with Section 4A(b)(1)(F), the proposed rules would require an issuer to prepare regular updates on its progress in meeting the target offering amount.[206] These updates would be filed with the Commission on EDGAR, under cover of Form C, provided to investors and the relevant intermediary and made available to potential investors. The issuer would check

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205 *See* Philipose Letter 1.

206 *See* proposed Rules 201(v) and 203(a)(3) of Regulation Crowdfunding.

the box for "Form C-U: Progress Update" on the cover of the Form C and provide the required update in the space provided. One commenter suggested that issuers should be exempted from issuing status updates and/or reports so long as the funding portal publicly displays the progress of the issuer in meeting the target offering amount.[207]

As proposed, the rules would require an issuer to file with the Commission and provide investors and the relevant intermediary regular updates regarding the issuer's progress in meeting the target offering amount no later than five business days after the issuer reaches particular intervals – *i.e.*, one-half and 100 percent – of the target offering amount.[208] If the issuer will accept proceeds in excess of the target offering amount, the issuer also would be required to file with the Commission and provide investors and the relevant intermediary a final progress update, no later than five business days after the offering deadline, disclosing the total amount of securities sold in the offering.[209] If, however, multiple progress updates are triggered within the same five-business-day period (*e.g.*, the issuer reaches one-half of the target offering amount on November 5 and 100 percent of the target offering amount on November 8), the issuer could consolidate such progress updates into one Form C-U, so long as the Form C-U discloses the most recent threshold that was met and the Form C-U is filed with the Commission and provided to investors and the relevant intermediary by the day on which the first progress update would be

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207 *See* RocketHub Letter 1 (also stating that if the Commission mandates the filing of status updates, it should not mandate a particular form of update).

208 *See* proposed Rule 203(a)(3) of Regulation Crowdfunding.

209 *Id.*

due.[210] The proposed rules also would require the intermediary to make these updates available to investors and potential investors through the intermediary's platform.[211]

We believe that this information would be important to investors by allowing them to gauge whether interest in the offer has increased gradually or whether it was concentrated at the beginning or at the end of the offering period. In addition, we believe that the final progress update would be necessary to inform investors of the total amount of securities sold by the issuer, especially in cases where an issuer may have sold more than the target offering amount. The proposed rules do not include an exemption from this requirement when progress updates are provided solely on the intermediary's platform. We believe that proposing to require that the progress updates be filed with the Commission would create a central repository for this information – information that otherwise might no longer be available on the intermediary's platform after the offering terminated. The progress updates filed with the Commission also would make data available that could be used to evaluate the effects of the Section 4(a)(6) exemption on capital formation.

Request for Comment

72. Views about what constitutes a "regular update" may vary, particularly when considering the length of the offering. Is the requirement to file an update when the issuer reaches one-half and 100 percent of the target offering amount appropriate? Is the proposed requirement to file a final update in offerings in which the issuer will accept proceeds in excess of the target offering amount appropriate? Why or why not? Should we require the progress updates to be

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210 *See* proposed Instruction 2 to paragraph (a)(3) of proposed Rule 203 of Regulation Crowdfunding.

211 *See* proposed Rule 303(a) of Regulation Crowdfunding and Section II.C.5.a below.

filed at different intervals (*e.g.*, one-third, two-thirds or some other intervals)? Why or why not? Alternatively, should the progress updates be filed after a certain amount of the offering time has elapsed (*e.g.*, weekly or monthly until the target or maximum is reached or until the offering closes)? Should the progress updates be based on reaching other milestones or on some other basis? If so, what milestones or other basis and why?

73. As proposed, issuers would have five business days from the time they reach the relevant threshold to file a progress update. Is this time period appropriate? Why or why not? If not, what would be an appropriate time period? Please explain. Should issuers be allowed to consolidate multiple progress updates into one Form C-U if multiple progress updates are triggered within a five-business-day period, as proposed? Why or why not?

74. Should issuers be required to certify that they have filed all the required progress updates prior to the close of the offering? Why or why not?

75. Should we exempt issuers from the requirement to file progress updates with the Commission as long as the intermediary publicly displays the progress of the issuer in meeting the target offering amount? Why or why not? If so, should the Commission establish standards about how prominent the display would need to be?

c. Amendments to the Offering Statement

We are proposing to require that an issuer amend its disclosure for any material change in the offer terms or disclosure previously provided to investors. The amended disclosure would be filed with the Commission on Form C, provided to investors and the relevant intermediary and made available to potential investors.[212] The issuer would check the box for "Form C-A: Amendment" on the cover of the Form C and explain, in summary manner, the nature of the changes, additions or updates in the space provided. An issuer would determine whether changes in the offer terms or disclosure are material based on the facts and circumstances. Information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding whether or not to purchase the securities.[213] For example, we believe that a material change to financial condition or to the intended use of proceeds would require an amendment to an issuer's disclosure. Also, in those instances in which an issuer has previously disclosed only the method for determining the price, and not the final price, of the securities offered, we believe that determination of the final price would be considered a material change to the terms of the offer and would have to be disclosed. These are not, however, the only possible material changes that would require amended disclosure. In addition, as discussed further in Section II.C.6 below, if any change, addition or update constitutes a material change to information previously disclosed, the issuer shall check the box indicating that investors must reconfirm their investment commitments. Investors would have five business days to reconfirm their investment commitments, or the investment commitments would be cancelled.[214]

Issuers would be permitted, but not required, to amend the Form C to provide information with respect to other changes that are made to the information presented on the intermediary's platform and provided to investors and potential investors.[215] Issuers amending the Form C to

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212 *See* proposed Rule 203(a)(2) of Regulation Crowdfunding.

213 *See Basic Inc. v. Levinson*, 485 U.S. 224 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438 (1976)).

214 *See* proposed Rule 203(a)(2) of Regulation Crowdfunding.

215 *See* proposed Instruction to paragraph (a)(2) of proposed Rule 203 of Regulation Crowdfunding.

provide information that it considers not material would not check the box indicating that investors must reconfirm their investment commitments.

Request for Comment

76. Should we specify that an amendment to an offering statement must be filed within a certain time period after a material change occurs? Why or why not? What would be an appropriate time period for filing an amendment to an offering statement to reflect a material change? Why?

77. If an issuer amends its Form C, should the intermediary be required to notify investors? If so, should we specify the method of notification, such as via e-mail or other electronic means?

78. Should establishment of the final price be considered a material change that would always require an amendment to Form C and reconfirmation, as proposed? Would it be appropriate to require disclosure of the final price but not require reconfirmation? Should we consider any change to the information required by Section 4A(b)(1) to be a material change? Why or why not?

79. Should we require issuers to amend Form C to reflect all changes, additions or updates regardless of materiality so that the Form C filed with us would reflect all information provided to investors through the intermediary's platform? Why or why not?

2. Ongoing Reporting Requirements

Section 4A(b)(4) requires, "not less than annually, [the issuer to] file with the Commission and provide to investors reports of the results of operations and financial statements of the issuer, as the Commission shall, by rule, determine appropriate, subject to such exceptions and termination dates as the Commission may establish, by rule."

One commenter suggested that the Commission should create a standardized form or template for this ongoing disclosure.[216] The same commenter suggested that this ongoing disclosure should be publicly available and shared with other regulators. Another commenter noted that the requirement to file reports not less than annually could be difficult to enforce and that it is unclear who would be responsible for enforcing the requirement.[217] The same commenter noted that this provision seems to presume the success of every business that raises capital through crowdfunding and questioned what would happen when an issuer goes out of business. One commenter suggested that financial statements included in an annual report should be required to be reviewed or audited only if the issuer's total assets exceeded a specified amount at the last day of the issuer's fiscal year.[218] One commenter suggested that annual reports should be required to be reviewed by a qualified accountant in good standing for at least five years.[219] Two commenters noted that compliance with the exemption would not be known at the time of the transaction if the annual reports are a condition to the exemption under Section 4(a)(6).[220] One commenter suggested that the Commission should require a failed business that

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216 *See* Commonwealth of Massachusetts Letter.

217 *See* Crowdfunding Offerings Ltd. Letter 5.

218 *See* ABA Letter 1 (suggesting that financial statements reviewed by an independent accountant be required only if the issuer's total assets as of the end of its fiscal year exceeded $300,000 and that audited financial statements be required only if the issuer's total assets exceeded $750,000 because (i) public reporting pursuant to Exchange Act Section 12(g) is based, in part, on an asset test and (ii) this would offer a reasonable predicate for balancing the relative costs to very small, early-stage issuers and the informational benefits to investors).

219 *See* Philipose Letter 2.

220 *See* Ohio Division of Securities Letter; Whitaker Letter (suggesting that the filing of the annual report should not be a condition to satisfying the exemption under Section 4(a)(6)).

issued securities pursuant to Section 4(a)(6) to file a final annual report, in the year of the failure, that provides final financial statements and discloses to investors the material reasons for the liquidation, dissolution, wind-down or bankruptcy.[221]

To implement the ongoing reporting requirement in Section 4A(b)(4), the proposed rules would require an issuer that sold securities in reliance on Section 4(a)(6) to file a report on EDGAR annually, no later than 120 days after the end of the most recent fiscal year covered by the report.[222] Although the statute provides that an "issuer who offers or sells securities" in reliance on Section 4(a)(6) shall provide ongoing reports, we do not believe the intent was to require ongoing reports from a company that has not completed a crowdfunding transaction and thus did not issue any securities.

To implement the statutory requirement that issuers provide the report to investors, we propose to require issuers to post the annual report on their websites.[223] We believe that investors in this type of Internet-based offering would be familiar with obtaining information on the Internet and that providing the information in this manner would be cost-effective for issuers. As discussed above, we believe Congress contemplated that crowdfunding would, by its very nature, occur over the Internet or other similar electronic media accessible to the public,[224] so we are not proposing to require issuers to provide physical copies of the report to investors. We also are not proposing to require issuers to provide a copy of the annual report, or refer investors to

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221 *See* Ohio Division of Securities Letter.

222 *See* proposed Rule 202(a) of Regulation Crowdfunding. *See also* proposed Rule 203(b) of Regulation Crowdfunding and proposed Instruction to paragraph (b)(1) thereof.

223 We are not proposing to require issuers to post the annual report on the intermediary's platform because issuers may not necessarily have an ongoing relationship with the intermediary following an offering. *See* discussion in Section II.C.4.b below.

224 *See* note 55.

the posting of the annual report, via e-mail because we believe that many issuers may not have e-mail addresses for the investors, especially after the shares issued pursuant to Section 4(a)(6) are traded by the original purchasers.[225] To the extent e-mail addresses for investors are available to issuers, an issuer could refer investors to the posting of the annual report via e-mail.

When filing the annual report with the Commission, an issuer would check the box for "Form C-AR: Annual Report" on the cover of the Form C. The issuer would be required to disclose information similar to the information required in the offering statement, including disclosure about its financial condition that meets the financial statement requirements that were applicable to its offering statement. The issuer also would be able to voluntarily provide financial statements that meet the requirements for a higher aggregate target offering amount than it was required to provide in its offering statement. If an issuer undertakes multiple offerings, which individually require different levels of financial statements, the issuer would be required to provide financial statements that meet the highest standard previously provided. We believe that investors who purchased on the basis of the higher level of financial statements should continue to receive that level of disclosure, and investors in other offerings of the issuer should receive the same information.[226] Although an issuer would not be required to provide the offering-specific information that it filed at the time of the offering (because the issuer will not

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225 We believe that in order for the issuer to have e-mail addresses for the investors, it would need to obtain those e-mail addresses from the intermediary, since it would be the intermediary that would collect that information when a potential investor opens an account. In order for the issuer to have e-mail addresses after the shares issued pursuant to Section 4(a)(6) are traded, an issuer would need to collect that information from each new investor in connection with any sale of the issuer's securities in a secondary market.

226 For example, if an issuer had previously completed an offering with a $200,000 target and an offering with a $700,000 target, the issuer would be required to provide audited financial statements rather than reviewed financial statements. This would be the case even if the $200,000 offering was conducted more recently than the $700,000 offering.

be offering or selling securities),[227] it would be required to disclose information about the company and its financial condition, as was required in connection with the offer and sale of the securities.[228] This should minimize the disclosure burden for issuers to the extent they would be able to use the offering materials as a basis to prepare the ongoing disclosure. Investors should benefit from receiving annual updates to the information they received when making the decision to invest in the issuer's securities, which should allow them to continue to be informed about issuer developments. Under the statute and the proposed rules, the securities will be freely tradable after one year and, therefore, this information also would benefit potential future holders of the issuer's securities and help them to make more informed investment decisions.

We are proposing to require issuers to file the annual report until one of the following events occurs: (1) the issuer becomes a reporting company required to file reports under Exchange Act Sections 13(a) or 15(d); (2) the issuer or another party purchases or repurchases all of the securities issued pursuant to Securities Act Section 4(a)(6), including any payment in full of debt securities or any complete redemption of redeemable securities; or (3) the issuer liquidates or dissolves its business in accordance with state law.[229] In these situations, we

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227 An issuer would not be required to provide information about: (1) the stated purpose and intended use of the proceeds of the offering; (2) the target offering amount and the deadline to reach the target offering amount; (3) whether the issuer will accept investments in excess of the target offering amount; (4) whether, in the event that the offer is oversubscribed, shares will be allocated on a pro-rata basis, first come-first served basis, or other basis; (5) the process to complete the transaction or cancel an investment commitment once the target amount is met; (6) the price to the public of the securities being offered; (7) the terms of the securities being offered; (8) the name, Commission file number and CRD number (as applicable) of the intermediary through which the offering is being conducted; and (9) the amount of compensation paid to the intermediary.

228 Issuers would be required to provide disclosure about its directors and officers, business, current number of employees, financial condition (including financial statements), capital structure, significant factors that make an investment in the issuer speculative or risky, material indebtedness and certain related-party transactions.

229 *See* proposed Rule 202(b) of Regulation Crowdfunding.

believe it is appropriate to terminate an issuer's reporting obligations because it will either be required by other provisions of the securities laws to provide investors with necessary information or it will no longer have investors. Any issuer terminating its annual reporting obligations would be required to file on EDGAR, within five business days from the date of the terminating event, a notice to investors and the Commission that it will no longer file and provide annual reports pursuant to the requirements of Regulation Crowdfunding.[230] The issuer would check the box for "Form C-TR: Termination of Reporting" on the cover of Form C.

Request for Comment

80. Should we require ongoing annual reports, as proposed? Why or why not? Should we require ongoing reporting more frequently than annually? Why or why not? If so, how often (*e.g.*, semi-annually or quarterly)?

81. Two commenters noted that compliance with the exemption would not be known at the time of the transaction if the annual reports are a condition to the exemption under Section 4(a)(6).[231] Should the requirement to provide ongoing annual reports be a condition to the exemption under Section 4(a)(6)? If so, for how long (*e.g.*, until the first annual report is filed, until the termination of an issuer's reporting obligations or some other period)? Please explain.

82. Should we require that the annual reports be provided to investors by posting the reports on the issuer's website and filing them on EDGAR, as proposed? Should we require issuers also to directly notify investors of the availability of the annual report, such as by e-mail or other electronic means? Should we

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230 *See* proposed Rule 203(b)(2) of Regulation Crowdfunding.

231 *See* Ohio Division of Securities Letter; Whitaker Letter.

instead require issuers to deliver the annual reports directly to investors? If so, should we specify the method of delivery (*e.g.*, e-mail or other electronic means, U.S. mail or some other method)? Would investors have an electronic relationship with the issuer after the offering terminates? If not, how would an issuer notify or deliver a copy of the annual report to the investor? Would issuers continue to have an ongoing relationship with intermediaries once the offering is completed? If so, should we also require that the issuer post its annual report on the intermediary's platform? Why or why not?

83. After completion of the offering, should we require that investors be represented by a nominee or other party who could help to facilitate physical delivery of the annual report to investors? Why or why not? Should the nominee or other party have other responsibilities, such as speaking on behalf of and representing the interests of investors (*e.g.*, when the issuer wishes to take certain corporate actions that could impact or dilute the rights of investors, distribution of dividend payments, etc.)? If a nominee or other party should be required, what structure should this arrangement take and why?

84. Are the proposed ongoing disclosure requirements appropriate? Why or why not? Should we modify or eliminate any of the proposed requirements?

85. Should the discussion of the issuer's financial condition address changes from prior periods? Why or why not? Should the number of years covered by the financial statements be the same as in the offering statement? Why or why not? If not, what should they be?

86. Should we require that reviewed or audited financial statements be provided only if the total assets of the issuer at the last day of its fiscal year exceeded a specified amount, as one commenter suggested?[232] Why or why not? If so, what level of total assets would be appropriate (*e.g.*, $1 million, $10 million, or some other amount)? Are there other criteria (other than total assets) that we should consider? Please explain.

87. The proposed rules would require any issuer terminating its annual reporting obligations to file on EDGAR, within five business days from the date of the terminating event, a notice to investors and the Commission that it will no longer file and provide annual reports. Is this approach appropriate? Why or why not? Should we require issuers to file the notice earlier (*e.g.*, within two business days of the event) or later (*e.g.*, within 10 business days of the event)? If so, what would be an appropriate amount of time after the event and why?

88. Should an issuer be able to terminate its annual reporting obligation in circumstances other than those provided in the proposed rules? For example, should an issuer be allowed to terminate its reporting obligation after filing a certain number of annual reports, as one commenter suggested,[233] so long as the issuer does not engage in additional transactions in reliance on Section 4(a)(6) (*e.g.*, after filing one annual report, two annual reports or some other number of annual reports)? Why or why not? If so, what would be an appropriate number of annual reports? Should all issuers be allowed to terminate their reporting

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232 *See* ABA Letter 1.

233 *See* Schwartz Letter.

obligations or only issuers that have not sold more than a certain amount of securities in reliance on Section 4(a)(6)? If so, what would be an appropriate amount of securities (*e.g.*, $100,000, $500,000, or some other amount)? Should an issuer be allowed to terminate its reporting obligation following the issuer's or another party's purchase or repurchase of a significant percentage of the securities issued in reliance on Section 4(a)(6) (including any payment of a significant percentage of debt securities or redemption of a significant percentage of redeemable securities), or receipt of consent to cease reporting from a specified percentage of the unaffiliated security holders? Why or why not? If so, what would be an appropriate percentage (greater than 50 percent, 75 percent or some other percentage)? Should an issuer be allowed to terminate its reporting obligation if the securities issued in reliance on Section 4(a)(6) are held by less than a specified number of holders of record, as suggested by a commenter?[234] Why or why not? If so, what would be an appropriate number of holders of record (less than 500, 300 or some other number)?

89. If an issuer files a petition for bankruptcy, what effect should that filing have on the issuer's reporting obligations? Please explain.

90. Should issuers be required to file reports to disclose the occurrence of material events on an ongoing basis? What events would be material and therefore require disclosure? Should we identify a list of material events that would

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234 *See* ABA Letter 1.

trigger a report, similar to the list in Form 8-K[235] (such as changes in control, bankruptcy or receivership, material acquisitions or dispositions of assets, issuances of securities and changes to the rights of security holders)? Or should we require that all material events be reported without specifying any particular events? How many days after the occurrence of the material event should the issuer be required to file the report? Please explain.

91. We have the authority to include exceptions to the ongoing reporting requirements in Section 4A(b)(4). Should we consider excepting certain issuers from ongoing reporting obligations (*e.g.*, those raising a certain amount, such as $100,000 or less)? Should any exception always apply or only after a certain number of reports have been filed? Please explain.

3. Form C and Filing Requirements

Section 4A(b)(1) does not specify a format that issuers must use to present the required disclosures and file these disclosures with the Commission. Several commenters stated that the Commission should require the disclosure on a form modeled after, or require the use of NASAA's Small Company Offering Registration Form (U-7).[236] One commenter suggested using Form 1-A, which is used for securities offerings made pursuant to Regulation A,[237] as a

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235 17 CFR 249.308. Form 8-K is a report that public companies must file to announce major events that shareholders should know about on a more current basis. Form 8-K includes a specific list of the types of events that trigger a public company's obligation to file a current report, including matters relating to the company's business and operations, financial information, securities and trading markets, accountants and financial statements, corporate governance and management, asset-backed securities, exhibits and other matters that are not specifically called for by Form 8-K that the company considers to be of importance to security holders. Generally, a Form 8-K must be filed within four business days from the date of the event that triggered the report.

236 *See* Coan Letter; Liles Letter 1; Vim Funding Letter; NASAA Letter.

237 17 CFR 230.251 *et seq.*

model.[238] One commenter requested that we create a form for issuers that "simplifies the process and provides legal certainty for investors, intermediaries and issuers,"[239] while another commenter suggested that we adopt a "simple, uniform, easy-to-understand yet comprehensive template prospectus that is similar in principle to the mutual fund industry's summary prospectus."[240] Another commenter recommended that disclosure be simple, allow for standardization and take into account the size and stage of development of the issuer.[241] One commenter suggested we create a disclosure template that would allow issuers to complete certain fields by inserting the required disclosure.[242] Another commenter suggested we require a single offering document incorporating disclosures that intermediaries and issuers are required to make.[243]

We are proposing to require issuers to file the mandated disclosure on EDGAR using new Form C.[244] As proposed, Form C would require certain disclosures to be presented in a specified format, while allowing the issuer to customize the presentation of other disclosures required by Section 4A(b)(1) and the related rules. This approach should provide key offering information in

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238 *See* Commonwealth of Massachusetts Letter.

239 CFIRA Letter 2.

240 The Motley Fool Letter.

241 *See* 2012 SEC Government-Business Forum, note 29.

242 *See* ABA Letter 1.

243 *See* Ohio Division of Securities Letter.

244 An issuer that does not already have EDGAR filing codes, and to which the Commission has not previously assigned a user identification number, which we call a "Central Index Key (CIK)" code, would need to obtain the codes by filing electronically a Form ID [17 CFR 239.63; 249.446; 269.7 and 274.402] at https://www.filermanagement.edgarfiling.sec.gov. The applicant also would be required to submit a notarized authenticating document as a Portable Document Format (PDF) attachment to the electronic filing. The authenticating document would need to be manually signed by the applicant over the applicant's typed signature, include the information contained in the Form ID and confirm the authenticity of the Form ID. *See* 17 CFR 232.10(b)(2).

a standardized format and give issuers flexibility in the presentation of other required disclosures. We believe this flexibility is important given that we expect that issuers engaged in crowdfunding transactions in reliance on Section 4(a)(6) would encompass a wide variety of industries at different stages of business development.

We propose to require issuers to use an XML-based fillable form to input certain information.[245] This XML-based fillable form would support the assembly and transmission of those required disclosures to EDGAR on Form C.[246] It also would help the Commission to collect certain key information about each offering to monitor the implementation of the crowdfunding exemption under Section 4(a)(6). For example, the Commission could monitor the types of issuers using the exemption, including the issuers' size, location, securities offered and offering amounts and the intermediaries through which the offerings are taking place. Monitoring the implementation of the crowdfunding exemption also would give the Commission more information to evaluate whether the rules include appropriate investor protections and facilitate capital formation. Issuers could customize the presentation of the rest of their disclosures and file those disclosures as exhibits to the Form C. For example, an issuer could provide the required disclosures by uploading to EDGAR, as an exhibit to Form C, a text version

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245 *See* proposed Instruction to paragraph (a)(1) of proposed Rule 203 of Regulation Crowdfunding. Issuers would input in the proposed XML-based filing the following information: name, legal status and contact information of the issuer; name, Commission file number and CRD number (as applicable) of the intermediary through which the offering will be conducted; the amount of compensation paid to the intermediary to conduct the offering, including the amount of referral and other fees associated with the offering; type of security offered; number of securities offered; offering price; target offering amount and maximum offering amount (if different from the target offering amount); whether oversubscriptions will be accepted and, if so, how they will be allocated; deadline to reach the target offering amount; current number of employees of the issuer; and selected financial data for the prior two fiscal years.

246 The Commission would disseminate the information in a format that provides normal text for reading and XML-tagged data for analysis. Currently the Commission's OnlineForms website (https://www.onlineforms.edgarfiling.sec.gov) supports the assembly and transmission of XML filings required by Exchange Act Section 16 (15 U.S.C. 78p).

of the relevant information presented on the intermediary's platform, including a transcript of any video presentation and a description of any charts or graphs.

Under the proposed rules, Form C would be used for all of an issuer's filings with the Commission.[247] The issuer would check one of the following boxes on the cover of the Form C to indicate the purpose of the Form C filing:

- "Form C: Offering Statement" for issuers filing the initial disclosures required for an offering made in reliance on Section 4(a)(6);
- "Form C-A: Amendment" for issuers seeking to amend a previously-filed Form C for an offering;
- "Form C-U: Progress Update" for issuers filing a progress update required by Section 4A(b)(1)(H) and the related rules;
- "Form C-AR: Annual Report" for issuers filing the annual report required by Section 4A(b)(4) and the related rules; and
- "Form C-TR: Termination of Reporting" for issuers terminating their reporting obligations pursuant to Section 4A(b)(4) and the related rules.

We believe that the use of one form would be more efficient than requiring multiple forms and would simplify the filing process for issuers and their preparers. EDGAR would automatically provide each filing with an appropriate tag depending on which box the issuer checks so that investors could distinguish between the different filings.[248]

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247 *See* proposed Rule 203 of Regulation Crowdfunding.

248 EDGAR would tag the offering statement as "Form C," any amendments to the offering statement as "Form C-A," progress updates as "Form C-U," annual reports as "Form C-AR" and termination reports as "Form C-TR."

Section 4A(b)(1) requires issuers to file the offering information with the Commission, provide it to investors and the relevant intermediary and make it available to potential investors.[249] Under the proposed rules, issuers would satisfy the requirement to file the information with the Commission by filing the Form C: Offering Statement, including any amendments and progress updates, on EDGAR. To satisfy the requirement to provide the disclosures to the relevant intermediary, we propose that issuers provide to the relevant intermediary a copy of the disclosures filed with the Commission on EDGAR.[250] To satisfy the requirement to provide the disclosures to investors and make them available to potential investors, we propose that issuers provide the information to investors electronically by referring investors to the information on the intermediary's platform.[251] Issuers could refer investors through a posting on the issuer's website or by e-mail.[252] We believe that investors in this type of Internet-based offering would be familiar with obtaining information on the Internet and that providing the information in this manner would be cost-effective for issuers. As discussed above, we believe Congress contemplated that crowdfunding would, by its very nature, occur over the Internet or other similar electronic medium that is accessible to the public,[253] so we are not proposing to require issuers to provide physical copies of the information to investors. We

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249 Section 4A(b)(4) requires issuers 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. As discussed above in Section II.B.2, to satisfy this requirement, the proposed rules would require an issuer to post the annual report on its website and file it on EDGAR. *See* proposed Rule 202(a) of Regulation Crowdfunding.

250 *See* proposed Instruction 1 to paragraph (a) of proposed Rule 203 of Regulation Crowdfunding. We anticipate that issuers seeking to engage in an offering in reliance on Section 4(a)(6) may likely work with an intermediary to prepare the disclosure that would be provided on the intermediary's platform and filed on EDGAR. In some cases, intermediaries may offer, as part of their service, to file the disclosure on EDGAR on behalf of the issuer.

251 *See* proposed Instruction 2 to paragraph (a) of proposed Rule 203 of Regulation Crowdfunding.

252 *Id.*

253 *See* note 55.

propose to allow issuers to refer investors to the information on the intermediary's platform through a posting on the issuer website or by e-mail, rather than requiring e-mail, because we believe that many issuers may not have e-mail addresses for investors.[254]

Request for Comment

92. Should we require a specific format that issuers must use to disclose the information required by Section 4A(b)(1) and the related rules?

93. Should issuers be required to file the Form C with the Commission in electronic format only, as proposed? Alternatively, should we permit issuers to file the Form C in paper format? What are the relative costs and benefits of permitting the filing of the Form C in paper format? Should issuers be precluded from relying on the hardship exemptions in Rules 201 and 202 of Regulation S-T?[255] Why or why not?

94. In what format would the information about an issuer be presented on an intermediary's platform? Will there be written text, graphics, charts or graphs, or video testimonials by the founder or other key stakeholders? Will the information be presented in a way that would allow for the filing of the information as an exhibit to Form C on EDGAR? If not, how should the rules address these types of materials?

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[254] *See* note 225. To the extent that intermediaries have the e-mail addresses of investors and potential investors (*e.g.*, as a result of investors and potential investors opening an account with the intermediary), intermediaries could provide an issuer's disclosures to investors and potential investors through e-mail.

[255] 17 CFR 232.201 and 232.202. These hardship exemptions allow filers, under certain conditions, to submit their filings and exhibits in paper form instead of electronically.

95. Should we require different forms for each type of required filing? Would the use of one form with different EDGAR tags for each type of filing create confusion among investors who review the issuer's filings? Would it create confusion for issuers that are filing the forms? Please explain.

96. Should we allow issuers to refer investors and potential investors to the information on the intermediary's platform? Are the proposed methods (website posting or e-mail) to refer investors effective and appropriate? Would issuers have access to the investors' e-mail addresses? Are there other methods we should consider? If so, what methods and why?

4. Prohibition on Advertising Terms of the Offering

Section 4A(b)(2) provides that an issuer shall "not advertise the terms of the offering, except for notices which direct investors to the funding portal or broker." We received a number of comments regarding this provision. One commenter stated that the inability to market an offering will prevent startups from reaching their desired goal.[256] One commenter suggested that we should allow issuers unrestricted use of advertising, both on the Internet and through conventional forms of advertising.[257] Another commenter suggested that communications between the issuer and investors should be limited to communication channels controlled by the intermediary and that direct communications between an issuer and investors should be discouraged.[258] Another commenter stated that it is unclear what constitutes a notice for these purposes and that issuers should be able to promote their offerings as long as investors register

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256 *See* VTNGLOBAL Letter.

257 *See* Loofbourrow Letter.

258 *See* CommunityLeader Letter.

with the intermediary and participate in the offering through that intermediary.[259] Another commenter suggested that issuers should be able to promote their offerings through "their own platforms" as long as all such notices include a link directly to the registered intermediary.[260] One commenter suggested that an issuer should be permitted to place a notice consisting of the basic terms of the offering on the issuer's website or at its place of business.[261] Alternatively, the commenter suggested an issuer should be permitted to include such notice in correspondence to its customers or mailing list subscribers.[262]

Another commenter stated that the advertising prohibition should not be read to restrict notices that: (1) alert the public to the issuer's project or company; (2) state that the public may participate in the fundraising; or (3) direct the public to the funding platform.[263] Another commenter suggested notices should be allowed to include: (1) the type of security being offered; (2) the offering amount; (3) the opening and closing date of the offering; and (4) the issuer's line of business or whether the offering will fund a new line of business.[264] One commenter suggested that, given the limitations on the number of characters allowed by some social media sites, we should allow notices that do not require lengthy legends or disclosure.[265] Another commenter suggested that we define the term "advertising" and provide a model form

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259 *See* Crowdfunding Offerings Ltd. Letter 5.

260 *See* CFIRA Letter 2.

261 *See* NCA Letter (stating that the Commission should clarify whether the rules will permit notices to state the offering period, whether investors may contact the issuer's management to discuss the offering or whether the notices may include names of accredited investors participating in the offering).

262 *Id.*

263 *See* RocketHub Letter 1.

264 *See* NSBA Letter.

265 *See* CFIRA Letter 1 (providing examples of notices varying in length from zero to 1,500 characters).

that can be used by issuers to direct investors to the intermediary.[266] Another commenter suggested that we require issuers to file all advertising and other materials that the issuers create relating to offerings made in reliance on Section 4(a)(6).[267] One commenter suggested that we allow advertising of non-financial elements of a transaction in the case of offerings conducted through an intermediary that is a community development financial institution.[268]

Under the proposed rules, an issuer could publish a notice advertising the terms of an offering in reliance on Section 4(a)(6), provided that the notice includes the address of the intermediary's platform on which additional information about the issuer and the offering may be found.[269] Consistent with Section 4A(b)(2), an issuer would not otherwise be permitted to advertise, directly or indirectly, the terms of an offering made in reliance on Section 4(a)(6). While we understand the importance that potential issuers likely will place on the ability to advertise, the statute specifically restricts the ability of issuers to advertise the terms of offerings made in reliance on Section 4(a)(6). Limiting the advertising of the terms of the offering to the information permitted in the notice is intended to direct investors to the intermediary's platform and to make investment decisions with access to the disclosures necessary for them to make informed investment decisions.

The proposed rules would allow notices advertising the terms of the offering to include no more than the following: (1) a statement that the issuer is conducting an offering, the name of the intermediary through which the offering is being conducted and a link directing the potential

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266 *See* CompTIA Letter.

267 *See* Commonwealth of Massachusetts Letter.

268 *See* City First Letter.

269 *See* proposed Rule 204 of Regulation Crowdfunding.

investor to the intermediary's platform; (2) the terms of the offering; and (3) factual information about the legal identity and business location of the issuer, limited to the name of the issuer of the security, the address, phone number and website of the issuer, the e-mail address of a representative of the issuer and a brief description of the business of the issuer.[270] Under the proposed rules, "terms of the offering" would include: (1) the amount of securities offered; (2) the nature of the securities; (3) the price of the securities; and (4) the closing date of the offering period.[271]

The permitted notices would be similar to the "tombstone ads" permitted under Securities Act Rule 134,[272] except that the notices would be required to direct investors to the intermediary's platform through which the offering is being conducted,[273] such as by including a link directing the potential investor to the platform.[274] We are not proposing to impose limitations on how the issuer distributes the notices. For example, issuers could place notices in newspapers or could post notices on social media sites. We believe this approach would allow issuers to leverage social media to attract potential investors, while at the same time protecting potential investors by limiting the ability of issuers to advertise the terms of the offering without providing the required disclosures.

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270 *See* proposed Rule 204(b) of Regulation Crowdfunding. While notices would not be required to include all of this information, they would be required to, at a minimum, direct investors and potential investors to the intermediary's platform on which additional information about the issuer and the offering may be found. *See* proposed Rule 204(a) of Regulation Crowdfunding.

271 *See* proposed Instruction to proposed Rule 204 of Regulation Crowdfunding.

272 17 CFR 230.134.

273 *See* proposed Rule 204(a) of Regulation Crowdfunding.

274 *See* proposed Rule 204(b)(1) of Regulation Crowdfunding.

The proposed rules also would allow an issuer to communicate with investors and potential investors about the terms of the offering through communication channels provided by the intermediary on the intermediary's platform, so long as the issuer identifies itself as the issuer in all communications. We believe that one of the central tenets of the concept of crowdfunding is that the members of the crowd decide whether or not to fund an idea or business after sharing information with each other. As part of those communications, we believe it is important for the issuer to be able to respond to questions about the terms of the offering or even challenge or refute statements made through the communication channels provided by the intermediary. Therefore, we have not proposed to restrict issuers from participating in those communications.

The proposed rules would not restrict an issuer's ability to communicate other information that does not refer to the terms of the offering. We believe that this is consistent with the statute because Section 4A(b)(2) only appears to impose a restriction on the advertising of the terms of the offer. To prohibit communications that do not refer to the terms of the offering would place a greater burden on issuers relying on Section 4(a)(6) than on issuers in registered offerings. For example, Securities Act Rule 169[275] permits non-Exchange Act reporting issuers engaged in an initial public offering to continue to publish, subject to certain exclusions and conditions, regularly released factual business information that is intended for use by persons other than in their capacity as investors or potential investors.[276] We believe that permitting issuers to continue to engage in communications that do not refer to the terms of the offering during the pendency of offering made in reliance on Section 4(a)(6) would increase the

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275 17 CFR 230.169.

276 *Id. See also Securities Offering Reform*, Release No. 33-8591 (July 19, 2005) [70 FR 44722 (Aug. 3, 2005)].

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.

Request for Comment

97. Should we require issuers to file with the Commission or provide to the intermediary a copy of any notice directing investors to the intermediary's platform? Why or why not?

98. The proposed rules would define "terms of the offering" to include: (1) the amount of securities offered; (2) the nature of the securities; (3) the price of the securities; and (4) the closing date of the offering period. Is this definition appropriate? Why or why not? Should the definition be modified to eliminate or include other items? If so, which ones and why? Should we provide further guidance as to the meaning of "terms of the offering?" Please explain.

99. Should we restrict the media that may be used for the advertising of notices (*e.g.*, prohibit advertising via television, radio or phone calls)? If so, why and what media should we restrict? What media should we permit? Please explain.

100. Should we require a specific format for issuer notices? Should we provide examples of notices that would comply with the requirements?

101. Should we further restrict or specify the information that could be included in a notice of the offering? If so, how and why? Is the information that we have proposed to permit in notices sufficient to inform potential investors of an offering? Should we permit the issuer to include any additional information in the notice if, for example, the offering aims to promote a particular social cause, such as driving economic growth in underinvested communities, as one

commenter suggested?[277] If so, what information and why? Should we allow any additional information to be included in the notices for all offerings made in reliance on Section 4(a)(6)? Please explain. Should we impose restrictions on the timing or frequency of notices? Why or why not? If so, what restrictions would be appropriate?

102. Should we limit the issuer's participation in communication channels provided by the intermediary on the intermediary's platform? Why or why not? If so, what limitations would be appropriate?

103. The proposed rules would allow an issuer to communicate with investors and potential investors about the terms of an offering through communication channels provided by the intermediary on the intermediary's platform, so long as the issuer identifies itself as the issuer in all communications. Is this approach appropriate? Why or why not? If not, why not?

104. The proposed rules would not restrict an issuer's ability to communicate information that does not refer to the terms of the offering. Is this approach appropriate? Why or why not? If not, what limitations should we include on an issuer's communications that do not refer to the terms of the offering and why?

5. Compensation of Persons Promoting the Offering

Section 4A(b)(3) provides that an issuer shall "not compensate or commit to compensate, directly or indirectly, any person to promote its offerings through communication channels provided by a broker or funding portal, without taking such steps as the Commission shall, by

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277 *See* City First Letter.

rule, require to ensure that such person clearly discloses the receipt, past or prospective, of such compensation, upon each instance of such promotional communication."

We received comments offering varying views on this provision. One commenter noted that it is unclear precisely what this provision attempts to prohibit or protect against.[278] Another commenter suggested the rules should distinguish between an issuer hiring an individual or entity for promotion, where investors may not be aware of the commercial relationship between the parties, and more standard web-based advertising, including through search engines or trending topics.[279] This commenter suggested that we should not adopt rules that may interfere with promotional compensation, but rather, we should require simple disclosure of a commercial relationship when it would not otherwise be apparent. One commenter suggested that the rules should provide that a clear statement of the compensation amount paid to promoters (or a formula for determining the same) in the disclosure document would satisfy this disclosure obligation.[280] Another commenter suggested that if the issuer will use any promoters in connection with the offering, the issuer should identify the promoters and disclose the amount and structure of promoter compensation.[281]

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278 *See* Crowdfunding Offerings Ltd. Letter 5 (asking a number of questions about what constitutes direct or indirect compensation, whether it is acceptable to promote offerings if no compensation is paid and whether the provision covers third parties who may have an interest in the offering and who pay for the promotion).

279 *See* RocketHub Letter 1.

280 *See* Schwartz Letter.

281 *See* Commonwealth of Massachusetts Letter.

Consistent with the statute, the proposed rules[282] would prohibit an issuer from compensating, or committing to compensate, directly or indirectly, any person to promote the issuer's offering through communication channels provided by the intermediary unless the issuer takes reasonable steps to ensure that the person clearly discloses the receipt (both past and prospective) of compensation each time the person makes a promotional communication.[283] In this regard, we anticipate that an issuer could, for example, contractually require any promoter to include the required statement about receipt of compensation, confirm that the promoter is adhering to the intermediary's terms of use that require promoters to affirm whether or not they are compensated by the issuer, monitor communications made by such persons and take the necessary steps to have any communications that do not have the required statement removed promptly from the communication channels, or retain a person specifically identified by the intermediary to promote all issuers on its platform. We anticipate that communication channels provided by the intermediary would provide a forum through which potential investors could share information to help the members of the crowd decide whether or not to fund the issuer.

We believe that it would be important for potential investors to know whether persons using these communication channels are the issuer, persons acting on behalf of the issuer or

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282 *See* proposed Rule 205 of Regulation Crowdfunding. *See also* proposed Rule 303(c)(4) and the discussion in Section II.C.5.c below for requirements on intermediaries as they relate to disclosure in intermediary-provided communication channels of certain compensation and promotional activities.

283 The receipt of transaction-based compensation in connection with the offer and sale of a security could cause a person to be a broker required to register with us under Exchange Act Section 15(a)(1) [15 U.S.C. 78*o*(a)(1)]. Issuers also would need to consider the application of Securities Act Section 17(b) [15 U.S.C. 77q] to these activities. Section 17(b) provides that "[i]t shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof."

persons receiving compensation from the issuer to promote the issuer's offering because of the potential for self-interest or bias in communications by these persons. As such, the proposed rules would apply broadly to persons acting on behalf of the issuer, regardless of whether or not they are compensated or they receive compensation specifically for the promotional activities. For example, the proposed rules would apply to persons hired specifically to promote the offering, as well as to individuals who are otherwise employed by the issuer or who undertake promotional activities on behalf of the issuer. A founder or an employee of the issuer who engages in promotional activities on behalf of the issuer through the communication channels provided by the intermediary would be required to disclose, with each posting, that he or she is engaging in those activities on behalf of the issuer.

The proposed rules also would specify that the issuer shall not compensate or commit to compensate, directly or indirectly, any person to promote its offerings outside of the communication channels provided by the intermediary, unless the promotion is limited to notices that comply with the advertising rules discussed above in Section II.B.4.[284] This prohibition should prevent issuers from circumventing the restrictions on advertising by compensating a third party to do what the issuer cannot do directly.

Request for Comment

105. The proposed rules would prohibit an issuer from compensating or committing to compensate, directly or indirectly, any person to promote its offering outside of the communication channels provided by the intermediary, unless the

[284] *See* proposed Rule 205(b) of Regulation Crowdfunding.

promotion is limited to notices that direct investors to the intermediary's platform. Is this approach appropriate? Why or why not?

106. The proposed rules would require issuers to take reasonable steps to ensure that persons promoting the issuer's offering through communication channels provided by the intermediary disclose the receipt (both past and prospective) of direct or indirect compensation each time they make a promotional communication. Is this an appropriate approach to the statutory requirement for issuers to ensure that promoters make the required disclosures? If not, what standard should we apply and why?

107. Should we require that any person who receives compensation from the issuer to promote an issuer's offering through communication channels provided by the intermediary register with, or otherwise provide notice to, the intermediary? If so, should we require that person to disclose the amount of the compensation and the structure of the compensation arrangement to the intermediary? Why or why not? If so, what would be the purpose of such a requirement?

108. Should the issuer provide disclosure of any person who receives compensation from the issuer to promote an issuer's offering? Why or why not?

6. Other Issuer Requirements

Some commenters addressed issues relating to oversubscriptions, the offering price, the type of securities that may be offered and how those securities should be valued.[285]

a. Oversubscriptions

285 Securities Act Section 4A(b)(5) states that issuers shall "comply with such other requirements as the Commission may, by rule, prescribe, for the protection of investors and in the public interest."

Two commenters suggested that we should permit an issuer to raise capital in excess of the target offering amount, subject to certain conditions.[286] The proposed rules would not limit an issuer's ability to accept investments in excess of the target offering amount, subject to the $1 million annual limitation.[287] Issuers, however, would be required to provide disclosure to investors concerning this possibility.[288] Some commenters suggested that the rules require a defined range for permissible oversubscriptions.[289] We believe, however, that limits on oversubscriptions are not necessary if an issuer discloses how much it would be willing to accept in oversubscriptions, how the oversubscriptions would be allocated and the intended purpose of those additional funds.[290] We believe that this approach would provide investors, prior to the sale, with useful information to make an informed investment decision about an issuer that is seeking investments in excess of the target offering amount.

Request for Comment

109. Should we require that oversubscribed investments be allocated using a pro-rata, first-come, first-served or other method, rather than leaving that decision up to the issuer? Please explain.

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[286] *See* ABA Letter 1 (stating that if the maximum amount exceeds the target offering amount, the issuer should be required to disclose: (1) the maximum amount that it could raise; (2) the total amount of securities that would be issued should the maximum amount be raised; (3) the anticipated use of proceeds should the maximum amount be raised; and (4) financial statements that would have been required had the target offering amount been equal to the maximum amount); Hutchens Letter (stating that issuers should be allowed to raise capital in excess of the target offering amount so long as the amount raised does not fall within a higher tier of financial statement requirements).

[287] *See* proposed Rule 201(h) of Regulation Crowdfunding.

[288] *Id.* Issuers also would need to allow investors to cancel the commitment to purchase the securities in the same way as it would have done had it not accepted oversubscriptions. *See* Section II.C.6 below for a discussion of the right to cancel the purchase commitment.

[289] *See* RocketHub Letter 1; CFIRA Letter 5; Hutchens Letter.

[290] *See* Section II.B.1.a.i(d) above for a discussion of the disclosure requirements if the issuer will accept investments in excess of the target offering amount.

110. Should we limit the maximum oversubscription amount to a certain percentage of the target offering amount? If so, what should the limit be and why?

111. Should we allow issuers to accept commitments in excess of the $1 million limitation so that if an investor withdraws his or her investment commitment prior to the closing of the offering, the issuer would still be able to raise $1 million? If so, should we require that investments in excess of $1 million be allocated using a pro-rata, first-come, first-served or other method, or should we leave that decision up to the issuer? Please explain.

b. Offering Price

One commenter suggested that the Commission should require issuers to set a fixed price for the offering and prohibit any dynamic pricing (*e.g.*, pricing per share that increases with the passage of time) because dynamic pricing schemes may apply time pressure on the investment decision.[291] We are not proposing to require issuers to set a fixed price or prohibit dynamic pricing because we believe that the statute contemplated flexible pricing by providing that issuers may disclose the method for determining the price provided that the final price and required disclosures are provided to each investor prior to the sale. We also believe that the proposed cancellation rights would address the concerns about time pressure on the investment decision because investors would have a reasonable opportunity to cancel the investment commitment after the price is fixed.[292]

Request for Comment

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291 *See* Spinrad Letter 1.

292 *See* Section II.C.6 below for a discussion of cancellation rights.

112. Should we require issuers to set a fixed price at the commencement of an offering or prohibit dynamic pricing? Why or why not?

c. Types of Securities Offered and Valuation

We received comments about the types of securities that could be offered and the valuation of securities offered. One commenter suggested that the Commission should not prescribe eligible types of securities because markets and securities may evolve.[293] Instead, the commenter urged the Commission to set forth minimum disclosure requirements for issuers and intermediaries to use when communicating the price and structure of offered securities. Another commenter suggested that the Commission require issuers to disclose their valuation and the factors they considered when determining such valuation.[294] Another commenter suggested that the Commission should prescribe a maximum valuation and ban certain dilution practices.[295] Another commenter suggested that if an offering exceeds certain valuation limitations (based, for instance, on company financial ratios), then the Commission should require that the shares held by company insiders be subject to a lock-up that would terminate after a period of time or after the company meets certain financial benchmarks.[296] Another commenter indicated that there are

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[293] *See* RocketHub Letter 1.

[294] *See* Sjogren Letter.

[295] *See* The Motley Fool Letter (stating that the Commission should specify a maximum valuation for issuers, perhaps at two, five, or 10 times the aggregate issue limit and should implement a rule to protect investors from issuers that might sell a special class of shares to the crowdfunding public that they eventually dilute in future offerings).

[296] *See* Commonwealth of Massachusetts Letter (stating that the Commission should require disclosure about the risks of buying securities of an early-stage company at a high valuation).

significant costs to properly ascertaining future valuations and that such a requirement could only be applied to corporations.[297]

The proposed rules would neither limit the type of securities that may be offered in reliance on Section 4(a)(6) nor prescribe a method for valuing the securities. In this regard, we note that the statute refers to "securities" and does not limit the types of securities that could be offered pursuant to the exemption. In addition, the statute does not require the use of a specific valuation method or ban any dilution practices. Issuers would be required to describe the terms of the securities and the valuation method in their offering materials.[298] We believe this approach is consistent with the statute and will provide flexibility to issuers to determine the types of securities that they offer to investors and how those securities are valued, while providing investors with the information they need to make an informed investment decision.

The proposed rules do not limit the types of securities that may be offered in reliance on Section 4(a)(6), and thus, debt securities may be offered and sold in crowdfunding transactions. In general, the issuance of a debt security raises questions about the applicability of the Trust Indenture Act of 1939 ("Trust Indenture Act").[299] The Trust Indenture Act applies to any debt security sold through the use of the mails or interstate commerce, including debt securities sold in transactions that are exempt from Securities Act registration. A debt security sold in reliance on Section 4(a)(6) would need to be issued under a qualified indenture[300] or under an indenture

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297 *See* CrowdFund Connect Letter (stating that the Commission should clarify that an issuer would satisfy the requirement to describe how the securities being offered are being valued by providing an operating and management statement that clearly defines capital distributions).

298 *See* proposed Rule 201(m) of Regulation Crowdfunding.

299 15 U.S.C. 77aaa *et seq*.

300 *See* Trust Indenture Act Section 309 [15 U.S.C. 77iii].

that is exempt from qualification.[301] The Trust Indenture Act and related rules provide exemptions in some circumstances. For example, Trust Indenture Act Section 304(b) provides an exemption for any transaction that is exempted from the provisions of Securities Act Section 5 by Section 4 thereof.[302] We believe an issuer offering debt securities in reliance on Section 4(a)(6) would be able to rely on this exemption.[303] Based on the availability of this exemption from the requirements of the Trust Indenture Act, we are not proposing a specific exemption from the requirements of the Trust Indenture Act for offerings of debt securities made in reliance on Section 4(a)(6).

Request for Comment

113. Should we limit the types of securities that may be offered and sold in reliance on Section 4(a)(6) (*e.g.*, should the exemption be limited to offers and sales of equity securities)? If so, to what securities should crowdfunding be limited and why? Should we create a separate exemption for certain types of offerings of limited types of securities, as one commenter proposed?[304]

114. Is it anticipated that issuers may want to conduct crowdfunding offerings of securities under Section 4(a)(6) alongside non-securities-based crowdfunding, such as a crowdfunding campaign for donations or rewards? If so, please describe how these offerings may be structured. Are there any issues in

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301 *See* Trust Indenture Act Section 304 [15 U.S.C. 77ddd].

302 15 U.S.C. 77ddd(b).

303 Trust Indenture Act Section 304(a)(8) [15 U.S.C. 77ddd(a)(8)] and Rule 4a-1 [17 CFR 260.4a-1] also provide an exemption to issue up to $5 million of debt securities without an indenture in any 12-month period.

304 *See* City First Letter.

particular that our rules should address in the context of such simultaneous crowdfunding offerings? Please explain.

115. Should we require or prohibit a specific valuation methodology? If so, what method and why? Should we specify a maximum valuation allowed as suggested by one commenter?[305] Why or why not?

C. Requirements on Intermediaries

1. Brokers and Funding Portals

Securities Act Section 4(a)(6)(C) requires a crowdfunding transaction to be conducted through a broker or funding portal that complies with the requirements of Securities Act Section 4A(a). The term "broker" is generally defined in Exchange Act Section 3(a)(4) as any person that effects transactions in securities for the account of others. Exchange Act Section 3(a)(80),[306] as added by Section 304 of the JOBS Act, defines the term "funding portal" as any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to Securities Act Section 4(a)(6), that does not: (1) offer investment advice or recommendations; (2) solicit purchases, sales or offers to buy the securities offered or displayed on its platform or portal; (3) compensate employees, agents or other person for such solicitation or based on the sale of securities displayed or referenced on its platform or portal; (4) hold, manage, possess or otherwise handle investor funds or securities; or (5) engage in such other activities as the Commission, by rule, determines appropriate.

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305 *See* The Motley Fool Letter.

306 The JOBS Act inadvertently created two Sections 3(a)(80) in the Exchange Act, the other being the definition of "emerging growth company" (added by Section 101(b) of Title I of the JOBS Act).

Because a funding portal would be engaged in the business of effecting securities transactions for the accounts of others through crowdfunding, it would meet the Exchange Act definition of broker.[307] The proposed rules would define "funding portal" consistent with the statutory definition of "funding portal," substituting the word "broker" for the word "person,"[308] to state explicitly and make clear that funding portals are brokers under the federal securities laws. We are not proposing at this time to exercise our discretion under Section 3(a)(80)(E) to prohibit any activities in which a funding portal may engage, other than those identified in the statute.[309]

The proposed rules would not only apply to funding portals, but also to their associated persons in many instances. The proposed rules would define the term "person associated with a funding portal or associated person of a funding portal" to mean any partner, officer, director or manager of a funding portal (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling or controlled by a funding portal, or any employee of a funding portal, but would exclude any persons whose functions are solely clerical or ministerial.[310] The rules would provide, however, that excluded persons nevertheless would be subject to our authority under Exchange Act Sections 15(b)(4) and 15(b)(6) because they are

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307 *See* discussion in Section II.D.2 below.

308 *See* proposed Rule 300(c)(2) of Regulation Crowdfunding.

309 In proposing Regulation Crowdfunding, we propose requirements that are tailored to the limited brokerage activities in which funding portals may engage. Even where requirements proposed for funding portals are the same as those imposed on brokers, such as the AML requirements discussed in Section II.D.4 below, due to the limited nature of funding portals' activities, the compliance burden on funding portals should be less extensive than those applicable to full service brokers under the existing regulatory regime for broker-dealers.

310 *See* proposed Rule 300(c)(1) of Regulation Crowdfunding.

associated with a broker.[311] This definition is consistent with, and modeled on, the definition of "person associated with a broker or dealer or associated person of a broker or dealer" under Exchange Act Section 3(a)(18).[312]

Request for Comment

116. Are there other funding portal activities, other than those in Exchange Act Section 3(a)(80), that we should prohibit? If so, which activities and why? Are there any prohibitions that should be modified or removed? If so, which ones and why?

117. Do we need to provide further guidance concerning which provisions of the Exchange Act and the rules and regulations thereunder would apply to funding portals? If so, what further guidance is necessary and why?

2. Requirements and Prohibitions

a. Registration and SRO Membership

Securities Act Section 4A(a)(1) requires that a person acting as an intermediary in a crowdfunding transaction register with the Commission as a broker or as a funding portal. The proposed rules would implement this requirement by providing that a person acting as an intermediary in a transaction involving the offer or sale of securities made in reliance on Section 4(a)(6) must be registered with the Commission as a broker under Exchange Act Section 15(b) or

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311 Exchange Act Section 15(b)(4) (15 U.S.C. 78*o*(b)(4)) authorizes the Commission to bring administrative proceedings against a broker when the broker violates the federal securities laws (and for other misconduct) and provides for the imposition of sanctions, up to and including the revocation of a broker's registration. Exchange Act Section 15(b)(6) (15 U.S.C. 78*o*(b)(6)) provides similar enforcement authority against the persons associated with a broker, including barring persons from associating with any Commission registrant. *See* note 559.

312 15 U.S.C. 78c(a)(18).

as a funding portal pursuant to Securities Act Section 4A(a)(1) and proposed Rule 400 of Regulation Crowdfunding.[313]

One commenter requested transparency in the registration process, stating that intermediaries' completed registration materials should be accessible to the public.[314] Brokers currently register with the Commission using Form BD. Information on that form regarding the broker's credentials, including current registrations or licenses and employment and disciplinary history, is publicly available on FINRA's BrokerCheck.[315] As discussed below, we are proposing to make the information that a funding portal provides on proposed Form Funding Portal, other than personally identifiable information or other information with a significant potential for misuse, accessible to the public.[316] One commenter urged the Commission to grant funding portals a one-year moratorium from having to register.[317] We are not proposing such a moratorium because the statute clearly states that a person acting as an intermediary in a crowdfunding transaction made in reliance on Section 4(a)(6) must be registered with the Commission either as a broker or as a funding portal.

Another commenter requested clarification on whether a person acting as an intermediary in a transaction under Section 4(a)(6) would be required to register with us as an exchange, as defined in Exchange Act Section 3(a)(1), or as an alternative trading system.[318] As discussed

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313 *See* proposed Rule 300(a)(1) of Regulation Crowdfunding.

314 *See* Commonwealth of Massachusetts Letter. *See also* Schwartz Letter (stating that the registration document should be made public because it would likely include many relevant disclosures, which would make it possible for the intermediary to file a single document to satisfy both the registration and disclosure requirements).

315 *See* FINRA, note 142.

316 *See* discussion in Section II.D.1 below.

317 *See* Loofbourrow Letter.

318 *See* ABA Letter 1.

above, Section 4A(a)(1) requires an intermediary that facilitates crowdfunded issuances of securities to register with us either as a broker or as a funding portal. Facilitating crowdfunded transactions alone would not require an intermediary to register as an exchange or as an alternative trading system (*i.e.*, registration as a broker-dealer subject to Regulation ATS). To the extent that an intermediary facilitates secondary market activity in securities issued in reliance on Section 4(a)(6), the intermediary would be required to register as an exchange or as an alternative trading system if it met the criteria in Exchange Act Rule 3b-16.[319] We note, however, that a funding portal, by definition, is limited to acting as an intermediary in transactions involving the offer or sale of securities for the account of others solely pursuant to Section 4(a)(6),[320] which are primary issuances of securities. Thus, a funding portal could not effect secondary market transactions in securities.

Exchange Act Section 4A(a)(2) requires an intermediary to register with any applicable self-regulatory organization ("SRO"), as defined in Exchange Act Section 3(a)(26).[321] Exchange Act Section 3(h)(1)(B) separately requires, as a condition of the exemption from broker registration, a funding portal to be a member of a national securities association that is registered with the Commission under Exchange Act Section 15A. The proposed rules would implement

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319 *See* 17 CFR 240.3b-16 (subject to the exceptions provided in part (b) of the rule, an organization, association or group of persons would generally be considered a market place or facility for bringing together purchasers and sellers of securities or for otherwise performing, with respect to securities, the functions commonly performed by a stock exchange, "if such organization, association, or group of persons (1) Brings together the orders for securities of multiple buyers and sellers; and (2) Uses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of a trade.").

320 *See* Section II.C.1 above.

321 15 U.S.C. 78c(a)(26). Exchange Act Section 3(a)(26) defines an "SRO" to mean "any national securities exchange, registered securities association, or registered clearing agency, or (solely for the purposes of [S]ections [19(b), 19(c), and 23 of the Exchange Act]) the Municipal Securities Rulemaking Board established by [S]ection [15B of the Exchange Act.]" *Id.*

these provisions by requiring an intermediary in a transaction involving the offer or sale of securities made in reliance on Section 4(a)(6) to be a member of FINRA or any other national securities association registered under Exchange Act Section 15A.[322] Today, FINRA is the only registered national securities association.

One commenter generally objected to the requirement for an intermediary to be a member of a registered national securities association.[323] As we noted above, the statute clearly requires a funding portal to be a member of a registered national securities association. Likewise, under Section 15(b)(8) of the Exchange Act, a broker-dealer that is engaged in crowdfunding activities must be a member of a national securities association.[324] We believe that requiring intermediary membership in a registered national securities association should help to ensure consistent regulation of intermediaries with fewer opportunities for regulatory gaps. In regulating broker-dealers that effect securities transactions with members of the public, FINRA has the most members and is responsible for conducting broker-dealer examinations of its members, mandating disclosures by its members, writing rules governing the conduct of its members and associated persons[325] and informing and educating the investing public.[326] FINRA investigates and brings enforcement actions against FINRA members and their associated

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322 *See* proposed Rule 300(a)(2) of Regulation Crowdfunding. We have proposed definitions for the terms "intermediary" and "SRO" in proposed Rule 300(c)(3) and 300(c)(5) of Regulation Crowdfunding, respectively. Intermediary would mean a broker registered under Section 15(b) of the Exchange Act or a funding portal registered under proposed Rule 400 and would include, where relevant, an associated person of the registered broker or registered funding portal. SRO is proposed to have the same meaning as in Section 36(a)(26) of the Exchange Act. *See also* Section II.D.1 below for a discussion regarding proposed Rule 400 of Regulation Crowdfunding, which addresses registration requirements for funding portals.

323 *See* Priore Letter.

324 The statute also permits brokers-dealers to be members of a national securities exchange if the broker-dealer effects transactions in securities solely on that exchange.

325 15 U.S.C. 78*o*-3.

326 FINRA, Inc., http://www.finra.org/AboutFINRA/P125239 (last visited Oct. 15, 2012).

persons who are suspected of violating its rules and the federal securities laws.[327] While FINRA has primary responsibility for examining its members,[328] the Commission staff generally examines broker-dealers if specific firm or industry risks have been identified or when fraud and rule violations may have occurred. Because the statute requires a national securities association to write rules expressly for funding portals,[329] we anticipate that funding portals would be subjected to requirements targeted to their limited business model and not the more comprehensive requirements applicable to brokers. We anticipate that the regulatory framework FINRA creates for funding portals would play an important role in the oversight of these entities and, through the information that FINRA shares with the Commission, the Commission's ability to effectively regulate registered funding portals' activities.[330]

In response to commenters' requests that we clarify the applicable SRO for crowdfunding intermediaries, and to address any confusion about which entity or entities may serve as an SRO for crowdfunding brokers and funding portals, we are expressly identifying FINRA as a registered national securities association within the meaning of the statute.[331] While FINRA currently is the only registered national securities association, we are not foreclosing the possibility that another national securities association could register with us in the future. In that

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327 *See, e.g.*, 15 U.S.C. 78*o*-3(b)(2); Testimony Before the Senate Subcommittee on Securities, Insurance, and Investment Committee on Banking, Housing, and Urban Affairs, 111th Cong. 8 (2010) (testimony of Stephen Luparello, Vice Chairman, FINRA).

328 15 U.S.C. 78*o*-3.

329 *See* Exchange Act Section 3(h)(2) [15 U.S.C. 78c(h)(2)].

330 *Id.*

331 *See* NCA Letter; NSBA Letter.

event, the proposed rule would permit funding portals to become members of the new association (should one become established in the future) instead of, or in addition to, FINRA.[332]

FINRA currently provides licensing and qualification requirements for associated persons of brokers. While we are not proposing any such requirement for persons associated with a funding portal, FINRA (or any other registered national securities association) could propose such requirements, as well as requirements dealing with supervision of funding portal personnel and appropriate compliance structures.[333] FINRA, like all SROs, is required to file all proposed rules with us under Exchange Act Section 19(b)[334] and Rule 19b-4.[335] In general, the Commission reviews proposed SRO rules and rule changes, publishes them for comment, approves or disapproves them, or the rules become effective immediately or by operation of law.

Request for Comment

118. We have named FINRA expressly in the proposed rules as an applicable registered national securities association for crowdfunding intermediaries. Is this helpful? Is this appropriate? Why or why not? Are there other entities considering applying to become registered national securities associations?

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332 For requirements to register as a national securities association, *see* Exchange Act Section 15A [15 U.S.C. 78*o*-3].

333 Exchange Act Section 15(b)(7) (15 U.S.C. 78*o*(b)(7)) requires that natural persons associated with brokers and dealers that are registered under Exchange Act Section 15(a)(1) (15 U.S.C. 78*o*(a)(1)) meet such standards of training, experience, competence and such other qualifications as the Commission finds necessary or appropriate in the public interest. The Commission historically has not exercised this authority but instead has relied on and deferred to the "substantive content of the SROs' entry requirements imposed on securities personnel in the various qualification categories." *See Requirement of Broker-Dealers to Comply with SRO Qualification Standards*, Release No. 34-32261 (May 4, 1993). *See also* Sections II.D.1 and II.D.2 below for a discussion regarding proposed Rules 400 and 401 of Regulation Crowdfunding.

334 15 U.S.C. 78s(b).

335 17 CFR 240.19b-4.

119. The proposed rules would require that an intermediary be a member of FINRA or of any other applicable national securities association. Is this an appropriate approach? At present, FINRA is the only registered national securities association. If we were in the future to approve the registration of another national securities association under Exchange Act Section 15A, would it be appropriate for us to require membership in both the existing and new association? Why or why not?

120. No intermediary can engage in crowdfunding activities without being registered with the Commission and becoming a member of FINRA or another registered national securities association. We recognize that while there is an established framework for brokers to register with the Commission and become members of FINRA, no such framework is yet in place for funding portals. We do not intend to create a regulatory imbalance that would unduly favor either brokers or funding portals.[336] Are there steps we should take to ensure that we do not create a regulatory imbalance?[337] Please explain.

121. The proposed rules do not independently establish licensing or other qualification requirements for intermediaries and their associated persons. The

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336 We note, however, that a registered broker could nonetheless have a competitive advantage to the extent it would be able to provide a wider range of services than a registered funding portal could provide in connection with crowdfunding transactions made in reliance on Section 4(a)(6). Unlike a funding portal, a registered broker-dealer could make recommendations, engage in solicitations and handle investor funds and securities. In addition, a registered broker-dealer, but not a funding portal, could potentially facilitate a secondary market for securities sold pursuant to Section 4(a)(6). *See* Exchange Act Section 3(a)(80) [15 U.S.C. 78c(a)(80)] (providing that a funding portal may act as an intermediary solely in securities transactions effected pursuant to Securities Act Section 4(a)(6), which are offerings by issuers and not resales).

337 *See* NCA Letter (stating that registered brokers should not be permitted to engage in crowdfunding activities until funding portals also become registered with, and members of, SROs).

applicable registered national securities associations may or may not seek to impose such requirements. Should the Commission consider establishing these requirements? Should the Commission consider establishing requirements only if the associations do not? Would licensing or other qualifications for intermediaries and their associated persons be necessary, for example, to provide assurances that those persons are sufficiently knowledgeable and qualified to operate a funding portal? Why or why not? If so, what types of licensing or other qualifications should we consider?

b. Financial Interests

Exchange Act Section 4A(a)(11) requires an intermediary to prohibit its directors, officers or partners (or any person occupying a similar status or performing a similar function) from having any financial interest in an issuer using its services. The proposed rules would implement this prohibition by importing the language of the statute, and also by extending this prohibition to the intermediary itself. The proposed rules would add that these persons are not only prohibited from having any financial interest in an issuer using its services, but also would specifically be prohibited from receiving a financial interest in the issuer as compensation for services provided to, or for the benefit of, the issuer, in connection with the offer and sale of its securities.[338] The proposed rules would interpret "any financial interest in an issuer," for purposes of Securities Act Section 4A(a)(11), to mean a direct or indirect ownership of, or economic interest in, any class of the issuer's securities.

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338 *See* proposed Rule 300(b) of Regulation Crowdfunding.

One commenter sought clarification of whether Section 4A(a)(11) prohibits an intermediary – as an entity – from accepting equity from an issuer as compensation for its services.[339] In the commenter's view, Section 4A(a)(11) should be interpreted as prohibiting an intermediary from having a financial interest in an issuer only at the time of the offering and not thereafter. Another commenter stated that permitting a funding portal to have a financial interest in an issuer would align the funding portal's interests with those of potential investors and that full disclosure of any financial interest should quell any potential concerns.[340] Another commenter stated that Section 4A(a)(11) does not expressly prohibit an intermediary, as an entity, from having a financial interest in an issuer and that this should be permitted under certain circumstances.[341]

We believe the prohibition in Section 4A(a)(11) is designed to protect investors from the conflicts of interest that may arise when the persons facilitating a crowdfunding transaction have a financial stake in the outcome. The proposed rules would extend the prohibition on holding a

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339 *See* NCA Letter.

340 *See* Dex Offshore Letter 1. *See also* Dex Offshore Letter 2 (stating that allowing funding portals to have an equity interest in an issuer would align the funding portals with investors, much like venture capital or private equity models, and that transparent disclosure would quell any concerns related to portals maintaining equity interests in issuers).

341 *See* EarlyShares Letter 2 (stating that the following principles should govern a funding portal's financial interest in an issuer: first, to prevent any potential unfair advantage, an intermediary should only be able to invest on the same terms under which the crowd invests; second, any material nonpublic information that the intermediary (or any person acting on behalf of the intermediary) possessed prior to and/or after taking a financial interest in an issuer must be disclosed on the platform in a secure manner, consistent with the disclosure of other material nonpublic information that investors will receive through the issuer's profile page on an intermediary's platform; third, because under Securities Act Section 4A(e), an intermediary will be bound by the same one-year restriction on sales period as any other investor, there would be no risk that investors would be misled by a "false start" or "pump-and-dump" scheme; and finally, an intermediary's interest should remain anonymous throughout the investment campaign, to avoid having the intermediary's interest be considered "investment advice or recommendations," in violation of the prohibitions in the definition of funding portal).

financial interest to the intermediary itself,[342] because we believe that the same concerns apply to the intermediary as to its directors, officers or partners (or any person occupying a similar status or performing a similar function). The existence of a financial interest in an issuer may create an incentive to advance that issuer's fundraising efforts over those of other issuers, which could potentially adversely affect investors. For similar reasons, the proposed rules also would prohibit receipt of a financial interest in an issuer as compensation for services provided to or on behalf of an issuer.[343] The proposed rules would define "financial interest in an issuer" to mean a direct or indirect ownership of, or economic interest in, any class of the securities of an issuer.[344]

As discussed above, one commenter suggested that an investor's and intermediary's interests may be aligned if an intermediary were allowed to take a financial interest in an issuer. We are concerned that the promise of a financial stake in the outcome could give an intermediary an incentive to ensure the success of its own investment in the issuer, to the disadvantage of investors and other issuers using the intermediary's platform, particularly if the financial interest is provided to the intermediary on different terms than to other investors.

Request for Comment

122. Should we permit an intermediary to receive a financial interest in an issuer as compensation for the services that it provides to the issuer? Why or why not? If we were to permit this arrangement, the proposed rules on disclosure

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342 *See* proposed Rule 300(b) of Regulation Crowdfunding. *See also* Securities Act Section 4A(a)(12) (granting us discretionary authority to include other requirements on intermediaries for the protection of investors and the public interest).

343 *See id.*

requirements for issuers would require the arrangement to be disclosed to investors in the offering material. Are there other conditions that we should require? If so, please identify those conditions and explain.

123. If an intermediary receives a financial interest in an issuer, should it be permitted to provide future services as long as it retains the interest? Why or why not?

124. One commenter suggested that an intermediary should be able to receive a financial interest under the same terms as other investors participating in an offering made in reliance on Section 4(a)(6).[345] We request comment on this suggestion. How could an intermediary address potential conflicts of interest that may arise from this practice? Would disclosure of the arrangement be sufficient? Please explain.

125. The proposed rules define "financial interest in an issuer," for purposes of Securities Act Section 4A(a)(11), to mean a direct or indirect ownership of, or economic interest in, any class of the issuer's securities. Should we define the term more broadly to include other potential forms of a financial interest? For example, should the term include a contract between an intermediary and an issuer or the issuer's directors, officers or partners (or any person occupying a similar status or performing a similar function), for the intermediary to provide ancillary or consulting services to the issuer after the offering? Should it include an arrangement under which the intermediary is a creditor of an issuer? Should

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[345] *See* EarlyShares Letter 2.

it include any carried interest or other arrangement that provides the intermediary or its associated persons with an interest in the financial or operating success of the issuer, other than fixed or flat-rate fees for services performed? Should any other interests or arrangements be specified in the term "financial interest in an issuer?" If so, what are they and what concerns do they raise?

126. In light of the reasons for the prohibition, should there be a *de minimis* exception? Why or why not? If so, what would be an appropriate *de minimis* amount? For example, would a one percent holding be an appropriate amount? Would another amount be more appropriate? Please explain. Should there be disclosure requirements for any *de minimis* exception? Why or why not?

127. Should we impose any other requirements or prohibitions on intermediaries? If so, what requirements or prohibitions and why?

3. 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)], as established by the Commission, by rule, including obtaining a background and securities 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 provision by requiring an intermediary to have a reasonable basis for believing that the issuer is in compliance with relevant regulations and has established means to keep accurate records of holders of the securities it offers, and by requiring that the intermediary deny access if it believes the issuer or its offering would present a potential for fraud.[346]

Specifically, the proposed rules would require an intermediary to 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 Securities Act Section 4A(b) and the related requirements in Regulation Crowdfunding.[347] While an issuer has an independent obligation to comply with these requirements, we believe it would help to reduce the risk of fraud if an intermediary were to also have an obligation to have a reasonable basis to believe that the issuer is in compliance.[348] The proposed rules would permit intermediaries to reasonably rely on representations of the issuer, absent knowledge or other information or indications that the representations are not true. While we do not propose to specify particular actions an intermediary must take in satisfying this requirement, we anticipate that in the course of its interactions with potential issuers, an intermediary may determine whether it could in fact reasonably rely on an issuer's representations and have a reasonable basis to believe the issuer is in compliance.

The proposed rules also would require an intermediary to have a reasonable basis for believing that an issuer has established means to keep accurate records of the holders of the

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346 *See* proposed Rule 301 of Regulation Crowdfunding.

347 *See* proposed Rule 301(a) of Regulation Crowdfunding.

348 *See* Section II.E.5 below for a discussion relating to intermediaries' potential statutory liability for statements made by issuers and intermediaries' policies and procedures. Proposed Rule 403(a) of Regulation Crowdfunding would require funding portals to have policies and procedures designed to achieve compliance with federal securities laws, while intermediaries that are brokers would be subject to FINRA rules requiring similar policies and procedures. *See* discussion in Section II.D.4 below.

securities it would offer and sell through the intermediary's platform.[349] The ability to keep track of the ownership of an issuer's securities is necessary to protect investors and critical for maintaining the integrity of securities transactions made in reliance on Section 4(a)(6), both with respect to the initial offering and any subsequent transfers of the securities. The statute does not assign responsibility in this regard but intermediaries would be well-positioned to make this determination, given that they would be interacting with the issuer, and particularly if they are advising the issuer to some extent about the offering.[350] One commenter stated that a direct registration system provides the best solution to policing transfers at a low cost and that, to the extent physical certificates are issued, they should include legends similar to those required for restricted securities.[351]

Another commenter suggested that the Commission should require the use of registered transfer agents, which are already subject to SEC regulations and examinations, to maintain records of share ownership and transfers in connection with crowdfunding transactions.[352] This commenter stated that small issuers may not have the resources to properly execute the routine services that registered transfer agents provide, including procedures to: record and balance registered shareowner positions; follow shareholder instructions (and retain records of the instruction) to change an address or transfer their interests as a result of death, divorce or sale (including signature guarantees where necessary); escheat unclaimed assets under state laws; or address lost or stolen certificates.

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349 *See* proposed Rule 301(b) of Regulation Crowdfunding.

350 *See* discussion in Section II.D.3 below relating to proposed Rule 402(b)(5) of Regulation Crowdfunding.

351 *See* RocketHub Letter 1. *See also* STA Letter.

352 *See* STA Letter.

We are not proposing to require a particular form or method of recordkeeping of securities, nor are we proposing to require that an issuer use a transfer agent or any other third party. We recognize the importance of accurate recordkeeping for investors and issuers, and that the failure to accurately record or maintain shareholder records of an issuer, or to prevent fraudulent transfers, can have significant negative impacts for both investors and issuers.[353] Among other things, investors without accurate records of their ownership of shares can find it difficult to prove such ownership in connection with a sale of their shares or execution of a corporate transaction. We believe that accurate recordkeeping can be accomplished by diligent issuers or through a variety of third parties. Accordingly, under the proposed rules, the recordkeeping function may be provided by the issuer, a broker, a transfer agent or some other (registered or unregistered) person.[354] In certain business models, for example, it may be possible for other regulated entities, such as banks, to provide this function.[355]

Requiring a direct registration system to monitor transfers could create additional costs to implement that we have not required in connection with any types of securities offerings, and thus we are not proposing to require it here. Similarly, we are not proposing to require the use of a registered transfer agent. While requiring a registered transfer agent to be involved after the offering could introduce a regulated entity with experience in maintaining accurate shareholder records, a transfer agent is not necessary for accurate recordkeeping. Issuers and other third

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353 *See, e.g.*, STA Letter.

354 An intermediary that is a funding portal could not provide these services, however, because by statute, it cannot "hold, manage, possess, or otherwise handle investor funds or securities." *See* Exchange Act Section 3(a)(80)(D) [15 U.S.C. 78c(a)(80)].

355 *See* City First Letter (indicating that there was interest in leveraging resources of Community Development Financial Institutions, which are certified by the U.S. Department of Treasury and include community development banks, credit unions, loan funds, and venture capital funds, with crowdfunded capital).

parties can also be well-positioned to keep accurate records of the holders of the securities an issuer would offer and sell through an intermediary's platform.[356]

In satisfying this requirement that an intermediary have a reasonable basis to believe that an issuer has established means to keep accurate records of the securities it would offer and sell through the intermediary's platform, the intermediary may rely on an issuer's representations concerning the means it has established, unless the intermediary has reason to question the reliability of the representations.[357] To keep accurate records, an issuer may need to have established means to perform a range of functions with respect to shareholder records. The precise scope of the needed functions will depend on the nature of the issuer and its securities. Such functions could include, for example, the ability to (1) monitor the issuance of the securities the issuer would offer and sell through the intermediary's platform, (2) maintain a master security holder list reflecting the owners of those securities, (3) maintain a transfer journal or other such log recording any transfer of ownership, (4) effect the exchange or conversion of any applicable securities, (5) maintain a control book demonstrating the historical registration of those securities, and (6) countersign or legend physical certificates of those securities. For some issuers, not all of these functions may be needed.

There are a number of ways by which an issuer could demonstrate or represent that it has established the necessary recordkeeping means. The issuer itself may have capabilities to

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356 Transfer agent registration is required with respect to securities registered under Exchange Act Section 12 (15 U.S.C. 78*l*). Because securities issued pursuant to a transaction relying on Section 4(a)(6) will not be registered under Exchange Act Section 12, as explained above, we are not proposing to require the use of transfer agents on the transfers of these securities. Nevertheless, issuers relying on Section 4(a)(6) could choose to engage a registered transfer agent to provide these services. *See* Exchange Act Section 17A(c)(1) [15 U.S.C. 78q-1]. *See also id.*

357 *See* proposed Rule 301(b) of Regulation Crowdfunding.

maintain accurate records of its securities and, as noted above, may represent such capabilities to the intermediary. The intermediary also may be able to establish a reasonable belief, for example, if the issuer has engaged a broker, transfer agent, or other third party that can provide the requisite recordkeeping services, including a third party providing such services tailored to crowdfunding issuers.

The proposed rules would require an intermediary to deny access to its platform, if the intermediary has a reasonable basis for believing that an issuer, or any of its officers, directors (or any person occupying a similar status or performing a similar function) or 20 Percent Beneficial Owners, is subject to a disqualification under the proposed rules or if the intermediary believes that the issuer or the offering presents the potential for fraud or otherwise raises concerns regarding investor protection.[358] The rules would require an intermediary to conduct a background and securities enforcement regulatory history check on each issuer whose securities are to be offered by the intermediary, as well as on each of its officers, directors (or any person occupying a similar status or performing a similar function) and 20 Percent Beneficial Owners. While the statute requires that these checks be conducted on persons holding *more than* 20 percent of the outstanding equity of the issuer, the proposed rules would extend this requirement to apply to the 20 Percent Beneficial Owners. This proposed requirement is consistent with the issuer disclosure requirements and with the issuer disqualification provisions.[359] Using the same standard here would be consistent with and reinforce the disclosure requirements and disqualification provisions applicable to issuers and would provide investors with protections

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[358] *See* proposed Rule 301(c) of Regulation Crowdfunding.

[359] *See* proposed Rules 201 and 503 of Regulation Crowdfunding, as well as the discussion in Section II.B.1 above and Section II.E.6 below.

and additional comfort when making investment decisions. At this time, we believe that requiring these background checks would be sufficient to meet the aims of Section 4A(a)(5) without imposing an undue burden, which could in turn discourage the use of the exemption provided in Section 4(a)(6).

A number of commenters requested guidance on the acceptable scope of background and securities enforcement regulatory history checks that an intermediary would be required to conduct.[360] One commenter suggested that the background check should consist of: a review of credit reports, verification of necessary business or professional licenses, evidence of corporate good standing, uniform commercial code checks and a CRD[361] snapshot report.[362] Another stated that the scope of the background and securities enforcement regulatory history check should be commensurate with the size of the transaction and that we should establish a minimum level of diligence that an intermediary must undertake to promulgate an effective mechanism against fraud.[363] The commenter further stated that such minimum level should be below that

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360 *See* CompTIA Letter; NASAA Letter; CrowdFund Connect Letter.

361 CRD is a central licensing and registration system for the U.S. securities industry and its regulators. It includes a computerized database of registration records, as well as qualification, employment and complaint histories.

362 *See* NASAA Letter (stating that these types of checks and reviews are necessary to ensure bad actors are not permitted to raise money in lightly regulated public offerings). *Compare* RocketHub Letter 1 (stating that intermediaries should query commonly-used databases for criminal background checks, bankruptcy filings and tax liens, as well as cross reference against the Department of Treasury's ("Treasury") Office of Foreign Asset Control sanctions lists and Specially Designated Nationals and Blocked Persons lists).

363 *See* CFIRA Letter 2 (stating that because there is no mandated infrastructure that intermediaries are required to use, each intermediary should utilize an infrastructure that incorporates some type of fraud deterrence and fraud detection system, whether proprietary or licensed through a third party; that, in order to deter fraud, funding portals should have a video interface "whereby each issuer is required to give a short presentation on their business which is capable of being viewed live and saved for later viewing at any time by a potential investor;" and that in terms of detecting fraud, we should require intermediaries to build certain fraud detection systems into the functionality of their platforms).

required of registered broker-dealers.[364] Other commenters requested guidance on the actions that an intermediary should take with respect to information uncovered during a background check.[365]

We are not proposing to establish specific procedures for intermediaries to follow to reduce the risk of fraud beyond conducting the prescribed background and securities enforcement regulatory history checks. We believe that this proposed approach would allow an intermediary to use its experience and judgment, as well as its concern for the reputational integrity of its platform and crowdfunding pursuant to Section 4(a)(6) in general, to design systems and processes to help reduce the risk of fraud in securities-based crowdfunding. In this regard, the proposed rules would require an intermediary to deny access to an issuer if it has information that is not necessarily the basis for a disqualification under proposed rules, but that the intermediary nevertheless believes presents the potential for fraud or otherwise raises concerns regarding investor protection.[366] For this particular proposed requirement to deny access, the intermediary would not be required to have a reasonable basis for its belief. This is because we believe it is important to provide intermediaries discretion in taking steps to reduce the risk of fraud as Congress intended, which would strengthen investor protection. The proposed rules also require that if this information becomes known to the intermediary after it has granted the issuer access to its platform, the intermediary must promptly remove the offering

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364 *See id.*

365 *See* NSBA Letter; Arctic Island Letter.

366 For example, in conducting the background checks on the officers and directors of an issuer, an intermediary may learn that an officer or director misrepresented his or her experience or background. In this situation, an intermediary may determine that the misrepresentation was intentional or material (*e.g.*, it was not the result of an inadvertent clerical error) and is an indication that an offering by the issuer would present potential for fraud or otherwise raises concerns regarding investor protection. The intermediary would then be required to deny access to its platform to the issuer.

from its platform, cancel the offering and return to investors any funds they may have committed. Under the proposed rules, an intermediary would also be required to deny access to an issuer if it believes that it is unable to adequately or effectively assess the risk of fraud of the issuer or its potential offering. For example, if certain officers of the issuer reside in a jurisdiction where background checks and securities enforcement regulatory history checks are not readily available to the intermediary, the intermediary may determine that it is unable to assess the risk of fraud of the issuer, and thus must deny the issuer access to its platform.

Some commenters stated that background checks could help reduce fraud if intermediaries were required to prominently display the results of the background checks on their platforms.[367] We believe that requiring intermediaries to conduct the checks and deny access to persons subject to disqualification satisfies the statutory requirement and achieves the underlying goal of the provision, which is to restrict the ability of certain parties to use the exemption. We do not believe it would be necessary to make publicly available the results of the background checks, especially as such a requirement could add to the cost of administration and could expose the individuals in question to harm, for example, if there were errors in the information made publicly available. Therefore, we are not proposing to require intermediaries to make publicly available the results of background checks. Other commenters suggested creating an online database of securities law violators,[368] or otherwise making certain information available so that investors could conduct their own background checks on officers and directors of an issuer,[369] which could help lower costs on intermediaries and, indirectly, on issuers, associated with

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367 *See* Arctic Island Letter; The Motley Fool Letter (stating the information should be displayed insofar as it bears on the honesty of the individual checked).

368 *See* CrowdFund Connect Letter.

369 *See* Cera Technology Letter.

conducting an offering pursuant to Section 4(a)(6). We are not persuaded at this time that the administrative costs of posting the information, which the intermediary might not be able to verify, would be justified.

Some commenters expressed concern over the costs and burdens associated with conducting background and securities enforcement regulatory history checks.[370] One commenter stated that it is important to control the expense of background checks to avoid making the cost of raising capital prohibitive to the issuer.[371] While we are mindful of the costs associated with conducting these checks, the statutory requirement is clear. To help mitigate the costs, however, the proposed rules provide intermediaries with flexibility in how they would meet this requirement, while still helping to reduce the risk of fraud.

We anticipate that an intermediary may use the services of a third party to gather the information to conduct the required background and regulatory checks on issuers and their control persons.[372] The intermediary, of course, would remain responsible for compliance with the requirements of Section 4A(a)(5) and proposed Rule 301(c).[373]

Request for Comment

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370 *See* CrowdFund Connect Letter; Cera Technology Letter; Schwartz Letter (stating that the Commission should not add to the costs of background and securities enforcement regulatory history checks by tacking on additional antifraud measures).

371 *See* CrowdFund Connect Letter (further stating that the requirement should be worded in a way "as to be compatible with the numerous online sites that currently provide criminal background checks and that only felonies be reported").

372 *See* discussion in Sections III.B.4 and IV.C below.

373 An intermediary should investigate and understand the procedures used by the third party to determine the reasonableness of the reliance on a third party. Furthermore, depending on how an arrangement is structured or the services provided, a third-party service provider could come within the meaning of the term associated person of a broker or dealer in Exchange Act Section 3(a)(18) (15 U.S.C. 78c(a)(18)). *See also* National Association of Securities Dealers ("NASD" n/k/a FINRA), *Outsourcing,* Notice to Members 05-48 (July 2005), *available at* http://www.finra.org/Industry/Regulation/Notices/2005/p014736.

128. We are not proposing to require that an issuer relying on Section 4(a)(6) engage a transfer agent due, in part, to the potential costs we believe such a requirement would impose on issuers. What would be the potential benefits and costs associated with having a regulated transfer agent for small issuers? Are there other less costly means by which an issuer could rely on a qualified third party to assist with the recordkeeping related to its securities?

129. The proposed rules incorporate a "reasonable basis" standard for intermediaries to determine whether issuers comply with the requirements in Securities Act Section 4A(b) and the related requirements of Regulation Crowdfunding, as well as for satisfying the requirement that the issuer has established means to keep accurate records of the holders of the securities it would offer and sell through the its platform.[374] Is a "reasonable basis" the appropriate standard for intermediaries making such determinations? Why or why not? Is it appropriate for one determination but not the other? If so, please explain which one and why. What other standard would be more appropriate, and why? What circumstances in the crowdfunding context should not be considered to constitute a reasonable basis? Should we permit an intermediary to reasonably rely on the representation of an issuer with respect to one or both determinations?

130. The proposed rules incorporate a "reasonable basis" standard for intermediaries to determine whether an issuer would be subject to a disqualification. In

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374 *See* proposed Rule 301(a) of Regulation Crowdfunding.

contrast, there is no reasonableness standard for intermediaries' requirement under the proposed rules to deny access to an issuer if it believes the issuer or the offering presents potential for fraud or otherwise raises concerns regarding investor protection. Is it appropriate to have these two different standards under the proposed rules? Why or why not? If one of these standards is not appropriate, please explain what would be a more appropriate standard and why.

131. 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 any person occupying a similar status or performing a similar function) or 20 Percent Beneficial Owners is subject to a disqualification, presents potential for fraud or otherwise raises concerns regarding investor protection. Is this approach appropriate? Why or why not? If not, why not? Would another approach be more appropriate? Why or why not?

132. Should we require intermediaries to make the results of the proposed background checks publicly available? Why or why not? Would doing so raise privacy concerns?

133. Should we specify the steps that an intermediary must take in obtaining background and securities enforcement regulatory history checks on the issuer and its officers, directors (or any person occupying a similar status or performing a similar function) and 20 Percent Beneficial Owners? Should we require, for example, an intermediary to check publicly-available databases, such as FINRA's BrokerCheck and the Commission's Investment Adviser

Public Disclosure program? Why or why not? Are there third parties who would be in a position to provide these types of services? Please discuss.

134. Should we require intermediaries to conduct specific checks or other steps (such as a review of credit reports, verification of necessary business or professional licenses, evidence of corporate good standing, Uniform Commercial Code checks or a CRD snapshot report)? Why or why not? Separately, should we specify a minimum or baseline level of due diligence to help establish a reasonable basis? Why or why not? If so, what should that level include? For instance, should it include a review or a verification of certain publicly available information about an issuer and its officers, directors (or any person occupying a similar status or performing a similar function) and 20 Percent Beneficial Owners? Should it include searches related or tailored to their location or place of incorporation, assets including real property and liens on those assets? Are there items it should or should not include? Please explain.

135. Are there resources available to an intermediary that enable it to collect the information necessary for making a determination regarding disqualification or the potential for fraud or potential concerns as to investor protection? If so, which resources? Are there aspects of the proposed issuer disqualification rule that would make it difficult for an intermediary to assess whether the issuer is subject to a disqualification? If so, please explain. Are there additional events or factors relevant to reducing the risk of fraud that intermediaries should be required to check? Please explain.

136. Section 4A(a)(5) authorizes the Commission to specify measures to reduce the risk of fraud, in addition to background checks. Are there other risks of fraud which are not contemplated by the proposed rules? Are there any additional measures that we should specifically require? Please discuss any suggested measures, and explain. For example, should we require intermediaries to monitor investment commitments and cancellations or take any other actions to detect potential attempts to promote an issuer's securities? If so, which actions and why?

137. Should the intermediary be required to report to the Commission (or another agency) issuers that are denied access? Why or why not?

4. Account Opening

Under the proposed rules, an investor seeking to invest in an offering conducted in reliance on Section 4(a)(6) would need to open an account with an intermediary and provide consent to electronic delivery of materials. The intermediary also would be required to deliver to the investor educational materials, as discussed below.

a. Accounts and Electronic Delivery

The proposed rules would prohibit an intermediary or its associated persons from accepting an investment commitment unless the investor has opened an account with the intermediary and the intermediary has obtained from the investor consent to electronic delivery of materials.[375] We are not proposing to specify any particular type or form of information that an intermediary must obtain from an investor in order to open an account; however, we

375 *See* proposed Rule 302(a)(1) of Regulation Crowdfunding.

anticipate that at a minimum the intermediary would obtain basic identifying and contact information, such as full name, physical address and e-mail address.[376] Because we believe that Congress contemplated that crowdfunding would, by its very nature, occur exclusively through electronic media, the proposed rules require that investors consent to electronic delivery.[377]

The proposed rules also would require an intermediary to provide all information it is required to provide under Subpart C, such as educational materials, notices and confirmations, through electronic means.[378] We also propose to require that, unless otherwise permitted, an intermediary must provide the information through an electronic message that contains the information, through an electronic message that includes a specific link to the information as posted on the intermediary's platform, or through an electronic message that provides notice of what the information is and that it is located on the intermediary's platform or on the issuer's website. The proposed rules would state that electronic messages include, but are not limited to, e-mail messages. According to the proposed rule, for example, in complying with requirements to provide notices to investors under proposed Rule 304(b), the intermediary must provide those notices electronically to investors, such as through an e-mail message containing or attaching the notice. With respect to the provision of issuer materials as required under proposed Rule 303(a), however, the proposed rule specifies that the intermediary must make the information publicly available on its platform. Therefore, the intermediary would only need to post the information

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376 Intermediaries also are subject to anti-money laundering obligations, including those relating to customer identification. *See* discussion in Section II.D.4 below regarding proposed Rule 403(b) of Regulation Crowdfunding.

377 *See Use of Electronic Media*, note 60 (citing *Use of Electronic Media for Delivery Purposes*, Release No. 34-36345 (Oct. 6, 1995) [60 FR 53548, 53454 (Oct. 13, 1995)]).

378 *See* proposed Rule 302(a)(2) of Regulation Crowdfunding.

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.

We believe that requiring consent to electronic delivery of documents relating to the offering, and requiring that intermediaries provide information electronically, would facilitate the ability of the investor, intermediary and issuer to comply with, and act in a timely manner, with respect to certain proposed requirements of Regulation Crowdfunding (such as the requirement for investors to reconfirm investment commitments within five business days of receiving notice of material changes).[379] As such, under the proposed rules, offerings made in reliance on Section 4(a)(6) would be "electronic-only," such that all information to be provided by intermediaries must be provided electronically, and investors would be permitted to participate only if they agree to accept electronic delivery of all documents in connection with the offering.[380]

Request for Comment

138. Should we specify the types of information that an intermediary must obtain from an investor as part of the account-opening process? If so, what information

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379 *See* discussion in Section II.C.6 below and proposed Rule 304(c) of Regulation Crowdfunding. We also note that, to the extent intermediaries are required to provide notices or other material to investors, it would not be sufficient for the intermediary simply to make the notice or material available for investors to access, such as by posting it on its platform or through social media sites; rather, the intermediary would need to deliver the notice or material to the investor, such as by e-mail or other electronic delivery methods. *See Use of Electronic Media,* note 60 at 25853 (discussing the "access equals delivery" concept).

380 *See* proposed Rule 100(a)(3) of Regulation Crowdfunding. *See also* discussion in Section II.A.4 above, particularly the text accompanying note 55, regarding the requirement that crowdfunding transactions made in reliance on Section 4(a)(6) be conducted exclusively through an intermediary's platform. *See also Use of Electronic Media*, note 60 (citing *Use of Electronic Media for Delivery Purposes*, Release No. 34-36345 [60 FR 53548, 53454 (Oct. 13, 1995)]).

and why? How would this information differ from what intermediaries would be required to obtain to fulfill their anti-money laundering obligations?[381]

139. Should we permit any exceptions to the proposed requirements to obtain consent to electronic delivery? If so, why and under what circumstances? If an investor does not receive materials electronically, how would he or she be able to participate fully in an offering made in reliance on Section 4(a)(6)?

140. Are there any other means of providing information electronically by an intermediary that are not covered in the proposed rules but that should be covered? Are there any means proposed to be included that should be eliminated or modified? If so, what means are they? For example, should intermediaries be permitted to post information in an investor's account on its platform, without sending a notification that it is posted there? Why or why not? Should different types of information be required to be provided through different means? Please explain.

b. Educational Materials

Section 4A(a)(3) states that an intermediary must "provide such disclosures, including disclosures related to risks and other investor education materials, as the Commission shall, by rule, determine appropriate," but it does not elaborate on the scope of this requirement. As described in further detail below, the proposed rules would require the intermediary to deliver to investors, at account opening, educational materials that are in plain language and otherwise designed to communicate effectively specified information. Intermediaries also would be

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[381] *See* Section II.D.4.b below for a discussion of the anti-money laundering provisions applicable to intermediaries.

required to make the current version of the educational materials available on their platforms and to make revised materials available to all investors before accepting any additional investment commitments or effecting any further transactions in securities offered and sold in reliance on Section 4(a)(6).[382]

The proposed rules would require the materials to include:

- the process for the offer, purchase and issuance of securities through the intermediary;
- the risks associated with investing in securities offered and sold in reliance on Section 4(a)(6);
- the types of securities that may be offered on the intermediary's platform and the risks associated with each type of security, including the risk of having limited voting power as a result of dilution;
- the restrictions on the resale of securities offered and sold in reliance on Section 4(a)(6);
- the types of information that an issuer is required to provide in annual reports, the frequency of the delivery of that information, and the possibility that the issuer's obligation to file annual reports may terminate in the future;
- the limitations on the amounts investors may invest, as set forth in Section 4(a)(6)(B);
- the circumstances in which the issuer may cancel an investment commitment;
- the limitations on an investor's right to cancel an investment commitment;

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382 *See* proposed Rule 302(b) of Regulation Crowdfunding.

- the need for the investor to consider whether investing in a security offered and sold in reliance on Section 4(a)(6) is appropriate for him or her; and
- that following completion of an offering, there may or may not be any ongoing relationship between the issuer and intermediary.

The proposed disclosures relating to the risks of investing in securities offered and sold in reliance on Section 4(a)(6), investors' cancellation rights, resale restrictions and issuer reporting are generally drawn from the statutory requirements.[383] These items of information are basic terms, relevant to transactions conducted in reliance on Section 4(a)(6), of which all investors should be aware before making an investment commitment. The circumstances in which an investor can cancel an investment commitment and obtain a return of his or her funds are particularly important to an investor's understanding of the investment process. Information on resale restrictions could affect an investor's decision to consider any offerings made pursuant to Section 4(a)(6).

We are proposing to require intermediaries to provide educational material about the types of securities available for purchase on their platforms and the risks associated with each type of security, including the risk of having limited voting power as a result of dilution.[384] As one commenter noted, some forms of securities may have limited rights with respect to voting, input into management decisions or redemption, among others, and also may be subject to

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383 *See* Securities Act Sections 4A(a)(4), 4A(a)(7), 4A(e), and 4A(b)(4).

384 *See* proposed Rule 302(b)(1)(ii) of Regulation Crowdfunding.

dilution.[385] Because we are not restricting the types of securities that an issuer may offer through Section 4(a)(6) transactions, this requirement would help investors understand the various types of securities that could be available on the platform and their associated risks.

We also are proposing to require intermediaries to provide educational material regarding the limitation on the amounts investors may invest pursuant to Section 4(a)(6)(B) and the proposed rules.[386] We believe it is important that investors are made aware of and understand the limits to which they would be subject, prior to making any investment commitments. As noted above, we are proposing to permit intermediaries to reasonably rely on investors' representations concerning compliance with the investment limitation requirements.[387] We believe providing these educational materials should enhance the accuracy of investor representations, because an investor may be less likely to inadvertently make an inaccurate representation that he or she complies with the investment limits after being presented with an explanation of what those limits are, how they apply and how they are calculated.

In addition, we are proposing to require that intermediaries provide, in the educational materials, a notice that the intermediary may or may not continue to have a relationship with the issuer following completion of the offering.[388] We believe that persons opening an account with an intermediary, for instance because they are interested in the offering of a particular issuer,

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385 *See* Commonwealth of Massachusetts Letter (stating that the investor education materials and other disclosures should make clear to investors the risks of their crowdfunding investments, including that investors may not have any meaningful voting power as minority shareholders and that their investment may not be readily liquid). *See also* 2012 SEC Government-Business Forum, note 29 (recommending that certain investor education materials, such as those relating to dilution, may need to be mandated by the Commission).

386 *See* proposed Rule 100(a)(2) of Regulation Crowdfunding.

387 *See* proposed Rule 303(b)(1) of Regulation Crowdfunding.

388 *See* proposed Rule 302(b)(1)(viii) of Regulation Crowdfunding.

could mistakenly assume that the intermediary will have an ongoing relationship with the issuer. Such persons also could assume that, following an offering conducted through the intermediary's platform through which they purchased securities, the intermediary would be the primary contact for investors wishing to obtain information about, or wishing to communicate with, the issuer or wishing to participate in secondary trading of the issuer's securities. Because intermediaries may not necessarily have an ongoing relationship with the issuer following an offering, and funding portals would not be permitted to be involved in secondary trading, we believe it would be helpful to require intermediaries to alert investors about this limitation the time they open accounts.

One commenter suggested that the user experience for investors engaging in crowdfunding transactions should be a "painless process" and that investors should be subject to mandatory investor education prior to investing.[389] Another commenter suggested that, in order to protect investors, intermediaries should be required to provide a glossary explaining each type of security available for purchase in each of the offerings on its portal.[390] We are proposing to require intermediaries to provide educational material about the types of securities available for purchase on their platforms and the risks associated with each type of security; however, in order to provide intermediaries with flexibility in how they present or format this information, we are not proposing to require that it be presented as a glossary. One commenter suggested that a warning on the front page of an issuer's offering materials should suffice for the purposes of

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389 *See* Vim Funding Letter.

390 *See* CFIRA Letter 2.

Section 4A(a)(3).[391] We do not believe that a disclaimer in isolation would be sufficient information to satisfy the statutory educational requirement.[392]

Other commenters requested that the Commission prepare and make available investor educational material or model text for use by intermediaries.[393] Other commenters requested that the Commission clarify whether educational materials may be provided to investors through electronic means, such as through the Internet or e-mail.[394] One commenter requested that intermediaries be given "wide latitude" to experiment with different methods of investor education.[395] We are not proposing to require a particular format or manner of presentation, other than the requirement that the materials be provided electronically.[396] Rather than requiring specific text or a particular format or presentation, we believe that the better approach is to provide each intermediary with sufficient flexibility to prepare educational materials in a manner reasonably designed to provide the required information, based on the types of offerings on the intermediary's platform and the types of investors drawn to its platform.[397] Under the proposed rules, the educational materials may be in any electronic format, including electronic and video

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391 *See* InitialCrowdOffering Letter (stating that the following type of language should be used: "you should purchase these shares only if you can afford a complete loss of your investment").

392 *See also* discussion in Section II.C.5.b below and proposed Rule 303(b)(2)(i) of Regulation Crowdfunding.

393 *See, e.g.*, NASAA Letter (providing model language for use in investor education material and recommending that the material state that: (1) investments in small businesses and start-up companies are often risky; (2) according to the U.S. Small Business Administration, half of all new businesses fail within five years; (3) because of these risks, investors should only invest if they can afford to lose the entire investment; and (4) an investor should not invest if the investor has an immediate need for the return of the funds). *See also* Tri Valley Law Letter; NSBA Letter. *But see* 2012 SEC Government-Business Forum, note 29 (recommending that while some investor education materials may need to be mandated by the Commission, the industry should work together to standardize educational materials).

394 *See* RocketHub Letter 1; Spinrad Letter 1.

395 *See* Schwartz Letter.

396 *See* proposed Rule 302(a)(2) of Regulation Crowdfunding and discussion in Section II.C.4.a above.

397 *See* 2012 SEC Government-Business Forum, note 29 (recommending that the market for transactions in reliance on Section 4(a)(6) should be permitted to develop best practices wherever possible).

format, that the intermediary determines is effective in communicating the contents of the educational material.[398]

Because the proposed rules require that the educational materials convey the specified pieces of information accurately, an intermediary would be required to update these materials over time as, for instance, the types of offerings on its platform change. For example, if an intermediary decides to expand the types of securities it offers through its platform, the intermediary would be required to update its educational materials. Similarly, an intermediary would be required to periodically review and update other aspects of its educational materials, such as the discussion of risk factors, as necessary. The proposed rules would require an intermediary to keep its educational materials accurate and thus current, which would require it to make the most current version of its educational materials available on its platform. In addition, to the extent an intermediary makes a material revision to its educational materials, it would be required to make the revised educational materials available to all investors before accepting any investment commitments.[399] We believe that this requirement is consistent with the Internet-based nature of crowdfunding. We also believe that this requirement would benefit investors, by helping to ensure that they have information about key aspects of investing through the intermediary's platform that may have changed since the last time they received the materials, prior to making investment commitments, as those key aspects could influence their investment decisions. Because these materials must be accurate, and thereby current, a change in

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398 As discussed in Section II.C.3 above, proposed Rule 302(a) of Regulation Crowdfunding would require that an intermediary obtain an investor's consent to such electronic delivery.

399 Pursuant to proposed Rule 303(b)(2)(i) of Regulation Crowdfunding, the intermediary would be required to obtain, from each investor, a representation that the investor has reviewed these educational materials before accepting an investment commitment from the investor.

the types of offerings conducted on an intermediary's platform would trigger an update. We believe requiring intermediaries to provide updated material on this basis, rather than at any regular intervals, should help to minimize the ongoing burden on intermediaries.

Request for Comment

141. Is the scope of information proposed to be required in an intermediary's educational materials appropriate? Why or why not? Is there other information that we should require an intermediary to provide as part of the educational materials? If so, what information and why?

142. Should any of the proposed requirements be modified or deleted, and if so, which requirements and why?

143. Should we prescribe the text or content of educational materials for intermediaries to use? Why or why not? Should we provide models that intermediaries could use? Why or why not?

144. Should we specifically prohibit certain types of electronic media from being used to communicate educational material? If so, which ones and why?

145. Should we require intermediaries to submit the educational materials to us or FINRA (or other applicable national securities association) for review? Why or why not? If we should require submission of materials, should we require submission before or after use, when they are first used, when the intermediary changes them or at some other point(s) in time? Please explain.

146. Should we require intermediaries to provide educational material at additional or different specified points in time, rather than only when the investor begins to open an account or make an investment commitment? Why or why not? If so,

why would that be preferable to requiring updates on an as-needed basis? For example, should educational material be provided on a quarterly, semi-annual, or annual basis? Should this material be provided again to investors who have not logged onto or accessed an intermediary's platform for a specified period of time? Why or why not? If so, what should that period of time be?

c. Promoters

Section 4A(b)(3) provides that an issuer shall "not compensate or commit to compensate, directly or indirectly, any person to promote its offerings through communication channels provided by a broker or funding portal, without taking such steps as the Commission shall, by rule, require to ensure that such person clearly discloses the receipt, past or prospective, of such compensation, upon each instance of such promotional communication." As discussed above, the proposed rules would include this prohibition.[400]

We also propose to require the intermediary to inform investors, at the account opening stage, that any person who promotes an issuer's offering for compensation, whether past or prospective, or who is a founder or an employee of an issuer that engages in promotional activities on behalf of the issuer on the intermediary's platform, must clearly disclose in all communications on the platform the receipt of the compensation and the fact that he or she is engaging in promotional activities on behalf of the issuer.[401] We believe that requiring intermediaries to inform investors about these disclosure obligations at the outset of their relationship should help to ensure and monitor issuers' compliance with Section 4A(b)(3) and the proposed rules, as it would alert investors that information about the participation of issuers

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[400] *See* proposed Rule 205 of Regulation Crowdfunding and the discussion in Section II.B.5 above.

[401] *See* proposed Rule 302(c) of Regulation Crowdfunding.

or representatives of issuers would have to be disclosed at a later time. Promoters also would need to disclose this information[402] each time they post a comment in the communication channels on the platform.[403]

Request for Comment

147. Should the proposed rules require intermediaries to take any different or additional steps to help achieve compliance with the requirement for promoters to disclose the receipt of compensation? If so, what other steps would be appropriate and why?

148. Should the proposed disclosures to investors be required to be made at some time other than at account opening? For instance, should the reminder about disclosure obligations be made each time an investor accesses the intermediary's platform or the communication channels provided by the intermediary? Why or why not?

149. The proposed rules would require disclosure be made to investors, in relation to obligations of any person who receives compensation, whether in the past or prospectively, to promote an issuer's offering, or who is a founder or an

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[402] In addition to the information proposed Rule 302(c) requires, promoters would also be required to disclose the amount of compensation pursuant to Section 17(b) of the Securities Act (15 U.S.C. 77q(b)).

[403] *See* proposed Rule 303(c)(4) of Regulation Crowdfunding. We recognize that after opening an account, an investor may come to be compensated by, or become an employee of, an issuer or potential issuer. For this reason, proposed Rule 303(c)(4) would require an intermediary to require that any person, when posting a comment in the communication channels, clearly disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or receives compensation, whether in the past or prospectively, to promote an issuer's offering. We anticipate that an intermediary could comply with this requirement in part by, for example, establishing a "pop-up" window which reminds the investor of the requirement each time the investor accesses, or attempts to post a comment on, the communication channels on the intermediary's platform. *See* discussion in Section II.C.5 below. *See also* proposed Rule 205 of Regulation Crowdfunding.

employee of an issuer that engages in promotional activities on behalf of the issuer on the intermediary's platform. Should the obligations apply to other classes of persons as well, such as affiliates of the issuer, regardless of whether they are engaged in promotional activities? Why or why not?

d. Compensation Disclosure

The proposed rules would require the intermediary, when establishing an account for an investor, to clearly disclose the manner in which it will be compensated in connection with offerings and sales of securities made in reliance on Section 4(a)(6).[404] This requirement would help to ensure investors are aware of any potential conflicts of interest of an intermediary that arise from the manner in which the intermediary is compensated. While the JOBS Act does not require this disclosure, we believe that providing this information to investors before they invest would help to ensure that they are making informed investment decisions.[405]

Request for Comment

150. Is the requirement for an intermediary to disclose how it is compensated an appropriate requirement? Why or why not? Would a time other than at account opening be more appropriate for this disclosure? Please explain.

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404 *See* proposed Rule 302(d) of Regulation Crowdfunding. *See also* proposed Rule 303(f) of Regulation Crowdfunding.

405 *See* Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers: As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (Jan. 2011) ("*Study on Investment Advisers and Broker-Dealers*"), *available at* http://www.sec.gov/news/studies/2011/913studyfinal.pdf, for more information about how compensation disclosure impacts investment decisions.

151. Should the proposed rules include any additional requirements with regard to disclosure of compensation? If so, what other requirements would be appropriate and why?

152. While the proposed rules do not specify the types of information that an intermediary must obtain from an investor at the account opening stage, we recognize that this stage provides an opportunity for intermediaries to collect certain demographic information about investors. Although some information intermediaries would collect from investors might already be required under their anti-money laundering obligations or pursuant to registered national securities association rules, there is some information about investors which might not be required to be collected but which, without involving disclosure of any personally identifiable information of investors, could help us and the applicable national securities association to better understand the level of investor sophistication in this market and investor protection needs, among other things. For instance, connecting certain demographic information to offering characteristics and outcomes could help in the evaluation of the effectiveness of crowdfunding in raising capital for startups and small businesses. The information that could be collected includes, for example, demographic information about investors that excludes any personally identifiable information and is aggregated on a per offering basis, indicating characteristics such as education level, income, wealth, geographic distance from the issuer and professional affiliations. At the same time, we recognize that requiring the collection of this data could likely increase the burden on investors and

intermediaries participating in transactions conducted pursuant to Section 4(a)(6). Should we require intermediaries to collect and provide some or all of this information to us and the applicable national securities association? Should some or all of this information be made more widely available? Why or why not? If so, which metrics should we require, and in what format, if any, should we require it be provided? To what extent do brokers already collect this information for offerings in which they are involved? Is there a particular point in time or method that would be more appropriate or convenient for intermediaries to collect this information? Would a requirement for intermediaries to collect this information at the account opening stage discourage investors from opening accounts with intermediaries, and ultimately limit the ability of issuers to raise capital in reliance on the exemption in Section 4(a)(6)? Please explain.

5. Requirements with Respect to Transactions

a. Issuer Information

Section 4A(a)(6) requires each intermediary to make available to the Commission and potential investors, not later than 21 days prior to the first day on which securities are sold to any investor (or such other period as the Commission may establish), any information provided by the issuer pursuant to Section 4A(b). The proposed rules would implement this provision by requiring each intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) to make available to the Commission and to potential investors any information required to be provided by the issuer under Rules 201 and 203(a) of proposed Regulation

Crowdfunding.[406] The proposed rules would further require that: (1) an intermediary make this information publicly available on the intermediary's platform, in a manner that reasonably permits a person accessing the platform to save, download or otherwise store the information;[407] (2) this information be made publicly available on the intermediary's platform for a minimum of 21 days before any securities are sold in the offering, during which time the intermediary may accept investment commitments;[408] and (3) this information, including any additional information provided by the issuer,[409] remain publicly available on the intermediary's platform until the offer and sale of securities is completed or cancelled. An intermediary would be prohibited from requiring any person to establish an account with the intermediary in order to access this information.

We believe that this approach also would satisfy the requirement under Section 4A(d) for the Commission to "make [available to the states], or . . . cause to be made [available] by the relevant broker or funding portal, the information" issuers are required to provide under Section 4A(b) and the rules thereunder. This approach should help investors, the Commission, FINRA (and any other applicable registered national securities association) and other interested parties, such as state regulators, to access information without impediment. The proposed rules should help to ensure that an investor has an adequate opportunity to evaluate the investment

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406 *See* proposed Rule 303(a) of Regulation Crowdfunding.

407 While we are not requiring that intermediaries make the relevant information available in any particular format, we note that issuers would be required to file the information on EDGAR. *See* proposed Rule 203 of Regulation Crowdfunding. *See also* Section II.B.3 above for a discussion of the filing requirements applicable to issuers.

408 Accordingly, the offering could not close at any time before the end of the 21st day after the issuer disclosure materials are made available on the intermediary's platform.

409 Additional information could include, for example, information required to be filed with the Commission in a specific format (*e.g.*, on EDGAR) under proposed Rules 201 and 203(a) of Regulation Crowdfunding, but prepared in a different presentation format, for example on slides, on the intermediary's platform.

opportunity and determine whether it is suitable for him or her.[410] Finally, we do not believe that any person should be required to open an account with, or otherwise provide personal information to, an intermediary before reviewing the materials related to an offering or the educational materials provided by the intermediary.

One commenter expressed the view that an intermediary should not be required to send information to the Commission before listing an offering on its platform.[411] The proposed rules would permit an intermediary to make issuer information available to both the Commission and potential investors simultaneously through its platform. Another commenter recommended that the private placement memorandum provided by the issuer should be reviewed by a properly qualified securities representative prior to the intermediary providing the information to potential investors.[412] We are not proposing at this time to impose such a requirement. Although review by a securities professional could provide some degree of additional investor protection, we are mindful of Congress' intent that these offerings present a cost-effective method of raising capital. Further, the proposed rules would provide a safeguard for investors by requiring an intermediary to have a reasonable basis for believing that an issuer complies with the requirements of Section 4A(b) and Regulation Crowdfunding, and to deny access to an issuer or cancel its offering, if the

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410 *See* proposed Rule 303(a)(1) of Regulation Crowdfunding. *See also* proposed Rules 303(a)(2) and 303(a)(3) of Regulation Crowdfunding. Intermediaries have broad recordkeeping obligations that would include any written materials that are used as part of an intermediary's business, which include issuer materials made available on its platform. Registered brokers would have to maintain records pursuant to Exchange Act Section 17 and the rules thereunder. 15 U.S.C. 78q; 17 CFR 240.17a *et seq*. Funding portals would be subject to the recordkeeping requirements of proposed Rule 406 of Regulation Crowdfunding. *See* discussion in Section II.D.5 below.

411 *See* Crowdfunding Offerings Ltd. Letter 2.

412 *See* Arctic Island Letter.

intermediary believes that the issuer or the offering presents the potential for fraud or otherwise raises concerns regarding investor protection.[413]

Request for Comment

153. Should we require intermediaries to continue to display issuer materials for some period of time after completion of the offering? Why or why not? If such a requirement were used, which time period would be appropriate? Why? What would be the potential costs and benefits associated with any such requirement?
154. Section 4A(a)(6) requires an intermediary to make available the information that an issuer is required to provide under Section 4A(b). Should we require an intermediary to make efforts to ensure that an investor who has made an investment commitment has actually reviewed the relevant issuer information? Why or why not? If so, how could we implement this?
155. Instead of, or in addition to, requiring that intermediaries make issuer information available on their platforms, should we require that intermediaries deliver this information to investors? Why or why not? If so, should we specify a particular medium, such as e-mail or a screen the investor must click through?
156. Should we consider timeframes other than the minimum 21 days from the time an issuer offers securities on an intermediary's platform, during which the offering information should be made available?

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413 *See* proposed Rule 302 of Regulation Crowdfunding and discussion in Section II.C.3 above.

157. Should some or all of the issuer's offering materials be required to remain on an intermediary's platform after the close of an offering? Why or why not? If so, for how long?

b. Investor Qualification

i. Compliance with Investment Limitations

Section 4(a)(6)(B) imposes certain limitations on the aggregate amount of securities that can be sold to an investor in reliance on Section 4(a)(6) during a 12-month period. Section 4A(a)(8) further imposes an obligation on intermediaries to ensure that no investor exceeds those limits. The proposed rules would implement this latter requirement by providing that, before permitting an investor to make an investment commitment on its platform, an intermediary must have a reasonable basis to believe that the investor satisfies the investment limitations under Section 4(a)(6)(B) and Regulation Crowdfunding.[414]

Three commenters stated that it would be difficult for an intermediary to determine whether an investor has exceeded the investment limitations because an investor may not always use the same intermediary.[415] Another commenter stated that it is unclear how an intermediary will be able to verify the investment limits, unless the intermediary is permitted to rely upon an investor's representations regarding his or her prior crowdfunding investments.[416] Another commenter raised concerns that an investor may be able to establish multiple user accounts with a single intermediary and thereby exceed the maximum investment limit, despite the best efforts

414 *See* proposed Rule 303(b)(1) of Regulation Crowdfunding. *See also* Section II.A.2 above for a further discussion of the limitations on investments.

415 *See* Cera Technology Letter; Crowdfunding Offerings Letter 3; Schwartz Letter.

416 *See* NSBA Letter. *See also* 2012 SEC Government-Business Forum, note 30 (recommending that investors should be permitted to self-certify as to their statutory investment limits and that funding portals should be permitted to rely on certifications made by third parties as to investment limits).

of the intermediary.[417] Another commenter suggested that each intermediary should be required to monitor investor activity only on its own platform.[418] The commenter further stated that before completing an investment through an intermediary, investors should be required to make representations to an intermediary regarding any investments made through another intermediary within the last year. Another commenter suggested that the Commission should permit intermediaries to create and use a centralized database for aggregate checks.[419]

We recognize that it would be difficult for intermediaries to monitor or independently verify whether each investor remains within his or her investment limits for each particular offering in which he or she intends to participate. While the proposed rules would permit reliance on a centralized database providing information about particular investors, if it could help provide an intermediary with a reasonable basis for a conclusion, we understand that none currently exists. For these reasons, the proposed rules provide that an intermediary may rely on an investor's representations concerning compliance with investment limitation requirements based on the investor's annual income and net worth and the amount of the investor's other investments in securities sold in reliance on Section 4(a)(6) through other intermediaries. For example, an intermediary may choose to satisfy this requirement by providing a function on its platform that prompts investors to enter amounts of their annual income, net worth, and the amount of total investments made over the past 12 months on all intermediaries' platforms, that

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417 *See* Grow VC Letter (stating that the Commission should require the following measures: "closely monitoring investment activity in any user account; requiring each user account to provide unique bank account details which are not used by any other user account; and requiring the investor to represent and warrant that such investor understands the maximum investment limit and will not exceed such limits").

418 *See* RocketHub Letter 1.

419 *See* Spinrad Letter 1 (stating that the underlying database would consist of information representing users, offerings, transactions and other elements of the market, and it would be used to ensure that investors do not purchase beyond the annual limits, even from multiple issuers across multiple intermediaries).

would then generate the amount of investment the investor would be permitted to make at that time pursuant to the investment limitations. The intermediary could not rely on an investor's representations if the intermediary had reason to question the reliability of the representation. In this regard, it would not be reasonable for an intermediary to ignore other investments made by an investor in securities sold in reliance on Section 4(a)(6) through an account with that intermediary or other information or facts about an investor within its possession.

Request for Comment

158. Is the proposed approach for establishing compliance with investment limits appropriate? Why or why not? Is there another approach that we should consider? Please explain.

159. As mentioned above, we are proposing that an intermediary may rely on the representations of a potential investor. Is this an appropriate approach? Why or why not? Is there another approach we should consider? Please explain.

160. Should we require an intermediary to avail itself of readily available information concerning investor limits, such as a centralized database containing information relating to whether particular investors were in compliance with the investment limits, should one become established? Why or why not?

161. Should we require intermediaries to request other intermediary accounts that an investor may have before accepting an investment commitment? Why or why not?

ii. Acknowledgement of Risk

Section 4A(a)(4) requires an intermediary to ensure that each investor: (1) reviews the educational materials discussed above; (2) positively affirms that the investor understands that he or she is risking the loss of the entire investment and that the investor could bear such a loss; and (3) answer questions demonstrating an understanding of the level of risk generally applicable to investments in startups, emerging businesses and small issuers, the risk of illiquidity and such other matters as the Commission determines appropriate. As discussed above, the proposed rules would require an intermediary to provide to investors certain educational materials in connection with the opening of an account.[420] The proposed rules would further require an intermediary, each time before accepting an investment commitment, to obtain from the investor a representation that the investor has reviewed the intermediary's educational materials, understands that the entire amount of his or her investment may be lost and is in a financial condition to bear the loss of the investment.[421] The intermediary also must ensure each time before accepting an investment commitment that each investor answers questions demonstrating the investor's understanding that there are restrictions on the investor's ability to cancel an investment commitment[422] and obtain a return of his or her investment, that it may be difficult for the investor to resell the securities, and that the investor should not invest any funds in a crowdfunding offering unless he or she can afford to lose the entire amount of his or her investment.

A commenter requested guidance on the steps intermediaries must take to ensure that an investor understands the educational materials intermediaries are required to provide.[423] One

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420 *See* proposed Rule 302(b) of Regulation Crowdfunding and discussion in Section II.C.4.b above.

421 *See* proposed Rule 303(b)(2) of Regulation Crowdfunding.

422 We proposed this requirement under discretionary authority granted in Section 4A(a)(4)(C)(iii). As discussed in Section II.C.4.b above, in relation to the educational materials, we believe that it is important for investors to receive this information before making any investment commitments.

423 *See* CFIRA Letter 2.

commenter expressed concern that the requirements in Section 4A(a)(4) could be intimidating to potential investors and recommended that we require very short affirmations that could easily be understood.[424] Another commenter stated that the level of understanding that an investor can prove is too subjective to be useful and that an intermediary could not design a system to guarantee that an investor understands a disclosure.[425] We agree that it would not be possible for an intermediary to ensure that all investors understand the risk disclosure. The requirements of the proposed rules are intended to require intermediaries to provide investors with meaningful disclosures concerning the risks of any potential investment and obtain answers demonstrating an understanding of the required statutory elements.[426] The questionnaire required under the proposed rules should help to address concerns of commenters that Section 4A(a)(4) requires more than a mere self-certification.[427]

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424 *See* Cera Technology Letter (stating that a check-the-box type approach could be used, as well as the following draft text: "I understand that I could easily lose all of the money I invest in this company," or "I understand that X% of start-ups in this category fail"). *See also* Liles Letter 2 (stating that asking potential investors to take a test to demonstrate understanding of risks would be unorthodox and awkward at best and that a signed acknowledgement by investors that they understand each enumerated warning about the specific risks in the investment would suffice for compliance with the risk disclosure requirement); Verdant Ventures Letter (stating that a check-the-box type of approach could be used on funding portal websites to acknowledge the understanding of risk specifically for investors who are making low investments of $100 to $500 and that the regulation levels should be adjusted proportionally to larger individual dollar investments, and therefore, low contribution amounts should be subject to less regulation).

425 *See* Crowdfunding Offerings Ltd. Letter 2.

426 *See* proposed Rule 303(b)(2) of Regulation Crowdfunding.

427 *See* proposed Rule 303(b)(2)(ii) of Regulation Crowdfunding. *See, e.g.*, Spinrad Letter 1; NASAA Letter (stating that intermediaries "should [at a minimum] be required to design their web portals to require investors to click through a page that indicates they have read the investor-education information and to require investors to correctly answer a series of specific questions that are controlled by the Commission," and further stating that such requirements should be a precondition for membership or registration of an investor with a funding portal); The Motley Fool Letter (stating that a more involved process than a simple check-the-box type approach should be used to verify that investors acknowledge and understand the risks and that multiple choice questions should be used and tailored to testing whether potential investors understand the nature of crowdfunding risk, the potential for fraud, their legal rights and responsibilities and the probability of losing their entire investment). *See also* TechnologyCrowdFund Letter 1 (stating that the Commission should require each individual seeking to invest more than $2,000 to take an on-line course with a quiz on the possible pitfalls of crowdfunding).

One commenter requested that the Commission develop a model form of acknowledgment that intermediaries can use and retain to satisfy the requirements of Section 4A(a)(4).[428] Another commenter suggested that intermediaries should have flexibility to try different methods of obtaining this acknowledgement.[429] We are not proposing a model form of acknowledgement or questionnaire. Rather, the proposed rules would permit an intermediary to develop the representation and questionnaire in any format that is reasonably designed to demonstrate the investor's receipt of the information and compliance with the other requirements under the proposed rules. As with the educational material requirements, we believe that an intermediary's familiarity with its business and likely investor base would make it best able to determine the format in which to present the material required under the proposed rules.[430] As one commenter suggested, an intermediary could design a multiple choice quiz that would not permit an investor to successfully make an investment commitment until the investor has correctly answered a specific number of questions.[431] Other formats that could be used are questions that must be answered "Yes" or "No," or "True" or "False." Any format used must be reasonably designed to demonstrate receipt and understanding of the information. Thus, the requirements of proposed Rule 303(b) would not be satisfied if, for example, an intermediary were to pre-select answers for an investor. We propose to give intermediaries flexibility in how they fulfill this requirement because we do not want to foreclose viable alternatives. There are

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428 *See* CompTIA Letter.

429 *See* Schwartz Letter.

430 *See* proposed Rule 303(b)(2)(i) of Regulation Crowdfunding.

431 *See* Spinrad Letter 1 (stating that if an investor were to answer a question incorrectly, an issuer could, for example, push the investor education material to investors for further review, or alternatively could, through a pop-up feature, explain the correct answer and then permit the investor to choose the right answer). *See also* note 427.

many ways, especially on a web-based system, to convey information to, and obtain effective acknowledgement from, investors.

The proposed rules would require an intermediary to obtain an investor representation and completed questionnaire before accepting any investment commitment. Accordingly, the intermediary would be required to obtain these items each time an investor seeks to make an investment commitment.[432] This proposed requirement is intended to help ensure that investors engaging in transactions made in reliance on Section 4(a)(6) are fully informed and reminded of the risks associated with their particular investment before making any investment commitment.

Another commenter suggested that intermediaries should be required to designate a key person who will bear the responsibility to ensure that all investors demonstrate an understanding of the level of risks applicable to investments.[433] We are not proposing this requirement at this time. Although Section 4A(a)(4) requires an intermediary to ensure that each investor positively affirms that he or she understands the risks of investing in securities sold in reliance on Section 4(a)(6), at this time, we believe that each intermediary should have flexibility to design its own compliance program in a manner that is effective for it in light of its business model, types of offerings and any other relevant considerations.[434]

Request for Comment

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432 *See* proposed Rule 303(b)(2) of Regulation Crowdfunding.

433 *See* Commonwealth of Massachusetts Letter.

434 FINRA (or any other applicable registered national securities association) could seek to impose a compliance structure that may require such designation. Any proposed requirement by FINRA (or any other applicable registered national securities association) would be filed with us pursuant to the Exchange Act and the rules thereunder. 17 CFR 240.19b-4.

162. Should we require intermediaries to have investors acknowledge issuer-specific or security-specific risks as part of the transaction process? Why or why not? If so, to what extent?

163. Are there considerations relating to investor acknowledgments we should take into account, other than those discussed above? Is the proposed requirement to obtain an acknowledgement as to investors' understanding of their ability to cancel investment commitments appropriate? Why or why not? Should we require acknowledgement of investors' understanding of any other matters? Why or why not? If so, which ones and why?

164. Are there any matters apart from the risks identified above that we should require to be addressed in the investor acknowledgements? If so, which ones, and why? How should they be addressed?

165. Should we provide a recommended form of questions and representations? Why or why not? If so, should the Commission provide the form as a starting point, and not a safe harbor, so that intermediaries can adapt the questions and representations to particular offerings? Why or why not?

c. Communication Channels

The proposed rules would require an intermediary to provide, on its platform, channels through which investors can communicate with one another and with representatives of the issuer about offerings made available on the intermediary's platform, subject to certain conditions.[435] While the JOBS Act does not impose this requirement, we believe that Congress

[435] *See* proposed Rule 303(c) of Regulation Crowdfunding.

contemplated that there would be such a mechanism in place for offerings made in reliance on Section 4(a)(6).[436] Some commenters refer to communication channels as an integral part of crowdfunding. For example, one commenter suggested that intermediaries should provide a mechanism for communication between issuers and investors, without necessarily requiring the communication itself to take place.[437] Others have urged us to encourage dialogue among potential investors and issuers as a key component of the crowdfunding model, suggesting that it would contribute to low levels of fraud.[438] One commenter also maintained that there is value in allowing interested parties generally, such as experts and journalists, to participate in these discussions, as well as maintaining transparency regarding the identity of those participating in the discussions.[439]

The communication channels we are proposing would provide a centralized and transparent means for members of the public that have opened an account with an intermediary to share their views about investment opportunities and to communicate with representatives of the issuer to better assess the issuer and investment opportunity. Also, though communications among investors could occur outside the intermediary's platform, communications by an investor with a crowdfunding issuer or its representatives about the terms of the offering would be

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436 *See* 158 CONG. REC. S2231 (daily ed. Mar. 29, 2012) (statement of Sen. Scott Brown) ("In addition to facilitating communication between issuers and investors, intermediaries should allow fellow investors to endorse or provide feedback about issuers and offerings, provided that these investors are not employees of the intermediary. Investors' credentials should be included with their comments to aid the collective wisdom of the crowd.").

437 *See* RocketHub Letter 1.

438 *See* Mollick Letter, Lucas Letter. One commenter raised a concern about communications being construed as investment advice by funding portals. *See* Grow VC Letter. *See also* Section II.D.3 below for a discussion of the proposed safe harbor for funding portals.

439 *See* Mollick Letter.

required to occur through these channels,[440] on the single platform through which the offering is conducted.[441] This requirement should provide transparency and accountability, and thereby further the protection of investors.

Under the proposed rules, an intermediary that is a funding portal would be prohibited from participating in any communications in these channels, apart from establishing guidelines for communication and removing abusive or potentially fraudulent communications.[442] For example, a funding portal could establish guidelines pertaining to the length or size of individual postings in the communication channels and could remove postings that include offensive or incendiary language. Intermediaries that are funding portals are prohibited from providing investment advice or recommendations. In contrast, intermediaries that are brokers may provide investment advice and recommendations, subject to certain conditions.[443]

The proposed rules would require the intermediary to make the communications on the channels publicly available for viewing. For instance, an intermediary could not restrict viewing of the communications to only those investors who have opened accounts with it. We believe that this requirement is consistent with the concept of crowdfunding, as it provides transparent crowd discussions about a potential investment opportunity. The proposed rule would, however,

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440 *See* proposed Rule 204 of Regulation Crowdfunding and discussion in Section II.B.4 above.

441 *See* proposed Rule 100(a)(3) of Regulation Crowdfunding and discussion in Section II.A.3 above.

442 *See* proposed Rule 303(c) of Regulation Crowdfunding.

443 The Investment Advisers Act of 1940 excludes from the definition of investment adviser any broker or dealer whose performance of investment advisory services is "solely incidental" to the conduct of its business as a broker or dealer and who receives no "special compensation" for those advisory services. *See* Advisers Act Section 202(a)(11)(C) [15 U.S.C. 80b-2(a)(11)(C)]. *See also Study on Investment Advisers and Broker-Dealers*, note 405 at 15-16 (discussing the terms used in this exclusion). As such, brokers that are not registered as investment advisers are able to provide investment advice, provided they meet these two requirements. Subject to applicable rules, brokers also can make recommendations concerning securities, if they have a reasonable basis to believe that the recommendations are suitable. *See, e.g.*, FINRA Rule 2111 ("Suitability").

require the intermediary to permit only those persons who have opened accounts with it to post comments. While we recognize that this requirement could narrow the range of views represented by excluding posts by anyone who has not opened an account with the intermediary, we believe that this proposed requirement would help to establish accountability for comments made in the communication channels. Among other things, the records required to be kept by intermediaries should help to track the origins of any abusive or potentially fraudulent comments made through the communication channels. Without this measure, we believe there could be greater risk of the communications including unfounded, potentially abusive, biased statements aimed unjustifiably to promote or discredit the issuer and improperly influence the investment decisions of members of the crowd.

The proposed rules also would require any person posting a comment in the communication channels to clearly and prominently disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or is otherwise compensated, whether in the past or prospectively, to promote the issuer's offering. This disclosure would apply to officers, directors and other representatives of the issuer, and also would be required of an intermediary that is a broker or its associated persons. Although the statute requires issuers, but not intermediaries, to disclose compensation to promoters of an offering, we believe that intermediaries, as the hosts of the communication channels, would be well placed to take measures to ensure that promoters are clearly identified in their communication channels, in accordance with Section 4A(b)(3).[444] This requirement would be consistent with Section 4A(b)(3), which requires issuers to take steps required by the

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[444] *See* discussion in Section II.B.5 above.

Commission and established by rule, to ensure disclosure of compensation or promotional activity "upon each instance of such promotional communication."

Request for Comment

166. Should we require intermediaries to provide communication channels, as proposed, on their platforms? Why or why not? If not, what other methods of communication could, or should, be used and why?

167. Are the proposed conditions imposed on the requirement to provide communication channels appropriate? Why or why not? For example, should the communications on the channels be available for public viewing or participation? Why or why not? What other restrictions, if any, should communication channels be subject to, and why? For example, should we require more specific actions for intermediaries to take in order to ensure adequate disclosure of issuers' and promoters' communications? If so, what actions and why?

168. Under the proposed rules, we limit the ability to post in the communication channels to only those persons who have opened accounts with the intermediaries and thereby identified themselves to the intermediaries. Is this restriction adequate? Why or why not? Would it be appropriate to permit anyone, including persons who have not identified themselves in any way, to post comments in intermediaries' communication channels? Why or why not?

169. The proposed rules would require any person posting a comment in the communication channels to disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf

of the issuer, or is otherwise compensated, whether in the past or prospectively, to promote the issuer's offering. Should we impose this requirement on other types of persons as well, such as affiliates of the issuer, regardless of whether they are engaging in promotional activities? Why or why not?

170. Should we require the intermediary to maintain the communication channels of its platform during the post-offering period, in order to permit communication between investors and the issuer after the offering has completed? Why or why not? If so, for how long after the offering is completed (*e.g.*, for one month, for six months, for one year, or longer) should the intermediary be required to maintain the channels?

d. Notice of Investment Commitment

The proposed rules would require an intermediary, upon receipt of an investment commitment from an investor, to promptly give or send to the investor a notification disclosing: (1) the dollar amount of the investment commitment; (2) the price of the securities, if known; (3) the name of the issuer; and (4) the date and time by which the investor may cancel the investment commitment.[445] This notification would be required to be provided by e-mail or other electronic media, and to be documented in accordance with applicable recordkeeping rules.[446] The proposed notification is intended, among other things, to provide the investor with

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445 *See* proposed Rule 303(d) of Regulation Crowdfunding. The statutory requirements for intermediaries do not expressly address an intermediary's obligation to notify an investor of receipt of the investor's commitment, although the statutory provision provides us with authority to do so in our rules. *See* Section 4A(a)(12).

446 Intermediaries that are brokers would be subject to the recordkeeping requirements of Exchange Act Rules 17a-3 and 17a-4, and intermediaries that are funding portals would be subject to recordkeeping requirements under proposed Rule 404 of Regulation Crowdfunding.

a written record of the basic terms of the transaction, as well as a reminder regarding his or her ability to cancel the investment commitment.

Request for Comment:

171. Would the notifications we are proposing to require be useful to investors? Why or why not? Should we provide further specificity as to when notice must be provided?

172. Are there any other circumstances under which an investor should receive a notice? If so, under what other circumstances?

e. Maintenance and Transmission of Funds

Securities Act Section 4A(a)(7) requires that an intermediary "ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount, . . . as the Commission shall, by rule, determine appropriate." The proposed rules would implement this provision and address the maintenance and protection of investor funds, pending completion of a transaction made in reliance on Section 4(a)(6).[447]

The proposed rules would require an intermediary that is a registered broker to comply with established requirements in Exchange Act Rule 15c2-4[448] for the maintenance and transmission of investor funds.[449] Application of Exchange Act Rule 15c2-4(b) to an intermediary that is a broker in the crowdfunding context, would require, in relevant part, that money or other consideration received is promptly deposited in a separate bank account, as agent

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447 *See* proposed Rule 303(e) of Regulation Crowdfunding.

448 17 CFR 240.15c2-4.

449 *See* proposed Rule 303(e)(1) of Regulation Crowdfunding.

or trustee for the persons who have the beneficial interest therein, until the appropriate event or contingency has occurred, and then the funds would be promptly transmitted or returned to the persons entitled thereto; or all such funds would be promptly transmitted to a bank, which has agreed in writing to hold such funds in escrow for the persons who have the beneficial interests therein and to transmit or return such funds directly to the persons entitled thereto when the appropriate event or contingency has occurred. Under Section 4A(a)(7), proceeds are to be transmitted to the issuer only if the target offering amount is met or exceeded. As explained in the adopting release to Rule 15c2-4, this rule was designed to prevent fraud "either upon the person on whose behalf the distribution is being made or upon the customer to whom the payment is to be returned if the distribution is not completed."[450]

The proposed rules would establish separate requirements for an intermediary that is a funding portal.[451] Because a funding portal cannot receive any funds, it would be required to direct investors to transmit money or other consideration directly to a qualified third party that has agreed in writing[452] to hold the funds for the benefit of the investors and the issuer and to promptly transmit or return the funds to the persons entitled to such funds.[453] The proposed rules would define "qualified third party" to mean a bank[454] that has agreed in writing either (i) to hold the funds in escrow for the persons who have the beneficial interests in the funds and to transmit

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450 *Adoption of Rule 15c2-4 under the Securities Exchange Act of 1934*, Release No. 34-6737 (Feb. 21, 1962) [27 F.R. 2089 (Mar. 3, 1962)].

451 *See* proposed Rule 303(e)(2) of Regulation Crowdfunding.

452 This written agreement would be required to be maintained by the funding portal pursuant to proposed Rule 404 of Regulation Crowdfunding. *See* discussion in Section II.D.5 below.

453 In the crowdfunding context, it is expected that the intermediary would be making the determination as to whether the contingency, *i.e.*, the target offering amount, has been met.

454 *See* Exchange Act Section 3(a)(6) [15 U.S.C. 78c(a)(6)] (defining "bank").

or return the funds directly to the persons entitled to them when the appropriate event or contingency has occurred; or (ii) to establish a bank account (or accounts) for the exclusive benefit of investors and the issuer. We have chosen to specify that the qualified third party would be a bank because investors, as well as intermediaries and issuers, would then be afforded the protections of existing regulations that apply to banks, in particular those pertaining to the safeguarding of customer funds.[455]

The proposed rules also would require an intermediary that is a funding portal to promptly direct transmission of funds from the qualified third party to the issuer when the aggregate amount of investment commitments from all investors is equal to or greater than the target amount of the offering and the cancellation period for each investor has expired,[456] but no earlier than 21 days after the date on which the intermediary makes publicly available on its platform the information required to be provided by the issuer such as information about the issuer and the offering pursuant to Rules 201 and 203(a) of proposed Regulation Crowdfunding.[457] We believe that this approach is consistent with the requirements in (1) Section 4A(a)(7) providing for the transfer of funds to an issuer when the issuer's target offering amount has been met, (2) Section 4A(a)(6) providing that issuer information be made available to investors for at least 21 days prior to the first day on which securities are sold in the offering, and (3) Section 4A(b)(1)(G) providing that investors must be allowed a reasonable opportunity to rescind their investment commitment. Under our proposed rules, an intermediary could

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455 For example, protections afforded to bank accounts include FDIC deposit insurance. *See* Federal Deposit Insurance Corp., *FDIC Deposit Insurance Coverage*, http://www.fdic.gov/deposit/deposits/dis/.

456 *See* Section II.C.6 below for a discussion of the cancellation period.

457 *See* proposed Rule 303(e)(3)(i) of Regulation Crowdfunding. *See also* Exchange Act Rule 10b-9 [17 CFR 240.10b-9].

permit a minimum-maximum offering, for example, in which the minimum would serve as the target offering amount.[458]

The proposed rules also would require an intermediary that is a funding portal to promptly direct the return of funds to an investor when an investment commitment has been cancelled (including when there has been a failure to obtain effective reconfirmation when there has been a material change).[459] The proposed rules also would require an intermediary that is a funding portal promptly to direct the return of funds to investors when an issuer does not complete an offering.[460] This could occur if an issuer does not receive investment commitments that meet its minimum target amount during the offering period. There also may be other circumstances in which an issuer chooses to cancel its offering.[461]

Some commenters suggested that investors should be able to transmit funds for an investment commitment through a mechanism such as those provided by Automated Clearing House ("ACH"), PayPal, Inc. or a linked bank account.[462] We are not proposing to limit or require a particular payment mechanism, so as to provide both intermediaries and investors with

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458 In a minimum-maximum offering, a minimum amount of securities must be sold within the offering period in order for a contingency to be satisfied, and the amount of securities sold may not exceed a pre-determined maximum. *See* Vim Funding Letter (suggesting that minimum and maximum offerings will allow issuers to focus on achieving "funding milestones" and the amount of funding they believe they need, while an "all or nothing" offering will likely incentivize issuers to seek smaller raises because of the possibility of failing at raising a larger amount). *Compare* AppleSeedz Letter (stating that an "all or nothing" offering would best protect investors). *See also* Section II.B.1.a.i(c) above for a discussion of the issuer's disclosure requirements about the use of proceeds in a minimum-maximum offering.

459 *See* proposed Rule 303(e)(3)(ii) of Regulation Crowdfunding.

460 *See* proposed Rule 303(e)(3)(iii) of Regulation Crowdfunding.

461 *See* proposed Rule 304(d) and discussion in Section II.C.6 below regarding offerings that are not completed.

462 *See* Vim Funding Letter (stating that investors should be able to authorize an intermediary to save investor banking information, in much the same way that consumers today can link a bank account to their online brokerage account); Arctic Island Letter (stating that funds should be transferred only to a bank in the United States).

flexibility in the means of payment, but we note that under the statute and the proposed rules, an intermediary that is a funding portal may not hold, manage, possess or otherwise handle investor funds or securities.[463] One commenter urged us not to permit the use of credit cards to fund an investment because investors could claim charge-backs[464] after a security is sold.[465] Two commenters[466] advocated permitting the use of credit cards for certain types of crowdfunding offerings, with one noting that this payment method involves customary Internet disclosures on the part of the investor.[467] Again, we are not proposing to limit payment mechanisms, but we note that an intermediary could, in its discretion, decline to accept certain payment methods, such as credit cards, or accept them only in certain circumstances.[468]

One commenter recommended that we prohibit purchases by an issuer or its officers, directors, control persons and other affiliates from counting toward meeting the target offering amount and obtaining a release of the funds held in escrow.[469] The commenter expressed concern that, without this prohibition, issuers that are unable to attract sufficient interest from unaffiliated investors could "game" the system by accepting affiliated investor funds in an

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463 *See* Exchange Act Section 3(a)(80)(D) [15 U.S.C. 78c(a)(80)(D)] and discussion in Section II.D.3 below.

464 In the United States, credit card customers have charge reversal rights under Regulation Z (12 CFR 226.13) of the Truth in Lending Act (15 U.S.C. 1666) and debit card holders are afforded such rights under Regulation E (12 CFR 205.6) of the Electronic Fund Transfer Act (15 U.S.C. 1693(b)).

465 *See* RocketHub Letter 1.

466 *See* City First Letter; RFPIA Letter 5.

467 *See* City First Letter.

468 We note that an investor's use of his or her right to dispute credit card charges could inhibit the ability of an issuer to meet its target or to provide accurate disclosures to investors and the Commission regarding the progress it has made toward, and whether it has, reached the target offering amount. This potential impact would affect offerings conducted through brokers and funding portals alike. We also note that pursuant to Exchange Act Section 3(a)(80)(D) (15 U.S.C. 78c(a)(80)(D)), a funding portal would be statutorily prohibited from extending credit or margin to customers.

469 *See* NASAA Letter.

offering that otherwise would have failed. We believe that this commenter's concern is reflected in the purpose and intent of the JOBS Act's crowdfunding provisions. In particular, we believe it would be contrary to the intent and purpose of the statute and the proposed rules to declare an offering "sold" on the basis of "*non-bona fide sales* designed to create the appearance of a successful completion of the offering."[470] As we have said in other contexts, non-bona fide purchases would include "purchases by the issuer through nominee accounts or purchases by persons whom the issuer has agreed to guarantee against loss."[471] Although we are not restricting directors and officers of an issuer from purchasing securities in an offering, we expect intermediaries to scrutinize any purchases by these individuals for "red flags," such as repeated investment commitments and cancellations, that would indicate that the purchase was designed to create an impression that the offering has reached, or will reach, its target amount.[472]

Several commenters urged us to adopt net capital standards for funding portals.[473] We are not proposing net capital standards for funding portals primarily because they are prohibited from handling, managing or possessing investor funds or securities. We believe that the requirements relating, in particular, to transmission of proceeds under the proposed rules would help ensure that investor funds are protected, without requiring funding portals to maintain net

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[470] *See Requirements of Rules 10b-9 and 15c2-4 under the Securities Exchange Act of 1934 Relating to Issuers, Underwriters and Broker-Dealers Engaged in an "All or None" Offering*, Release No. 34-11532, 7 S.E.C. Docket 403, 1975 WL 163128, at 1 (July 11, 1975).

[471] *Id.*

[472] Intermediaries are required to cancel an offering if they believe the issuer or offering presents the potential for fraud or otherwise raises concerns regarding investor protection. *See* proposed Rule 301(c)(2) of Regulation Crowdfunding and discussion in Section II.C.3 above.

[473] *See, e.g.*, Risingtidefunding.com Letter (stating that capital standards should be limited); Arctic Island Letter (stating that funding portals should be required to maintain net capital that is at least equivalent to that of broker-dealers that handle customer funds).

capital. We are, however, proposing to require funding portals to obtain fidelity bonds, as discussed below.[474]

Request for Comment

173. Are the proposed requirements for fund maintenance and transmission appropriate? Are there other types of custody arrangements that we should specifically permit? Why or why not? If so, what types of arrangements should we permit and how would they protect investor funds?

174. Should we prohibit any variations of a contingency offering, like minimum-maximum offerings? Why or why not? Should we require that offerings made in reliance on Section 4(a)(6) be conducted on an "all-or-none" basis? Why or why not?

175. Instead of a requirement to transmit funds "promptly," as proposed, should we establish fixed deadlines for transmission, such as three business days? Why or why not?

176. Should we expressly incorporate into the rules prior Commission, SRO and staff guidance regarding Exchange Act Rule 15c2-4 on, among other things: (1) the meaning of the phrase "distribution";[475] (2) the meaning of "prompt

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474 *See* discussion in Section II.D.1.c below.

475 *See, e.g., Baikie & Alcantara, Inc.*, Release No. 34-19410 (Jan. 6, 1983). *See also* Letter from Larry E. Bergmann, Assistant Director, Division of Market Regulation, Securities and Exchange Commission to Linda A. Wertheimer, Chairman, Subcommittee on Partnerships, Trusts and Unincorporated Associations, Federal Regulation of Securities Committee, American Bar Association (Oct. 16, 1984) (explaining that a "distribution" is any offering of securities, whether or not registered, that "is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods.").

transmittal";[476] (3) the payment mechanics for escrow arrangements;[477] (4) "receipt of offering proceeds" in the context of payment by check;[478] (5) "prompt deposit," as it applies to the use of segregated deposit accounts; and (6) specifics as to who could act as the "agent or trustee" maintaining the segregated deposit account?[479] Why or why not? Should any other specific guidance regarding Rule 15c2-4 be explicitly incorporated into the rules? Please explain.

177. Should we expand the definition of "qualified third party" to include entities other than a bank? Why or why not? If so, which ones? Please explain how other entities could adequately safeguard customers' funds and securities?

178. Should we require funding portals to maintain a certain amount of net capital? Why or why not? If so, what would be an appropriate amount, and how should that amount be determined?

179. Should we require or prohibit certain methods of payments for the purchase of securities under Section 4(a)(6)? Why or why not? Are there any particular concerns raised by different methods? Would it depend upon whether a broker-dealer or funding portal is facilitating the transaction? Why or why not?

f. Confirmation of Transaction

The proposed rules would require that an intermediary, at or before the completion of a transaction made pursuant to Section 4(a)(6), give or send to each investor a notification

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476 *See* NASD (n/k/a FINRA), Notice to Members 84-64 (Nov. 26, 1984). *See also* NASD, Notice to Members 84-7 (Jan. 30, 1984).

477 *Id.*

478 *See* NASD (n/k/a FINRA), Notice to Members 94-7 (Jan. 24, 1994).

479 *Id.*

disclosing: (1) the date of the transaction; (2) the type of security that the investor is purchasing; (3) the identity, price and number of securities purchased by the investor, as well as the number of securities sold by the issuer in the transaction and the price(s) at which the securities were sold; (4) certain specified terms of the security, if it is a debt or callable security; and (5) the source and amount of any remuneration received or to be received by the intermediary in connection with the transaction, whether from the issuer or from other persons.[480] This notification would be required to be provided by e-mail or other electronic media, and to be documented in accordance with applicable recordkeeping rules.[481] As the Commission has long stated, transaction confirmations serve an important and basic investor protection function by, among other things, conveying information and providing a reference document that allows investors to verify the terms of their transactions, acting as a safeguard against fraud and providing investors a means by which to evaluate the costs of their transactions.[482] Each of the transaction items of information proposed to be required is intended to assist investors in memorializing and assessing their transactions. The requirement for an intermediary to disclose to an investor the source and amount of any remuneration received or to be received should help to highlight potential conflicts of interest the intermediary may have.

An intermediary that gives or sends to each investor the notification described above would be exempt from the requirements of Exchange Act Rule 10b-10 for the subject

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480 *See* Proposed Rule 303(f)(1) of Regulation Crowdfunding. The statutory requirements for intermediaries do not expressly address an intermediary's obligation to provide investors confirmation of a transaction, but the statute provides us with authority to do so in our rules. *See* Section 4A(a)(12).

481 Intermediaries that are brokers would be subject to the recordkeeping requirements of Exchange Act Rules 17a-3 and 17a-4, and intermediaries that are funding portals would be subject to recordkeeping requirements under proposed Rule 404 of Regulation Crowdfunding.

482 *See Confirmation of Transactions*, Release No. 34-34962 (Nov. 10, 1994) [59 FR 59612, 59613 (Nov. 17, 1994)].

transaction.[483] The confirmation terms are similar to, but not as extensive as, those under Rule 10b-10. We believe that this difference is appropriate given the more limited scope of an intermediary's role in crowdfunding transactions. For example, Rule 10b-10 requires disclosure regarding such matters as payment for order flow,[484] riskless principal transactions,[485] payment of odd-lot differentials[486] and asset-backed securities.[487] These items generally would not be relevant to crowdfunding securities transactions or an intermediary's participation in such transactions, and their inclusion in a crowdfunding securities confirmation may be confusing to investors. We believe, therefore, that if an intermediary satisfies the notification requirements of the proposed rules, the intermediary would have provided investors with sufficient relevant information regarding the crowdfunding security, and so would not be required to meet the additional requirements of Rule 10b-10.

Request for Comment

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483 *See* proposed Rule 303(f)(2) of Regulation Crowdfunding. Exchange Act Rule 10b-10 (17 CFR 240.10b-10) generally requires a broker-dealer effecting a customer transaction in securities (other than U.S. savings bonds or municipal securities) to provide a notification to its customer, at or before completion of a securities transaction, that discloses certain information specific to the transaction. Specifically, Rule 10b-10 requires the disclosure of the date, time, identity, prices and number of securities bought or sold; the capacity in which the broker-dealer acted (*e.g.*, as agent or principal); yields on debt securities; and under specified circumstances, the amount of remuneration the broker-dealer will receive from the customer and any other parties. With regard to the specified circumstances mentioned above, the remuneration disclosures of Rule 10b-10 generally are required, but certain exclusions apply. For example, the remuneration disclosures are generally required where a broker or dealer is acting as agent for a customer or some other person. In the case where remuneration is received or to be received by the broker from such customer in connection with the transaction, the disclosures are not required where the remuneration paid by such customer is determined pursuant to written agreement with such customer, otherwise than on a transaction basis. 17 CFR 240.10b-10(a)(2)(i)(B). In contrast, the remuneration disclosures of proposed Rule 303(f)(2)(vi) would be required across all crowdfunding transactions where remunerations are received or are to be received. Given the limitations on the dollar amount of securities that could be offered, as well as the limits on individual investment amounts, in transactions relying on Section 4(a)(6), we would not expect investors or potential investors to negotiate individualized compensation agreements.

484 17 CFR 240.10b-10(a)(2)(i)(C).

485 17 CFR 240.10b-10(a)(2)(ii).

486 17 CFR 240.10b-10(a)(3).

487 17 CFR 240.10b-10(a)(7).

180. Are the proposed items of disclosure appropriate? Should we require more or less disclosure? Please explain. Should the disclosure items differ from those in Rule 10b-10? Are there any proposed disclosures that should be modified or deleted? Why or why not? If so, what different items should be included and why? Should the proposed notification requirements be deemed to be satisfied if an intermediary complies with Rule 10b-10? Why or why not? If we take this approach, would this confuse investors?

181. As mentioned above, we do not expect that investors would negotiate individualized compensation agreements with intermediaries in the crowdfunding context. Is this expectation appropriate? Why or why not? Should the proposed rules require disclosure of these arrangements, and if so, in a way that would be similar to or different from what is required under Rule 10b-10? Please explain.

6. Completion of Offerings, Cancellations and Reconfirmations

Section 4A(a)(7) requires an intermediary to allow investors to cancel their commitments to invest as the Commission shall, by rule, determine appropriate. As discussed above, Section 4A(b)(1)(G) requires issuers to provide investors, "prior to sale, . . . a reasonable opportunity to rescind the commitment to purchase the securities."

Commenters suggested a range of approaches to these statutory requirements. Some commenters favored a "rolling" rescission right, similar to the three business day rescission right provided in the Truth in Lending Act,[488] under which an investor could cancel an investment

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488 15 U.S.C. 1601 *et seq.*; 12 CFR 226.

commitment within 24[489] or 48 hours[490] of making the initial commitment. Other commenters suggested permitting investors to cancel their investment commitments at any time prior to a specified date. For example, one commenter recommended permitting investors to cancel a commitment for up to three days before the target date.[491] Another commenter suggested that an investor should be permitted to cancel a commitment until the moment that the target offering amount is reached, but not thereafter.[492] Another commenter recommended a ten-day window, after a target offering amount is met, during which investors could cancel a commitment to invest.[493] Another commenter recommended that an investor be permitted to cancel a commitment until the date the offering closes.[494] In contrast, one commenter recommended that

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489 *See* RocketHub Letter 1 (stating that: (1) a system could be used whereby commitments to invest would be considered "pending" for 24 hours, during which an investor would be able to cancel his or her investment commitment; after the 24-hour period expires, an investor's commitment status would be changed from "pending" to "committed," and the investor's funds would be held in escrow until transferred to the issuer; (2) if an offering did not reach its target offering amount before a specific deadline, an investor's funds should be returned; (3) a short rescission period will protect investors from "pump & dump" schemes and minimize an issuer's exposure to the risk of a funding "short fall"; (4) a longer rescission period is unnecessary because Title III requires a minimum offering period of 21 days, giving potential investors enough time to review an offering before making an investment commitment; and (5) because Title III contemplates that issuers could raise capital "greater than a target offering amount," the issuer also must establish an offering cap that would limit oversubscriptions).

490 *See* NCA Letter (stating that this will prevent commitments from being made solely for the purpose of attracting new investors (*i.e.*, "pumping" the offering) and that cancellation should be permitted when there is a change in investment terms or materially adverse information is subsequently disclosed).

491 *See* RFPIA Letter 3 (further stating that the Commission should impose penalties on issuers if they abuse this provision).

492 *See* Cera Technology Letter (stating that permitting investors to cancel a commitment to invest after the funding goal is reached could cause an entire fundraising round to collapse).

493 *See* Crowdfunding Offerings Ltd. Letter 2 (stating that funding portals should be permitted to have an open and closed period for rescinding a commitment to invest; that this option is necessary in the event that an investor cancels his or her commitment to invest during the window; and that a competitor could commit to invest and then cancel that commitment at a critical moment during the fundraising effort, causing the offering to fall short of the target offering amount).

494 *See* CFIRA Letter 9.

an investor be permitted to cancel a commitment only if the offering fails to meet the target amount or for other limited purposes.[495]

We believe that the principles underlying crowdfunding indicate that investors should have the full benefit of the views of other potential investors regarding offerings made in reliance on Section 4(a)(6), even after they have made investment commitments.[496] The proposed rules, therefore, would give investors an unconditional right to cancel an investment commitment for any reason until 48 hours prior to the deadline identified in the issuer's offering materials.[497] Under this approach, an investor could reconsider his or her investment decision with the benefit of the views of the crowd and other information, until the final 48 hours of the offering. Thereafter, an investor would not be able to cancel any investment commitments made within the final 48 hours (except in the event of a material change to the offering, as discussed below). We believe that the other approaches suggested by commenters, described above, could either terminate the cancellation right too early, so that investors would not be able to benefit from the views of the crowd and other information they obtain, or too late, so that the issuer would be subject to uncertainty as to whether it had met the target offering amount. We believe that the proposed rules strike an appropriate balance between giving investors the continuing benefit of the collective views of the crowd and then, if desired, to cancel their investment commitments, while providing issuers with certainty about their ability to close an offering at the end of the offering period.

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495 *See* Schwartz Letter.

496 *See, e.g.*, 158 CONG. REC. S5474-03 (daily ed. July 26, 2012) (statement of Sen. Jeff Merkley) ("Two important investor protections in the Crowdfund Act are the public review period and withdrawal rights. They are designed to allow investors the chance to carefully consider offerings, permitting the 'wisdom of the crowd' to develop, rather than perhaps just the 'excitement of the crowd.'").

497 *See* proposed Rule 304(a) of Regulation Crowdfunding.

Pursuant to the proposed rules, if an issuer reaches the target offering amount prior to the deadline identified in its offering materials, it may close the offering once the target offering amount is reached, provided that: (1) the offering will have remained open for a minimum of 21 days; (2) the intermediary provides notice about the new offering deadline at least five business days prior to the new offering deadline; (3) investors are given the opportunity to reconsider their investment decision and to cancel their investment commitment until 48 hours prior to the new offering deadline; and (4) at the time of the new offering deadline, the issuer continues to meet or exceed the target offering amount.[498] We believe these conditions are appropriate, as they would result in adequate notice being provided to investors and are consistent with the statutory provisions that offering materials are made available for at least 21 days before any securities can be sold to an investor,[499] that proceeds be provided to the issuer only once the target offering amount has been met[500] and that investors are provided an opportunity to cancel their commitments.[501]

If there is a material change to the terms of an offering[502] or to the information provided by the issuer regarding the offering, the proposed rules would require the intermediary to give or

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498 *See* proposed Rule 304(b) of Regulation Crowdfunding. Consistent with the cancellation provision for an offering that does not close prior to the deadline identified in its offering materials, an investor would not be able to cancel any investment commitments made within the final 48 hours prior to the new offering deadline (except in the event of a material change to the offering).

499 *See* Section 4A(a)(6).

500 *See* Section 4A(a)(7).

501 *See id.*

502 We note that in those instances where an issuer has previously disclosed in its offering materials only the method for determining the price of the securities offered and not the final price of those securities, setting of the final price would be considered a material change. *See* Section II.B.2 above. We also note if the material change is to close the offering once the target offering amount is reached, which would be prior to the deadline identified in the offering materials, then the procedures required under proposed Rule 304(b), and not 304(c), would apply. *See* discussion in this Section II.C.6 above.

send to any potential investors who have made investment commitments notice of the material change, stating that the investor's investment commitment will be cancelled unless the investor reconfirms his or her commitment within five business days of receipt of the notice.[503] We recognize that complying with this requirement could result in certain offerings being extended beyond the offering period specified in the offering statement. If the investor fails to reconfirm his or her investment within those five business days, the proposed rules would require an intermediary, within five business days thereafter, to: (1) provide or send the investor a notification disclosing that the investment commitment was cancelled, the reason for the cancellation and the refund amount that the investor should expect to receive; and (2) direct the refund of investor funds. We believe that when material changes arise during the course of an offering, an investor who had made a prior investment commitment should have a reasonable period during which to review the new information and to decide whether to invest. This notification would be required to be provided by e-mail or other electronic media, and to be documented in accordance with applicable recordkeeping rules.[504]

Finally, if an issuer does not complete an offering because the target is not reached or the issuer decides to terminate the offering, the proposed rules would require an intermediary, within five business days, to: (1) give or send to each investor who had made an investment commitment a notification disclosing the cancellation of the offering, the reason for the cancelation, and the refund amount that the investor should expect to receive; (2) direct the refund of investor funds; and (3) prevent investors from making investment commitments with

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503 *See* proposed Rule 304(c)(1) of Regulation Crowdfunding.

504 Intermediaries that are brokers would be subject to the recordkeeping requirements of Exchange Act Rules 17a-3 and 17a-4, and intermediaries that are funding portals would be subject to recordkeeping requirements under proposed Rule 404 of Regulation Crowdfunding.

respect to that offering on its platform.[505] This notification would be required to be provided by e-mail or other electronic media, and to be documented in accordance with applicable recordkeeping rules.[506]

Request for Comment

182. Are the proposed requirements for cancellations and notifications appropriate? Why or why not? Should investors be permitted to withdraw commitments at any time until the offering closes? Should investors be provided with additional time to cancel their commitments after the closing of the offering if the commitment was made within 48 hours of the offering deadline? Would some time period other than 48 hours be more appropriate? Do the proposed rules, whereby an investor cannot cancel commitments made within 48 hours of the offering deadline, strike the appropriate balance between (1) giving investors the ability to cancel commitments in light of new views expressed in the crowd and (2) providing issuers with certainty about their ability to close an offering by meeting the target offering amount? Please explain. What are the advantages and disadvantages of any alternative time period? Should no new investment commitments be permitted after a date that is two full business days prior to the beginning of the 48-hour period when investments are no longer cancellable? Why or why not?

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505 *See* proposed Rule 304(d) of Regulation Crowdfunding.

506 Intermediaries that are brokers would be subject to the recordkeeping requirements of Exchange Act Rules 17a-3 and 17a-4, and intermediaries that are funding portals would be subject to recordkeeping requirements under proposed Rule 404 of Regulation Crowdfunding.

183. Should an investor be required to reconfirm his or her commitment to invest when a material change has occurred? Why or why not? Is the five business day period for reconfirmation after material changes appropriate? Would another time period be more appropriate? If so, what time period and why?

184. The proposed rules provide a mechanism by which existing disclosure materials can be modified in the event of a material change, with the original offering remaining open. Should the proposed rules require that an offering be cancelled in the event of a material change, and then, if the issuer desires, reopened in a new offering that includes the revised disclosure? Why or why not?

185. Are there any other circumstances under which an investor should receive a notification? If so, under what other circumstances? Should we provide further specificity on when notifications must be provided?

186. Under the proposed rules, in the event of a cancellation an intermediary would be required to provide a notice to prospective investors within five business days. Is this requirement appropriate? Should the time period be longer or shorter, such as 3 business days or 10 business days? Why or why not? Should we include any other notification requirements in the event an offering is canceled? If so, what requirement should we include and why?

7. Payments to Third Parties

Section 4A(a)(10) provides that an intermediary in a transaction made in reliance on Section 4(a)(6) shall not compensate "promoters, finders, or lead generators for providing the broker or funding portal with the personal identifying information of any potential investor."

One commenter noted that the terms "promoters," "finders" and "lead generators" are not defined in the statute.[507] The commenter also expressed concern that promoters, finders and lead generators could provide a broker or funding portal with potential investors' personally identifiable information as long as the broker or funding portal did not directly compensate them.[508]

Another commenter stated that "personal identifying information" should be clearly defined.[509] While agreeing that funding portals should not be permitted to compensate third parties for personally identifiable information of potential investors, the commenter asserted that funding portals, but not registered brokers, should be allowed to compensate promoters, finders or lead generators for directing potential issuers or investors to view either the portal itself or specific offerings.[510] The commenter further stated that revenue sharing arrangements should not be restricted when these relationships are not promoter-, finder- or lead generator-based.[511]

The proposed rules would broadly prohibit an intermediary from compensating any person for providing it with the personally identifiable information of any investor or potential investor.[512] The term "personally identifiable information" would be defined to mean any information that can be used to distinguish or trace an individual's identity, either alone or when combined with other personal or identifying information that is linked or linkable to a specific

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507 *See* Crowdfunding Offerings Letter 2.

508 *See id.* (stating that there could be circumstances in which a third party stands to gain in some way by a successful crowdfunding effort).

509 *See* RocketHub Letter 1.

510 *See id.*

511 *See id.*

512 *See* proposed Rule 305(a) of Regulation Crowdfunding.

individual.[513] Personally identifiable information could include, for example, any information, such as name, social security number, date or place of birth, mother's maiden name or biometric records, that can be used to identify an individual, as well as any other information that is linked directly to an individual, such as financial, employment, educational or medical information. We believe that any person compensated for providing the personally identifiable information of potential investors would be acting as a promoter, finder or lead generator within the meaning of Section 4A(a)(10). Thus, the proposed rules would prohibit compensation broadly to "any person."

The proposed rules would, however, permit an intermediary to compensate a person for directing issuers or potential investors to the intermediary's platform if (1) the person does not provide the intermediary with the personally identifiable information of any potential investor, and (2) the compensation, unless it is paid to a registered broker or dealer, is not based, directly or indirectly, on the purchase or sale of a security offered in reliance on Section 4(a)(6) on or through the intermediary's platform.[514] The proposed rules would not permit a funding portal to compensate third parties by commission or other transaction-based compensation unless that third party is a registered broker or dealer and thereby subject to an established regulatory and

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513 See proposed Rule 305(c) of Regulation Crowdfunding. The proposed definition is consistent with those used in other government agency reports that discuss strategies for protecting personally identifiable information. *See, e.g.*, Government Accountability Office ("GAO"), *Privacy: Alternatives Exist for Enhancing Protection of Personally Identifiable Information*, GAO-08-536, at 1 n.1 (May 2008); GAO, *Information Security: Protecting Personally Identifiable Information,* GAO-08-343, at 5 n.9 (Jan. 2008). *See also* Erika McCallister, Tim Grance and Karen Scarfone, *Guide to Protecting the Confidentiality of Personally Identifiable Information (PII): Recommendations of the National Institute of Standards and Technology*, U.S. Department of Commerce, National Institute of Standards and Technology, Special Publication 800-122, at ES-1 (Apr. 2010).

514 *See* proposed Rule 305(b) of Regulation Crowdfunding. We note that the receipt of direct or indirect transaction-based compensation would strongly indicate that the recipient is acting as a broker. As such, the party receiving the compensation in the scenario described needs to consider whether it would be required to register as a broker

oversight regime that provides important safeguards to investors. We believe that the prohibition on transaction-based compensation in the proposed rules would help to remove the incentive for high-pressure sales tactics and other abusive practices.[515] Under the proposed rules, an intermediary could pay a person a flat fixed fee[516] to direct other persons to the intermediary's platform through, for example, hyperlinks or search term results, if the intermediary received no personally identifiable information. Although the statute is clear that an intermediary cannot pay for the personally identifiable information of potential investors, we do not believe Congress intended to disrupt current practices, such as paying for advertising based on Internet search rankings. It would be acceptable under the proposed rules, therefore, for an intermediary to make payments to advertise its existence, provided that in doing so, it does not pay for the personally identifiable information of investors or potential investors.[517]

Request for Comment

187. Should we permit an intermediary to compensate a third party for directing potential investors to the intermediary's platform under the limited circumstances described above? Why or why not? Should any disclosures be

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515 *See Persons Deemed Not to Be Brokers,* Release No. 34-22172 (June 27, 1985) [50 FR 27,940, 27942 (July 9, 1985)] ("Compensation based on transactions in securities can induce high pressure sales tactics and other problems of investor protection that require application of broker-dealer regulation."). *See also* 158 CONG. REC. S5474-03 (daily ed. July 26, 2012) (statement of Sen. Jeff Merkley) ("[T]he limitation on off-platform advertising is intended to prohibit issuers—including officers, directors, and 20 percent shareholders—from promoting or paying promoters to express opinions outside the platform that would go beyond pointing the public to the funding portal. Such paid testimonials and manufactured excitement would represent a prohibited form of off-site advertising if those disclosures were not present. Whether on or off the platform, paid advertising must clearly be disclosed as such. In short, the investor deserves a transparent medium for making healthy decisions.").

516 A flat fixed fee is one that is not based on the success of the offering, and so would not be transaction-based compensation. As noted above, receipt of transaction-based compensation would strongly indicate that the recipient is acting as a broker, and the party receiving this kind of compensation needs to consider whether it would be required to register as a broker.

517 *See also* proposed Rule 402 of Regulation Crowdfunding and discussion in Section II.D.3 below.

required? Why or why not? Please identify reasonable alternatives to this approach, if any.

188. What other concerns may be relevant in the context of third parties referring others to intermediaries, and how could they be addressed? For example, should compensation be limited in some additional way? Please explain.

D. Additional Requirements on Funding Portals

1. Registration Requirement

a. Generally

Securities Act Section 4A(a)(1) requires that an intermediary facilitating a transaction made in reliance on Section 4(a)(6) register with the Commission as a broker or a funding portal. The statute does not, however, prescribe the manner in which a funding portal would register with the Commission.[518] Securities Act Section 4A(a)(12) requires intermediaries to comply with requirements as the Commission may, by rule, prescribe for the protection of investors and in the public interest. Exchange Act Section 3(h)(1)(C) also permits us to impose, as part of our authority to exempt funding portals from broker registration, "such other requirements under [the Exchange Act] as the Commission determines appropriate."

Some commenters asked specifically for clarification on the nature of a funding portal's registration requirements.[519] One commenter suggested that we permit a funding portal to have

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518 *Compare* Exchange Act Section 15(b) [15 U.S.C. 78*o*(b)] (prescribing the manner of registration of broker-dealers).

519 *See* NSBA Letter; RocketHub Letter 1. *See also* Applied Dynamite Letter (stating that the requirements for those who wish to be intermediaries in offerings pursuant to Rule 506 of Regulation D should be harmonized with those for funding portals, and that we should provide for a common registration process for the two). We note, however, that Securities Act Section 4(b)(1) provides an exemption from broker-dealer registration for certain portals facilitating transactions pursuant to Rule 506 of Regulation D, as revised by Section 201 of the JOBS Act.

multiple intermediary websites under a single registration application.[520] The commenter argued that this will permit a registered funding portal to offer issuers the opportunity to offer their securities on a funding portal website that is specific as to parameters such as industry, geography, community and affinity group, which would result in a better organized market for both issuers and investors.

One commenter asked us to consider the creation of a "Registered Portal-Check," similar to the BrokerCheck system maintained by FINRA, to provide greater transparency to participants in Section 4(a)(6) transactions.[521] Another commenter asked us to require that funding portals, like issuers engaged in crowdfunding transactions in reliance on Section 4(a)(6), be organized under and subject to the laws of a State or territory of the United States or the District of Columbia.[522]

We are proposing to establish a streamlined registration process under which a funding portal would register with the Commission by filing a form with information consistent with, but less extensive than, the information required for broker-dealers on Form BD.[523] Under the proposed rules, a funding portal would register by completing a Form Funding Portal, which includes information concerning the funding portal's principal place of business, its legal

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520 *See* NCA Letter.

521 *See* CFIRA Letter 2 (further stating that the system should "clearly identify the registration status of a funding portal and its management, display any regulatory actions against such portal and provide a hyperlink to its website").

522 *See* Liles Letter 2 (stating that this requirement would strengthen the ability of the Commission and other U.S. authorities to make surprise audits or investigations of, or bring enforcement action against, a funding portal).

523 *See* 158 CONG. REC. S2230-31 (daily ed. Mar. 29, 2012) (statement of Sen. Scott Brown) ("As the Securities and Exchange Commission works to implement this new law, it is my hope that it will recognize that the funding portal registration process is meant to be more streamlined and less burdensome than traditional broker-dealer registration"); 158 CONG. REC. S1817-29 (daily ed. Mar. 20, 2012) (statement of Sen. Jeff Merkley) ("Our amendment provides two pathways: The first pathway is for a portal to register as a broker-dealer. The second is streamlined funding portal registration.").

organization and its disciplinary history, if any; business activities, including the types of compensation the funding portal would receive; control affiliates of the funding portal and disclosure of their disciplinary history, if any; FINRA membership or membership with any other registered national securities association; and the funding portal's website address(es) or other means of access.[524] We also are proposing, as discussed in greater detail below, not to permit nonresident entities to register as funding portals unless they comply with certain conditions designed to provide the Commission and FINRA (or any other registered national securities association) with appropriate tools for supervising such entities.

The funding portal's registration would become effective the later of: (1) 30 calendar days after the date that the registration is received by the Commission; or (2) the date the funding portal is approved for membership in FINRA or any other registered national securities association. This approach is intended to help ensure that a funding portal is subject to regulation by the Commission and FINRA or any other national securities association before it can engage in business with the public.

We also are proposing to require a funding portal to file an amendment to Form Funding Portal within 30 days of any of the information previously submitted on Form Funding Portal becoming inaccurate for any reason.[525]

The proposed rules would permit a funding portal that succeeds to and continues the business of a registered funding portal to also succeed to the registration of the predecessor on

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[524] *See* proposed Rule 400(a) of Regulation Crowdfunding. We discuss below the information required to be included in the form.

[525] *See* proposed Rule 400(b) of Regulation Crowdfunding. A similar process exists for registered broker-dealers under Exchange Act Rule 15b3-1 (17 CFR 240.15b3-1).

Form Funding Portal.[526] The registration would be deemed to remain effective as the registration of the successor, if the successor, within 30 days after such succession, files a registration on Form Funding Portal and the predecessor files a withdrawal on Form Funding Portal.[527] The rule would further provide that, if succession is based solely on a change of the predecessor's date or state of incorporation, form of organization or composition of a partnership, the successor may, within 30 days after the succession, amend the notice registration of the predecessor on Form Funding Portal to reflect these changes. Form Funding Portal would require the successor to provide certain information, such as the name and Commission file number of the predecessor. The successor also would be required to briefly describe details of the succession, including any assets or liabilities not assumed by the successor.

The proposed rules are intended to provide an efficient registration mechanism for a person that becomes a successor to a funding portal.[528] The provisions on succession are intended to be used only when there is a direct and substantial business nexus between the predecessor and the successor.[529] The proposed rules would not be designed for use by a funding portal in order to sell its registration, eliminate substantial liabilities, spin off personnel or facilitate the transfer of a "shell" organization that does not conduct a funding portal business. To require that there be a legitimate connection between the predecessor and the successor, the

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526 *See* proposed Rule 400(c) of Regulation Crowdfunding.

527 Under the proposed rules, the registration of the predecessor funding portal would be deemed withdrawn 45 days after the notice registration on Form Funding Portal is filed by the successor. A similar process exists for registered broker-dealers under Exchange Act Rule 15b1-3 (17 CFR 240.15b1-3).

528 We are proposing to treat funding portal successions in a manner consistent with broker-dealer successions. *See Registration of Successors to Broker-Dealers and Investment Advisers*, Release No. 34-31661 (Dec. 28, 1992) [58 FR 7 (Jan. 4, 1993)].

529 We are proposing that a direct and substantial nexus exist between a predecessor and successor funding portal to be consistent with the applicable rules for broker-dealer successions.

instructions to the proposed Form Funding Portal would limit the term "successor" to an entity that assumes or acquires substantially all of the assets and liabilities of the predecessor funding portal's business. In addition, the proposed rule would not apply where the predecessor funding portal intends to continue to engage in funding portal activities.[530]

In certain circumstances, the proposed rule would allow the successor to file an amendment to the predecessor's Form Funding Portal. Successions by amendment would be limited to those successions that result from a formal change in the structure or legal status of the funding portal but do not result in a change in control.[531] Assuming that there is no change in control, succession by amendment would be available for changes in the form of organization, in legal status and in composition of a partnership.

In all other successions, the successor would be able to operate under the registration of the predecessor for a limited period of time only if it files its own completed application for registration on Form Funding Portal within 30 days after such succession. Examples of the types of successions that would require this type of application filing would include, but not be limited to, acquisitions and consolidations.

The proposed rules would require a funding portal to promptly file a withdrawal of registration on Form Funding Portal upon ceasing to operate as a funding portal.[532] The withdrawal would be effective on the later of 30 days after receipt by the Commission, after the funding portal is no longer operational, within such longer period of time as to which the funding portal consents or within such period of time as to which the Commission, by order, may

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530 *See* proposed Rule 400(c)(1) of Regulation Crowdfunding, which requires the predecessor funding portal to file a withdrawal on Form Funding Portal as a condition of the successor registration.

531 *See* proposed Rule 400(c)(2) of Regulation Crowdfunding.

532 *See* proposed Rule 400(d) of Regulation Crowdfunding.

determine as necessary or appropriate in the public interest or for the protection of investors.[533] This delaying provision would provide time to evaluate whether a withdrawal is the result of a legitimate winding down of a funding portal's business or whether there are additional factors to consider in connection with the funding portal's withdrawal that are relevant to the protection of investors. Based on such information, we would determine whether any actions, including enforcement proceedings, should be taken against the withdrawing funding portal.

The proposed rules[534] provide that each application for registration, amendment thereto, successor registration or withdrawal would be considered filed when a complete Form Funding Portal is submitted with the Commission or its designee. The proposed rules also require duplicate originals of the application to be filed with surveillance personnel designated by the registered national securities association of which the funding portal is a member.

Under the approach to registration that we are proposing, and as described by the requirements of proposed Form Funding Portal (discussed below), a funding portal would be able to operate multiple website addresses under a single funding portal registration, provided the funding portal discloses on Form Funding Portal all the websites and names under which it does business. Allowing for multiple website addresses might allow a funding portal to customize each address to fit its specific needs, such as appealing to certain industries or investors while reducing regulatory costs. We recognize that permitting multiple website addresses by a single registrant could result in investors being confused about the identity of the registrant. We

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533 A similar process exists for registered broker-dealers under Exchange Act Section 15(b)(5) (15 U.S.C. 78*o*(b)(5)) and Rule 15b6-1 (17 CFR 240.15b6-1) thereunder.

534 *See* proposed Rule 400(e) of Regulation Crowdfunding.

believe, however, that the potential for confusion is justified by the value of the additional flexibility afforded to intermediaries.[535]

One commenter requested that we implement a system similar to the BrokerCheck system operated by FINRA for registered funding portals.[536] We are not proposing that the Commission create such a system at this time because, as discussed below, the information in a funding portal's completed Form Funding Portal would be available for public viewing through the Commission's website or other such electronic system, as determined by the Commission in the future, subject to the redaction of certain personally identifiable information, or other information with a significant potential for misuse, of the contact person(s) or other identified individuals of the funding portal.

Request for Comment

189. Is the proposed method for registration appropriate? Why or why not? Are there methods that would be less burdensome to potential funding portals while not impairing investor protection? If so, what are those methods?

190. Should we impose other restrictions or prohibitions on affiliations of the funding portal, such as affiliation with a registered broker-dealer or registered transfer agent? If so, what are they and why?

191. Should the Commission, as proposed, permit a funding portal to have multiple intermediary websites under a single registration application? Why or why not?

b. Form Funding Portal

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535 We note that brokers are currently required to prominently disclose in any retail communications their name, or the name under which their broker-dealer business is primarily conducted as disclosed on their registration form. *See* FINRA Rule 2210(d)(3).

536 *See* CFIRA Letter 2.

A funding portal seeking to register with the Commission would need to file a completed Form Funding Portal with the Commission.[537] We propose to make a blank Form Funding Portal available through the Commission's website or such other electronic database, as determined by the Commission in the future.

To access the registration system and enter information on Form Funding Portal, a funding portal would have to first establish an account and obtain credentials (*i.e.*, username and password). We propose that an applicant would need to fill out general user information fields, including name, address, phone number, e-mail address, organization name and employer identification number, and user account information (*i.e.*, username and password), and select and answer a security question. Once accepted by the registration system, the applicant would receive an e-mail notification that the account has been established, and the applicant would be able to access and complete Form Funding Portal. We anticipate that applicants ordinarily would obtain access credentials the same day that they are requested.

In order to complete Form Funding Portal, a funding portal would be required to check a box indicating the purpose for which the funding portal is filing the form:

- to register as a funding portal with the Commission, through an initial application;
- to amend any part of the funding portal's most recent Form Funding Portal, including a successor registration; or
- to withdraw from registration as a funding portal with the Commission.

If the funding portal is submitting an amendment or withdrawing from registration, it also would be necessary to provide the Commission file number assigned to the funding portal at the

537 *See* proposed Rule 400(a) of Regulation Crowdfunding.

time of its initial application to register. This information would be used to cross-reference amendments and withdrawals to the original registration, thus allowing Form Funding Portal to be used for the initial application to register, amendments to registration and withdrawal from registration.

We intend proposed Form Funding Portal to be a streamlined version of Form BD. We believe Form BD is an appropriate model for Form Funding Portal, because funding portals are limited purpose brokers that are conditionally exempt from registration as broker-dealers. There are certain questions on Form BD that we believe are not applicable to funding portals. For example, a funding portal is prohibited from holding or maintaining customer funds or securities; therefore, proposed Form Funding Portal, unlike Form BD, does not include any questions about holding customer funds and securities. Funding portals also are restricted in their activities in ways that broker-dealers are not; thus, proposed Form Funding Portal includes particular questions that address these differences. For example, because a funding portal is prohibited from holding and maintaining customer funds, proposed Form Funding Portal would request information about a funding portal's escrow arrangements. As funding portals also are subject to certain compensation restrictions, Form Funding Portal would require a description of the funding portal's compensation arrangements.

Form Funding Portal seeks to strike a balance between efficiency in completing the form and requesting sufficient information from funding portals. The proposed form consists of eight sections, including items related to: identifying information, form of organization, successions, control persons, disclosure information, non-securities related business, escrow, and compensation arrangements, and withdrawal. These items would require an applicant to provide certain basic identifying and contact information concerning its business; list its direct owners and executives; identify persons that directly or indirectly control the funding portal, control the management or policies of the funding portal and persons the funding portal controls; and supply information about its litigation and disciplinary history and the litigation and disciplinary history of its associated persons.[538] In addition, an applicant would be required to describe any non-securities related business activities and supply information about its escrow arrangements, compensation arrangements with issuers and fidelity bond.[539] Upon a filing to withdraw from registration, a funding portal would be required to provide certain books and records information. In addition, as discussed in detail below,[540] applicants that are incorporated in or organized under the laws of a jurisdiction outside of the United States or its territories, or whose principal place of business is not in the United States or its territories, would be required to complete Schedule C to Form Funding Portal, which requires information about the applicant's arrangements to have an agent for service of process in the United States, as well as an opinion of counsel addressing the ability of the applicant to provide the Commission and the national securities association of which it is a member with prompt access to its books and records and to submit to onsite inspection and examination by the Commission and the national securities association.

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538 This information would be used to determine whether to approve an application for registration, to decide whether to revoke registration, to place limitations on the applicant's activities as a funding portal and to identify potential problem areas on which to focus during examinations. If an applicant or its associated person has a disciplinary history, then the applicant could be required to complete the appropriate Disclosure Reporting Page ("DRP"), either Criminal, Regulatory, Civil Judicial, Bankruptcy, Bond or Judgment.

539 *See* Section II.D.1.c. below.

540 *See* Section II.D.1.d. below.

We propose that a person duly authorized to bind the funding portal be required to sign Form Funding Portal in order to execute the documents.[541] A person executing Form Funding Portal and Schedule C (if applicable) would be required to represent that the person has executed the form on behalf of, and is duly authorized to bind, the funding portal; the information and statements contained in the form and other information filed are current, true and complete; and if the person is filing an amendment, to the extent that any information previously submitted is not amended, such information is currently accurate and complete.[542] The funding portal also would be required to consent that service of any civil action brought by, or notice of any proceeding before, the Commission or any national securities association of which it is a member, in connection with the funding portal's investment-related business, may be given by registered or certified mail to the funding portal's contact person at the main address, or mailing address, on the form.[543]

We believe that this information is important for our oversight of funding portals, including, among other things, assessing a funding portal's application and performing examinations of funding portals, and that it is pertinent to investors and issuers. We propose to make all current Forms Funding Portal, including amendments and registration withdrawal requests, immediately accessible and searchable by the public, with the exception of certain personally identifiable information or other information with significant potential for misuse (including the contact employee's direct phone number and e-mail address and any IRS Employer Identification Number, social security number, date of birth, or any other similar

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541 *See* execution statement of proposed Form Funding Portal.

542 *See id.*

543 *See id.*

information).[544] Making these documents publicly available and searchable would enhance transparency of the registration process and the funding portal industry as it develops, while the limited redactions would appropriately protect the privacy of the individuals involved.

Request for Comment

192. What type of web-based registration should the Commission use for accessing Form Funding Portal? Would a system like EDGAR be appropriate, or would a different type of system be preferable? Why?

193. Should we consider alternatives to creating a new form for funding portal registration? Should we amend the existing Form BD to provide for funding portal registration? Why or why not? Which questions on Form BD would be relevant to funding portals and why? Are there other questions we should include for funding portals that are not on the proposed Form Funding Portal or in existing Form BD? If so, which questions and why?

194. Are there types of information (other than personally identifiable information) required by proposed Form Funding Portal that should not be made readily accessible to the public? If so, what types of information and why?

195. Should we require the identifying and contact information requested on Form Funding Portal, or should it be modified in any way? Should additional information be required? If so, which information and why?

196. Are the proposed disclosures in Form Funding Portal unduly burdensome? Are there certain requirements that should be eliminated or modified? Which

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544 *See* the proposed Instructions to Form Funding Portal.

requirements and why? Would such changes be consistent with investor protection?

197. Should proposed Form Funding Portal be modified to request from funding portals a narrative description of their compliance programs and due diligence procedures with respect to issues? Would some other form of reporting be more useful? Why or why not?

198. Are the proposed representations required of a person who executes Form Funding Portal appropriate? Should the Commission require attestations? If so, from whom?

199. Should we require any other information from a funding portal that is withdrawing from registration?

c. Fidelity Bond

The proposed rules would require, as a condition of registration, that a funding portal have in place, and thereafter maintain for the duration of such registration, a fidelity bond[545] that: (1) has a minimum coverage of $100,000; (2) covers any associated person of the funding portal unless otherwise excepted in the rules set forth by FINRA or any other registered national securities association of which it is a member; and (3) meets any other applicable requirements, as set forth by FINRA or any other registered national securities association of which it is a member.[546]

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545 A fidelity bond is a type of insurance that aims to protect its holder against certain types of losses, including but not limited to those caused by the malfeasance of the holder's officers and employees, and the effect of such losses on the holder's capital. *See* Release No. 34-63961 (Feb. 24, 2011) [76 FR 11542 (Mar. 2, 2011)].

546 *See* proposed Rule 400(f) of Regulation Crowdfunding.

Although not mandated by the statute, we believe that a fidelity bond requirement 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. This is a meaningful protection because funding portals would not be members of the Securities Investor Protection Corporation ("SIPC"). If a firm is a SIPC member and goes out of business, then the cash and securities held for each customer by that firm are generally protected up to $500,000, including a $250,000 limit for cash.[547] Because funding portals are non-SIPC members,[548] funding portal customers would not receive this SIPC protection. Furthermore, given that we are not proposing to require, pursuant to our discretionary authority, that funding portals be subject to minimum net capital requirements, a fidelity bond would provide a single layer of protection, in the event of such losses. While the proposed rule imposes this requirement as a condition to registration, we anticipate that, like the fidelity bond requirement registered broker-dealers are currently subject to pursuant to SRO rules, specific requirements of the fidelity bond for funding portals would be set forth in rules of FINRA or any other registered national securities association. In recognition of the limits on the amounts investors may invest, and the amounts issuers may raise, through crowdfunding, as provided in Section 4(a)(6), we propose to require that funding portals' fidelity bonds have an amount of coverage that is equivalent to the minimum amount of coverage

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547 *See* the Securities Investor Protection Act of 1970, Pub. L. No. 91-598 (1970).

548 Membership in SIPC applies only to persons registered as brokers or dealers under Section 15(b) of the Exchange Act. *See* 15 U.S.C. 78ccc(a)(2).

registered broker-dealers are required to have under FINRA Rule 4360, which is $100,000.[549] Furthermore, we believe that fidelity bond coverage would be most effective if it covers actions by not only the funding portal entity, but also all of its associated persons.

Request for Comment

200. Is it appropriate for us to require a funding portal to have a fidelity bond? Why or why not?

201. With respect to the fidelity bond requirement, is the proposed coverage of $100,000 appropriate for funding portals? If not, what other amount or formula for calculating the required amount would be more appropriate and why?

202. Is it appropriate to require the fidelity bond to cover associated persons of the funding portal? Why or why not?

203. Are there other specific terms of a fidelity bond that we should consider requiring? If so, what terms and why?

204. Apart from requiring a funding portal to have a fidelity bond, is there some other requirement that could be imposed on funding portals, like insurance or something similar to SIPC, which would further protect investors? If so, what type of requirement and why?

d. Requirements for Nonresident Funding Portals

Although there is no statutory requirement that funding portals be domestic entities, we are mindful of our ability to effectively oversee this new category of registrants – as well as more

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549 *See* FINRA Rule 4360. Introducing brokers, like funding portals, do not hold customer funds and securities. Introducing brokers are required to maintain a minimum bond of $100,000 under current SRO rules, and we are proposing the same minimum amount for funding portals.

generally the development of the new crowdfunding market and role of intermediaries in that market – given the greater challenges entailed in supervising, examining, and enforcing the requirements that would be applicable to activities of intermediaries based outside the United States.[550] At the same time, we recognize that the use of funding portals located outside the United States could provide more choices for U.S. issuers seeking to engage an intermediary to facilitate a crowdfunding offering, and potentially expand those issuers' access to investors located abroad. In seeking to strike an appropriate balance among these considerations, we propose not to permit nonresident entities to register as funding portals unless they comply with certain conditions designed to provide the Commission and FINRA (or any other registered national securities association) with appropriate tools for supervising such entities.

Under the proposed rules, registration pursuant to Rule 400 of Regulation Crowdfunding by a nonresident funding portal (a funding portal incorporated in or organized under the laws of any jurisdiction outside of the United States or its territories, or having its principal place of business outside the United States or its territories)[551] would be first conditioned upon there being an information sharing arrangement in place between the Commission and the competent regulator in the jurisdiction under the laws of which the nonresident funding portal is organized or where it has its principal place of business that is applicable to the nonresident funding portal. The proposed rules would further require a nonresident funding portal to (1) obtain a written consent and power of attorney appointing an agent for service of process in the United States (other than the Commission or a Commission member, official or employee), upon whom may

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550 The exemption under Section 4(a)(6) is not available for a transaction involving the offer or sale of securities by an issuer that is not organized under and subject to the laws of a State or territory of the United States or the District of Columbia. *See* Section 4A(f), discussed in Section II.A.3 above.

551 *See* proposed Rule 400(g)(1) of Regulation Crowdfunding.

be served any process, pleadings, or other papers in any action; (2) furnish the Commission with the name and address of its agent for services of process on Schedule C of Form Funding Portal; (3) certify that it can, as a matter of law, provide the Commission and any national securities association of which it is a member with prompt access to its books and records and can, as a matter of law, submit to onsite inspection and examination by the Commission; and (4) provide the Commission with an opinion of counsel and certify on Schedule C on Form Funding Portal that the firm can, as a matter of law, provide the Commission and such national securities association with prompt access to its books and records and can, as a matter of law, submit to onsite inspection and examination by the Commission and the national securities association.[552]

In general, the requirements for nonresident funding portals that we are proposing are consistent with those we have proposed for other nonresident entities subject to our regulation.[553] These requirements aim to ensure that funding portals that are not based in the United States, or that are subject to laws other than those of the United States, would nevertheless be accessible to us and other relevant regulators for purposes of accessing the books and records of, conducting examinations and inspections of, and enforcing U.S. laws and regulations with respect to, these entities.

Requirements for a nonresident funding portal to obtain an agent for service of process in the United States, and to furnish the Commission with the name and address of this agent, are

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552 *See* proposed Rule 400(g) of Regulation Crowdfunding. Exchange Act Section 3(h)(1)(C) permits us to impose, as part of our authority to exempt funding portals from broker registration, "such other requirements under [the Exchange Act] as the Commission determines appropriate."

553 *See, e.g., Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants*, Release No. 34-65543 (Oct. 12, 2011) [76 FR 65784 (Oct. 24, 2011)], at 65799 – 65801. *See also Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants*, Release No. 34-69490 (May 1, 2013) [78 FR 30968 (May 23, 2013)].

important to facilitate enforcement of the federal securities laws and the rules thereunder by the Commission and others (*e.g.*, the U.S. Department of Justice and any other agency or entity with law enforcement authority). The proposed rules also would require a registered nonresident funding portal to promptly appoint a successor agent if it discharges its identified agent for service of process or if its agent for service of process is unwilling or unable to accept service on its behalf. A registered funding portal must promptly amend Schedule C to its Form Funding Portal if its agent, or the agent's name or address, changes. Finally, the proposed rules would require the registered nonresident funding portal to maintain, as part of its books and records, the agreement with the agent for service of process for at least three years after termination of the agreement.

The proposed rules would require that each nonresident funding portal provide an opinion of counsel and certify, as a matter of law, that it can provide the Commission, and the national securities association of which it is a member, with prompt access to its books and records and submit to onsite inspections and examinations. We believe that this proposed certification and supporting opinion of counsel are important to confirm that each nonresident funding portal is in the position to provide the Commission and the national securities association with information that is necessary for us and the national securities association to effectively fulfill our regulatory oversight responsibilities.[554] Commenters have previously brought to our attention that it may conflict with the laws of certain jurisdictions to provide such an opinion.[555] Failure to make this

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554 *See* Exchange Act Section 3(h)(1)(A).

555 *See* comment letter from Sarah A. Miller, Chief Executive Officer, Institute of International Bankers, dated August 21, 2013, *available at* https://www.sec.gov.edgekey.net/comments/s7-34-10/s73410.shtml. *See also* comment letters from Patrick Pearson, European Commission, dated August 21, 2013, and Kenneth E Bentsen, Jr., Executive Vice President, Public Policy and Advocacy, Securities Industry and Financial Markets Association, dated December 16, 2011, *available at* https://www.sec.gov.edgekey.net/comments/

certification or provide an opinion of counsel would provide a basis to deny an application for registration.

The requirement for an information sharing agreement is designed to provide the Commission greater assurance that it will be able to obtain the information about a nonresident funding portal necessary for the Commission's oversight of the nonresident funding portal. The home country regulator may possess information concerning, for example, the funding portal's affiliations, contractual relationships with issuers, and the nature and extent of measures taken to protect investors. In this context, particularly in the event that evidence arises of potential fraudulent or other unlawful activity by a nonresident funding portal, the ability to obtain information and secure the cooperation of the home country regulator according to established practices and protocols should help to address the increased challenges that may arise from oversight of entities located outside the United States.

A registered nonresident funding portal also would be required to re-certify, on Schedule C to Form Funding Portal, within 90 days after any relevant changes in its legal or regulatory framework, and provide a revised opinion of counsel confirming that, as a matter of law, the entity will continue to meet its obligations to provide the Commission and the national securities association with prompt access to its books and records and to be subject to inspection and examination. Failure to make this certification or provide an opinion of counsel may be a basis for the Commission to revoke the nonresident funding portal's registration.

Request for Comment

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s7-34-10/s73410.shtml; comment letter from Carlos Tavares, Vice-Chairman, European Securities and Markets Authority, dated January 17, 2011, *available at* http://www.sec.gov/comments/s7-35-10/s73510-19.pdf.

205. Is the term nonresident funding portal defined appropriately? If not, how should it be modified? Please explain.

206. Should the Commission impose additional or different conditions for nonresident funding portals than those proposed? If so, what conditions, and why? Should any be eliminated? Why or why not? What effect might such conditions have on the development of the industry and the market, and on issuers and investors? Please explain.

207. If, as a matter of law, it would be impossible or impractical for a nonresident funding portal to obtain the required opinion of counsel, what other actions or requirements could address our concern that we and the national securities association would be able to have direct access to books and records and adequately examine and inspect the funding portal?

208. Should any of the proposed requirements be more specific? For example, should only certain types of entities (such as law firms) be allowed to act as U.S. agents for service of process? Please explain.

209. Should a nonresident funding portal be required to appoint a U.S. agent for purposes of all potential legal proceedings, including those from nongovernmental entities? Why or why not?

210. Should we require the opinion of counsel if it might contradict the laws of a jurisdiction where an intermediary is incorporated? Why or why not? If not, should we impose an alternative requirement?

211. Should we specify that the opinion of counsel contain any additional information? For instance, should we require the opinion to reference the

applicable local law or, in the case of an amendment, the manner in which the local law was amended? Please explain.

2. Exemption from Broker-Dealer Registration

Exchange Act Section 3(h)(1) directs the Commission to exempt, conditionally or unconditionally, a registered funding portal from the requirement to register as a broker or dealer under Exchange Act Section 15(a), provided that the funding portal: (1) remains subject to the examination, enforcement and other rulemaking authority of the Commission; (2) is a member of a registered national securities association; and (3) is subject to other requirements that the Commission determines appropriate. The proposed rules would exempt a registered funding portal from the broker registration requirements of Exchange Act Section 15(a)(1), in connection with its activities as a funding portal.[556]

But for the exemption from registration Congress directed, a funding portal would be required to register as a broker under the Exchange Act.[557] The obligations imposed under the JOBS Act on an entity acting as an intermediary in a crowdfunding transaction would bring that entity within the definition of "broker" under Exchange Act Section 3(a)(4). A funding portal 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

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556 *See* proposed Rule 401(a) of Regulation Crowdfunding.

557 *See* Exchange Act Section 3(a)(4)(A) [15 U.S.C. 78c(a)(4)(A)] (defining "broker" as "any person engaged in the business of effecting transactions in securities for the account of others"). An entity acting as an intermediary in the offer and sale of securities pursuant to Section 4(a)(6), as contemplated in Title III of the JOBS Act, would not come within the meaning of "dealer," which is defined in Exchange Act Section 3(a)(5)(A) (15 U.S.C. 78c(a)(4)(A)), because it would not be engaging in the business of buying and selling securities for its own account. *See also* Exchange Act Section 15(a) [15 U.S.C. 15*o*(a)] and proposed Rule 300(b) of Regulation Crowdfunding.

transfer of funds and securities as required by Securities Act Section 4A(a)(7).[558] In addition, a funding portal's receipt of compensation linked to the successful completion of the offering also would be indicative of acting as a broker in connection with these transactions.

Pursuant to Exchange Act Section 3(h)(1), as stated above, we are proposing rules that would exempt an intermediary that is registered as a funding portal from the requirement to register as a broker-dealer under Exchange Act 15(a)(1). Consistent with the JOBS Act, the funding portal would remain subject to the full range of our examination and enforcement authority.[559] In this regard, the proposed rules would require that a funding portal permit the examination and inspection of all of its business and business operations that relate to its activities as a funding portal, such as its premises, systems, platforms and records, by representatives of the Commission, and of the national securities association of which it is a member.[560] The proposed rules also would impose certain recordkeeping requirements.[561]

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558 At the same time, there are statutory restrictions on the scope of services that a funding portal could provide. Among other things, a funding portal could act as an intermediary only in transactions involving the offer or sale of securities pursuant to Securities Act Section 4(a)(6). Further, a funding portal, by definition, could not offer investment advice or recommendations; solicit purchases, sales, or offers to buy the securities offered or displayed on its website or portal; compensate persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal; or hold manage, possess or otherwise handle investor funds or securities. *See generally* Exchange Act Section 3(a)(80).

559 *See* Exchange Act Section 3(h)(1)(C). *See also* Securities Act Section 20 [15 U.S.C. 77t] and Exchange Act Sections 21 and 21C [15 U.S.C. 78u and 78u-3]. In addition, we highlight that Exchange Act Sections 15(b)(4) and 15(b)(6) (15 U.S.C. 78*o*(b)(4) and 78*o*(b)(6)) apply to brokers (including funding portals) regardless of whether or not they are registered with the Commission as brokers. Exchange Act Section 15(b)(4) authorizes the Commission to bring administrative proceedings against a broker when the broker violates the federal securities laws (and for other misconduct) and provides for the imposition of sanctions, up to and including the revocation of a broker's registration. Exchange Act Section 15(b)(6) provides similar enforcement authority against the persons associated with a broker, including barring persons from associating with any Commission registrant. *See* Section II.D.3 below for further discussion, in response to commenters' concerns, about the scope of permissible activities in which funding portals may engage under the safe harbor of proposed Rule 402.

560 *See* proposed Rule 403 of Regulation Crowdfunding. *See also* discussion in Section II.D.4 below.

561 *See* proposed Rule 404 of Regulation Crowdfunding. *See also* discussion in Section II.D.5 below.

The proposed rules would provide that, notwithstanding this exemption from broker registration, for purposes of Chapter X of Title 31 of the Code of Federal Regulations, a funding portal would be deemed to be "required to be registered" as a broker with the Commission under the Exchange Act, thereby requiring funding portals to comply with Chapter X, including certain anti-money laundering ("AML") provisions thereunder.[562]

Request for Comment

212. Is the proposed exemption for funding portals from broker registration appropriate? Why or why not?

213. Should the exemption be conditioned on the funding portal remaining in compliance with Subpart D of the proposed rules? Why or why not?

214. Is it appropriate to propose to require funding portals to comply with the same requirements for purposes of Chapter X of Title 31 of the Code of Federal Regulations as imposed on a person required to be registered as a broker or a dealer? Why or why not?

215. Should the proposed exemption from broker registration be conditioned upon a funding portal's compliance with applicable Subpart C and D rules of proposed Regulation Crowdfunding? Why or why not? Should the failure to comply with

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562 *See* 31 CFR 1010.100(h) and 1023.100(b) (defining broker or dealer for purposes of the applicability of AML requirements). *See* Currency and Foreign Transactions Reporting Act of 1970 (commonly referred to as the Bank Secrecy Act ("BSA")) [12. U.S.C. 1829b, 12 U.S.C. 1951-1959, 31 U.S.C. 5311-5330]. *See also* proposed Rule 403(b) of Regulation Crowdfunding and discussion in Section II.D.4 below. Securities Act Section 4A(a)(12) requires intermediaries to comply with requirements as the Commission may, by rule, prescribe for the protection of investors and in the public interest. As discussed in Sections II.C.1 and II.D.2 above, a funding portal is a broker that, in the absence of the exemption from the requirement to register as a broker or dealer provided for under the JOBS Act in Exchange Act Section 3(h)(1), would otherwise be required to register as a broker under Section 15(a) (15 U.S.C. 78*o*) of the Exchange Act, and by being so registered, would be subject to the full range of BSA obligations applicable to registered broker-dealers. As discussed further in Section II.D.4.b below, we believe such obligations also should be imposed on funding portals.

certain requirements cause a funding portal to lose its exemption? If so, which requirements and why? Under what circumstances should the Commission consider revoking the exemption of a funding portal that fails to comply with these requirements?

3. Safe Harbor for Certain Activities

Exchange Act Section 3(a)(80) provides that a funding portal may not offer investment advice or make recommendations; solicit purchases, sales or offers to buy the securities offered or displayed on its platform or portal; compensate employees, agents or other persons for such solicitation or based on the sale of securities displayed or referenced on its platform or portal; hold, manage, possess or otherwise handle investor funds or securities; or engage in such other activities as the Commission, by rule, determines appropriate.

We received a number of comments concerning the scope and definition of permissible activities for a funding portal. A number of commenters sought guidance on services they might be permitted to provide consistent with the prohibition on offering investment advice or recommendations.[563] We also received comments seeking clarification about the prohibitions on funding portals soliciting investors and handling funds and securities.[564]

One commenter asked us to clarify what activities would constitute prohibited investment advice and suggested that the Commission should establish "bright lines" that would make it clear how a funding portal can avoid being viewed as giving prohibited investment advice.[565]

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563 *See, e.g.*, NCA Letter; NSBA Letter; CFIRA Letter 2.

564 *See, e.g.*, CFIRA Letter 2; NCA Letter; Wright Letter 1; RocketHub Letter 1; Grow VC Letter.

565 *See* CFIRA Letter 2.

This commenter and others provided numerous examples of potential funding portal activities, including:

- advising issuers on the structure and contents of their offerings;[566]
- providing access to the portal's platform to certain issuers and rejecting or removing others, based on criteria such as the "type" or "market characteristics" of the offerings (*e.g.*, film production securities, women- or minority-owned businesses or businesses in specific geographical areas);[567]
- removing an offering before the end of the offering period for lack of investor interest;[568]
- removing an issuer for failing to provide documents responsive to the funding portal's due diligence or qualification standards, including standards other than those established by our rules,[569] or the portal's belief that an offering or the issuer may be fraudulent or abusive;[570]
- highlighting, or otherwise making more prominent, the offering(s) of one or more issuers;[571]
- organizing issuers listed on the funding portal's platform into groups based on the funding portal's view of the riskiness of the investment;[572]

566 *See id.*

567 *See* NCA Letter; NSBA Letter.

568 *See id.*

569 *See id.*

570 *See* CFIRA Letter 3.

571 *See* RocketHub Letter 1; Wright Letter 1.

572 *See id.*

- providing information management tools (*i.e.*, search functions and automatic notification mechanisms) on the funding portal's platform;[573]
- providing a "valuation framework" that could guide investors in determining a fair valuation for securities listed on the funding portal's platform, while also creating a "negotiation space" for an issuer and its potential investors;[574] and
- hosting on the funding portal's platform:
  - third-party market and news updates;[575]
  - third-party opinions (including those of investors) on message boards and other information exchanges moderated by the funding portal;[576] or
  - judgments about issuers made by a funding portal or its vendors or partners.[577]

With regard to the prohibition on solicitation, one commenter noted that the mere act of having a web platform available to the public on which issuers can list their offerings could be viewed as impermissible solicitation.[578] Another commenter asked whether funding portals would be permitted to compensate employees and agents to solicit issuers by commission,

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573 *See* CFIRA Letter 3.

574 A "negotiation space" would provide some ability for investors to set or influence the price of the securities, which would not necessarily depend on a specific valuation of the securities. *See* Pearfunds Letter.

575 *See* RocketHub Letter 1; Wright Letter 2.

576 *See* CFIRA Letter 3; Applied Dynamite Letter; Grow VC Letter.

577 *See* Applied Dynamite Letter.

578 *See* Crowdfunding Offerings Ltd. Letter 2.

referral fee or otherwise.[579] Another commenter asked that we preserve the ability of funding portals to pay for search listings or advertisements in online social networks.[580]

Commenters requested that we identify the kinds of third parties that could hold, manage, possess or otherwise handle investor funds and securities in connection with an offering made in reliance on Section 4(a)(6).[581] One commenter stated that a fiduciary would likely hold the funds for disposition as instructed by the funding portal and asked whether this instruction would constitute an impermissible handling of the funds.[582] Another commenter stated that an intermediary should be authorized by the issuer and investors to operate as an escrow agent to facilitate transactions.[583] One commenter asserted that funding portals need the ability to temporarily hold customer funds to properly clear and settle a securities transaction.[584] The commenter further contended that, to ensure issuers are not overwhelmed with thousands of new shareholders, intermediaries, including funding portals, should be able to act as nominees of the investors who are the beneficial owners of the securities.

In light of these questions and comments, we are proposing to provide a non-exclusive, conditional safe harbor for funding portals that engage in certain limited activities.[585] Failure of

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579 *See* NCA Letter.

580 *See* Cera Technology Letter.

581 *See* Crowdfunding Offerings Ltd. Letter 2; NSBA Letter.

582 *See* Crowdfunding Offerings Ltd. Letter 4.

583 *See* RocketHub Letter 1 (further stating that the intermediary should be permitted to hold investor funds in an escrow account that is segregated from the operating funds of the intermediary and that withdrawals from the account only be permitted for: "payments to offerings that have successfully closed (having reached or exceeded their funding goals); payments to investors requesting refunds of uncommitted funds; or payment of established intermediary fees").

584 *See* Grow VC Letter.

585 *See* proposed Rule 402 of Regulation Crowdfunding. The term "investment advice" is not defined in the crowdfunding provisions of the JOBS Act or otherwise in the federal securities laws, and we do not include a definition of that term in our proposal. In the context of interpreting the term "investment adviser," the

a funding portal to meet the conditions of this non-exclusive safe harbor would not create a presumption that the funding portal is in violation of the statutory prohibitions of Exchange Act Section 3(a)(80) or the rules in proposed Regulation Crowdfunding.[586]

In proposing the safe harbor, we are mindful that, while Section 304 of the JOBS Act directs us to exempt a registered funding portal, conditionally or unconditionally, from broker-dealer registration and associated regulatory requirements, the statutory provisions also make clear that the activities in which a funding portal may engage are far more limited than those of a registered broker-dealer.[587] At the same time, we recognize that the statutory prohibitions could be read so broadly as to limit the utility of funding portals. The proposed rule seeks to strike an appropriate balance by identifying certain limited activities in which a funding portal may engage, consistent with the statutory prohibitions.[588] These activities relate to:

- limiting offerings made on or through the funding portal's platform based on eligibility requirements;

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determination of whether a particular communication rises to the level of investment advice depends on the facts and circumstances and is construed broadly. To the extent a funding portal limits its securities activities to those permitted by the proposed rules, including the safe harbor, we preliminarily believe that it would not come within the meaning of the term investment adviser under the Advisers Act. If it conducts other activities, such as advising an issuer concerning the investment of proceeds in securities, however, it would need to consider whether it comes within the meaning of that term under the Advisers Act. *See* Advisers Act Section 202(a)(11) [15 U.S.C. 80b-2(a)(11)]. *See also* 2012 SEC Government-Business Forum, note 29 (stating that there is a need for safe harbors that explicitly permit certain activities that may otherwise be seen as indicia of broker-dealer status or activities that are prohibited or otherwise subject to separate regulation).

586 *See* proposed Rule 402(a) of Regulation Crowdfunding.

587 *See* Exchange Act Section 3(a)(80). *See also* 158 CONG. REC. S5474-03 (daily ed. July 26, 2012) (statement of Sen. Jeff Merkley) ("The Crowdfund Act is designed so that funding portals will be subject to fewer regulatory requirements than broker-dealers because they will do fewer things than broker-dealers. Among other limits, the law prohibits funding portals from engaging in solicitation, making recommendations, and providing investment advice. Relative passivity and neutrality, especially with respect to the investing public, are touchstones of the funding portal streamlined treatment.").

588 *See* proposed Rule 402 of Regulation Crowdfunding.

- highlighting and displaying offerings on the platform;
- providing communication channels for potential investors and issuers;
- providing search functions on the platform;
- advising issuers on the structure or content of offerings;
- compensating others for referring persons to the funding portal and for other services; and
- advertising the funding portal's existence.

In addition, the proposed rules would clarify that, consistent with other provisions of Regulation Crowdfunding,[589] funding portals may deny access to issuers in certain circumstances, accept investment commitments and direct the transmission of funds, in connection with offerings conducted on their platforms.

- **Limiting Offerings**

We anticipate that some funding portals may wish to limit, to some extent, the scope of their businesses by, for example, specializing in offerings by issuers in certain industries or geographic locations. In some circumstances, these limitations could be viewed as providing investment advice. To accommodate reasonable limitations, the proposed safe harbor would permit a funding portal to apply objective criteria to limit the offerings on its platform, without being deemed to be providing investment advice.[590] Those criteria would be required to be reasonably designed to result in a broad selection of issuers offering securities through the funding portal's platform and be applied consistently to all potential issuers and offerings, so as

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589 *See, e.g.*, proposed Rules 303(d) and 303(e) of Regulation Crowdfunding.

590 *See* proposed Rule 402(b)(1) of Regulation Crowdfunding.

not to recommend or implicitly endorse one issuer or offering over others. The criteria also would be required to be clearly displayed on the funding portal's platform.

The requirements that the objective criteria be reasonably designed to result in a broad selection of issuers, and be applied consistently, are intended to ensure that the funding portal does not provide impermissible investment advice by, for example, applying criteria that would so limit the number of issuers that the funding portal could be viewed as providing an implicit endorsement or recommendation of those issuers' offerings. An issuer that meets these criteria, and is not otherwise disqualified, would, subject to the funding portal's measures to reduce the risk of fraud under proposed Rule 301,[591] be eligible to list its offering on the funding portal's platform.

One criterion could include the type of security being offered (such as common stock, preferred stock or debt securities). We believe that this criterion would be appropriate because potential investors may be interested in certain types of securities as a consideration separate from the identity of issuers. Other criteria also could include the geographic location of the issuer or the industry or business segment of the issuer. We believe that these criteria would be appropriate because a funding portal may wish to specialize and focus its efforts on facilitating offerings in particular areas or industries.[592] The proposed rule would require funding portals to disclose to investors the criteria they use to limit the offerings available on their platforms. This should help investors better appreciate any niche focus of a funding portal and the scope of the offerings available on the funding portal's platform. In addition, we recognize that a funding

591 *See* discussion in Section II.C.3 above.

592 *See, e.g.*, CrowdFund Connect Letter (stating that rural communities could build new local based co-operatives similar to the electric and telephone cooperatives for new technologies).

portal may seek to limit the number of issuers or offerings on its platform at any given time, including for resource reasons. The application of the objective criteria could, in practice, result in the number of issuers or offerings displayed on the platform being very small, such as, for example, in the period soon after a funding portal begins operations. Nevertheless, we would not consider the funding portal to be providing investment advice if the objective criteria are designed to result in a broad selection of issuers.

To qualify for the safe harbor, a funding portal may not use criteria based on an assessment of the merits or the shortcomings of a particular issuer or offering. In particular, a funding portal may not deny access to an issuer based on the advisability of investing in the issuer or its offering.[593] As noted above, one commenter stated that the prohibition on investment advice could potentially preclude a funding portal from denying access to a fraudulent offering or issuer.[594] This would place investors at unnecessary risk and would be contrary to the funding portal's obligation under the proposed rules to deny access to its platform if it believes that the issuer or its offering presents potential for fraud or otherwise raises concerns regarding investor protection.[595] Thus, as described above, a funding portal must deny access if it believes that the issuer or its offering has potential for fraud or otherwise raises concerns regarding investor protection.[596]

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[593] Of course, a funding portal would be required to deny access to the issuer if the funding portal has a reasonable basis for believing that issuer is subject to a disqualification or if the funding portal believes that the issuer or the offering presents the potential for fraud or otherwise raises concerns regarding investor protection. *See* proposed Rule 301(c) of Regulation Crowdfunding.

[594] *See* CFIRA Letter 3.

[595] *See* proposed Rule 301 of Regulation Crowdfunding.

[596] Consistent with proposed Rule 301, proposed Rule 402(b)(10) of Regulation Crowdfunding would clarify that a funding portal may deny access to an issuer if the funding portal believes that the issuer or its offering has potential for fraud or otherwise raises concerns regarding investor protection.

- **Highlighting Issuers and Offerings**

Under the proposed rules, a funding portal may highlight particular offerings of securities made in reliance on Section 4(a)(6) on its platform based on objective criteria that may include: the type of securities being offered (*e.g.*, common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the number or amount of investment commitments made; and the progress in meeting the target offering amount or, if applicable, the maximum offering amount, and minimum or maximum investment amount.[597] A potential investor, for example, may have a strong interest in supporting a small issuer that is within the potential investor's geographic vicinity. Other potential investors may be interested in offerings that are about to close soon, that have particular maximum investment amounts or that have generated significant interest from users of the funding portal's platform. Some investors may only be interested in offerings in which a significant percentage of the target amount has been committed.[598] We believe that the listed criteria are sufficiently objective, so as to reduce the risk of a funding portal applying them to advance a particular bias or subjective assessment of the issuers or offerings.

Consistent with the prohibition on investment advice and recommendations, the criteria must be reasonably designed to highlight a broad selection of issuers, so as not to recommend or implicitly endorse one issuer or offering over another, and must be applied consistently to all potential issuers and offerings. The selection criteria may not be based on an assessment of the merits of a particular issuer or offering and must be clearly displayed on the funding portal's platform, to permit investors to comprehend on what basis certain issuers are being highlighted,

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597 *See* proposed Rule 402(b)(2) of Regulation Crowdfunding.

598 *See* Howe, note 2.

and, thereby, to help prevent them from misconstruing the highlighting as a recommendation or implicit endorsement of any issuer or offering. The funding portal may not highlight an issuer or offering based on the advisability of investing in the issuer or offering. To help prevent conflicts of interest and incentives for funding portals to favor certain issuers over others, the proposed rules would prohibit a funding portal from receiving any special or additional compensation for highlighting (or offering to highlight) one or more issuers or offerings on its platform.[599]

Some commenters sought clarification whether funding portals could distinguish offerings based on riskiness.[600] We are not proposing a safe harbor for this type of distinction at this time, because we preliminarily believe that an assessment of risk necessarily involves the exercise of judgment indicative of the giving of investment advice.

- **Providing Search Functions**

The proposed rules would permit a funding portal to provide, on its platform, search functions or other tools that users could use to search, sort or categorize the offerings available on the funding portal's platform according to objective criteria.[601] Search functions could help potential investors to more efficiently search for offerings that focus on a specific industry, funding goal or other criteria. Under the proposed rules, a funding portal also would be able to categorize offerings into general subject areas, so that a potential investor could readily find those offerings on the funding portal's platform. The proposed rules would also permit more

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599 *See* proposed Rule 402(b)(2)(iii) of Regulation Crowdfunding.

600 *See* RocketHub Letter 1; Wright Letter 1.

601 *See* proposed Rule 402(b)(3) Regulation Crowdfunding. *See also* 158 CONG. REC. 2231 (daily ed. Mar. 29, 2012) (statement of Sen. Scott Brown) ("Funding portals should be allowed to organize and sort information based on certain criteria. This will make it easier for individuals to find the types of companies in which they can potentially invest. This type of capability – commonly referred to as curation – should not constitute investment advice.").

granular tools that, for example, could provide a potential investor the ability to sort offerings based on a combination of different criteria, such as by the percentage of the target offering amount that has been met, geographic proximity to the investor and number of days remaining before an offering is to close.[602] The objective criteria specified in the proposed rules are consistent with those in the proposed safe harbor for highlighting issuers and offerings.[603] Consistent with the activities specifically prohibited by statute, funding portals would not be permitted to use criteria that search, sort or categorize offerings based on the advisability of investing in the issuer or its offering or an assessment of any characteristic of the issuer, its business plan, its management, or risks associated with an investment. One commenter questioned whether a funding portal could give potential investors the ability to create automated e-mail notifications, based on criteria they have provided to identify particular offerings on the funding portal's platform.[604] The proposed rules would permit funding portals to do so.

We recognize that there are many potential ways that a tool or mechanism can be used to search, sort or categorize offerings. The proposed rules are intended to be sufficiently broad to cover any number of combinations of implementing tools or mechanisms for a search, while limiting the search parameters to objective criteria.

- **Providing Communication Channels**

The proposed rules would permit a funding portal to provide, on its platform, communication channels by which investors could communicate with one another and with representatives of the issuer about offerings of securities displayed on the funding portal's

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602 *See* proposed Rule 402(b)(3) of Regulation Crowdfunding.

603 *See* proposed Rule 402(b)(2)(ii) of Regulation Crowdfunding.

604 *See* CFIRA Letter 3.

platform, in accordance with the conditions set out in proposed Rule 303(c).[605] The safe harbor would specify that a funding portal (including its associated persons, such as its employees) may not participate in these communications, other than to establish guidelines about communication and to remove abusive or potentially fraudulent communications. For the reasons discussed above, a funding portal would be required to make communication channels available to the general public and to restrict the posting of comments on those channels to those who have accounts.[606] In addition, the funding portal would need to require persons posting comments to disclose, in the channel, whether they receive or would receive any compensation for promoting an issuer.

Communication channels should facilitate the access to information among members of the public and provide potential investors with the crowd's insight as to the merits of an issuer or business plan.[607] Restricting funding portal participation should help to ensure that funding portals do not provide impermissible recommendations or investment advice. Moreover, requiring potential investors to have accounts with the funding portal before posting a comment should provide a control that could aid in promoting accountability for comments made and help ensure that interested persons, such as those associated with the issuer or receiving compensation to promote the issuer, are properly identified.[608]

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605 *See* proposed Rule 402(b)(4) of Regulation Crowdfunding.

606 *See* discussion in Section II.C.5.c above and proposed Rule 303(c)(2) of Regulation Crowdfunding.

607 *See, e.g.*, Bradford, note 1. *See also* Howe, note 2.

608 *See* 158 CONG. REC. S2231 (daily ed. Mar. 29, 2012) (statement of Sen. Scott Brown) ("In addition to facilitating communication between issuers and investors, intermediaries should allow fellow investors to endorse or provide feedback about issuers and offerings, provided that these investors are not employees of the intermediary. Investors' credentials should be included with their comments to aid the collective wisdom of the crowd.") *See also* discussion in Section II.C.5.c above.

As suggested by commenters, the proposed rule would permit a funding portal to create a "negotiation space" in which those who have opened accounts with the funding portal and issuers could discuss and potentially negotiate certain aspects of the issuer's offering, including the price of the issuer's securities.[609]

- **Advising Issuers**

The proposed rules would permit a funding portal to advise an issuer about the structure or content of the issuer's offering, including preparing offering documentation.[610] This advice is not the type of advice that we believe should be impermissible.[611] We also believe that funding portals and brokers could provide certain services to issuers in order to facilitate the offer and sale of securities in reliance on Section 4(a)(6), and without this kind of advice to issuers, crowdfunding as a method to raise capital would not be viable. In particular, to the extent that the issuers that may choose to conduct offerings in reliance on Section 4(a)(6) would include startups and small businesses, we expect that these issuers would seek in many cases to obtain advice on the structure of the offering from intermediaries. Funding portals would be in a position to provide this type of assistance relatively efficiently, together with the other services under the proposed rules that they would be permitted to provide to issuers.

The proposed safe harbor would permit funding portals to advise an issuer about the structure and content of the issuer's offering in a number of ways. A funding portal could, for example, provide pre-drafted templates or forms for an issuer to use in its offering that would

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609 *See* Pearfunds Letter; CFIRA Letter 3.

610 *See* proposed Rule 402(b)(5) of Regulation Crowdfunding.

611 *Compare Registration of Municipal Advisors*, Release No. 34-63576 (Dec. 10, 2010) [76 FR 824 (Jan. 6, 2011)] (noting that Commission staff has taken the position that financial advisors that limit their advisory activities to advising municipal issuers as to the structuring of their financings, rather than providing advice for compensation regarding the investment of assets, may not need to register as investment advisers).

help it comply with its proposed disclosure obligations.[612] Other examples of permissible assistance could include, as commenters have suggested, advice about the types of securities the issuer can offer, the terms of those securities and the procedures and regulations associated with crowdfunding.[613]

- **Paying for Referrals**

The proposed rules would clarify that, consistent with proposed Rule 305, a funding portal could compensate a third party for referring a person to the funding portal if the third party does not provide the funding portal with personally identifiable information of any potential investor. For example, a third party could provide hyperlinks to a funding portal in order to inform potential investors learn about securities offerings made in reliance on Section 4(a)(6). Any compensation, unless paid to third party that is a registered broker or dealer, could not 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 funding portal's platform.[614] Otherwise, such transaction-based compensation could trigger broker-dealer registration requirements. We also believe that this

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612 *See, e.g.*, 158 CONG. REC. S2231 (daily ed. Mar. 29, 2012) (statement of Sen. Scott Brown) ("Similarly, funding portals should be allowed to engage in due diligence services. This would include providing templates and forms, which will enable issuers to comply with the underlying statute. In crafting this law, it was our intent to allow funding portals to provide such services."); 158 CONG. REC. S5474-03 (daily ed. July 26, 2012) (statement of Sen. Jeff Merkley) ("Subject to such limits as the SEC determines necessary for the protection of investors and the crowdfunding issuers, funding portals should be able to provide (or make available through service providers) services to assist entrepreneurs utilizing crowdfunding, including, for example, providing basic standardized templates, models, and checklists. Enabling them to help small businesses construct simple, standard deal structures will facilitate quality, low-cost offerings.").

613 *See* CFIRA Letter 2.

614 *See* proposed Rule 402(b)(6) of Regulation Crowdfunding. *See also* discussion in Section II.C.7 above. Proposed Rule 305 of Regulation Crowdfunding would implement the prohibition in Section 4A(a)(10).

prohibition on transaction-based compensation would help to remove the incentive for high-pressure sales tactics and other abusive practices.[615]

- **Compensation Arrangements with Registered Broker-Dealers**

The proposed rules would specify that a funding portal could enter into certain arrangements with a registered broker-dealer, through which they could compensate each other for services.[616] In speaking with industry participants, we understand that because the statute narrowly defines the permissible activities in which funding portals may engage, funding portals may wish to contract or affiliate with registered broker-dealers, which are not subject to similar constraints.[617] For example, a registered broker-dealer could, among other things, recommend securities offered on the funding portal's platform or provide services involving the handling of investor funds and securities. Conversely, funding portals may wish to offer certain services, including information technology services, to a broker-dealer, for a fee. Each party to this type of arrangement would, because it is a regulated entity, need to comply with all applicable regulations, including the rules of the registered national securities association of which it is a member.

Proposed Rule 402(b)(7) would permit a funding portal to pay or offer to pay compensation to a registered broker or dealer for services in connection with the funding portal's offer or sale of securities in reliance on Section 4(a)(6). Proposed Rule 402(b)(8) would permit a funding portal to provide services to and receive compensation from a registered broker-dealer in

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615 *See* note 515.

616 *See* proposed Rules 402(b)(7) and 402(b)(8) of Regulation Crowdfunding.

617 Exchange Act Section 3(a)(80) limits the permissible securities activities of a funding portal to those in connection with the offer and sale of securities in reliance on Securities Act Section 4(a)(6).

connection with the funding portal's offer or sale of securities in reliance on Section 4(a)(6).[618] Compensation could include any monetary form of payment, such as fees, discounts, commissions, concessions, reimbursement of expenses and other allowances. The proposed safe harbor would not, however, permit a funding portal to receive transaction-based compensation for referrals of potential investors in other types of offerings being effected by a registered broker-dealer, such as a Rule 506 offering.[619] The proposed rules would require the funding portal to provide any services pursuant to a written agreement with the registered broker-dealer, and they also would require the payments to be compliant with, and not prohibited by, the rules of the registered national securities association of which the funding portal is a member.[620] The proposed rules would require that a funding portal's offers to pay, and payments made to, a registered broker-dealer, as well as a funding portal's receipt of compensation from a registered broker-dealer, under these arrangements, be compliant with Regulation Crowdfunding. In particular, these arrangements would have to be compliant with proposed Rule 305 which prohibits, with certain exceptions, an intermediary from compensating any person for providing the intermediary with the personally identifiable information of any investor or potential investor.[621] These proposed provisions, taken as a whole, are intended to facilitate intermediaries' cooperation with each other and promote the use of the Section 4(a)(6) exemption to raise capital, while maintaining a clear audit trail.

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618 *See also* FINRA, *Payments to Unregistered Persons: FINRA Request Comment on Proposed Consolidated FINRA Rule Governing Payments to Unregistered Persons*, Regulatory Notice 09-69 (Dec. 2009), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p120480.pdf.

619 Receipt of transaction-based compensation in connection with such referrals could cause a funding portal to be a broker required to register with us under Exchange Act Section 15(a)(1) (15 U.S.C. 78*o*(a)(1)).

620 *See, e.g.*, FINRA Rule 4311 ("Carrying Agreements").

621 *See* proposed Rule 305 of Regulation Crowdfunding and discussion in Section II.C.7 above.

- **Advertising**

The proposed rules would permit a funding portal to advertise its existence and engage in certain other limited advertising activities.[622] The proposed rule does not limit the manner in which a funding portal could advertise its existence. A funding portal may, for example, choose to advertise through social media, internet advertisements or traditional sources of advertising like print media.

In addition, funding portals could identify issuers and offerings in the advertisements on the basis of criteria that are reasonably designed to identify a broad selection of issuers (so as not to recommend or implicitly endorse one issuer or offering over others) and are applied consistently to all potential issuers and offerings. The criteria, consistent with those described above with regard to highlighting issuers and offerings on the platform and the ability to provide investors with search functions, could include the type of securities being offered, the geographic location of the issuer, the industry or business segment of the issuer, the number or amount of investment commitments made, the progress in meeting the issuer's target offering amount and, if applicable, the maximum offering amount and the minimum or maximum investment amount.[623] Of course, a funding portal is subject to the statutory prohibition on providing investment advice and recommendations, and soliciting, and so the safe harbor would not permit a funding portal to advertise in such a way that expresses that any of the offerings offered on its platform are of a higher quality, are safer, or are more worthy investments compared to any others, whether offered on its platform or those of other intermediaries.

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622 *See* proposed Rule 402(b)(9) of Regulation Crowdfunding.

623 As a funding portal could be subject to liability for fraud, it would need to consider whether its advertisements are not misleading or otherwise fraudulent, such as by implying that past performance of offerings on its platform is indicative of future results. *See* Exchange Act Rule 10b-5 [17 CFR 240.10b-5].

The proposed rule would also specify that the funding portal could not receive special or additional compensation for identifying an issuer or offering in its advertisement, because this could create an incentive for the funding portal to promote one issuer over another. This prohibition should help to limit the dissemination of information that may be misleading or easily misconstrued.[624]

- **Denying Access Based on Potential Fraud or Investor Protection Concerns**

In light of the comments received, the proposed rules would require a funding portal to deny access to its platform to, or cancel an offering of, an issuer that the funding portal believes may present the potential for fraud or otherwise raises concerns regarding investor protection, as is required under proposed Rule 301(c).[625]

- **Accepting Investor Commitments**

The proposed rules would permit a funding portal, on behalf of an issuer, to accept investment commitments from potential investors for securities offered in reliance on Section 4(a)(6) by that issuer on the funding portal's platform.[626] Given the breadth of the statutory prohibition on holding, managing, possessing or otherwise handling investor funds or securities, we believe that it is important to clarify the activities, in this area, in which a funding portal may permissibly engage, including with regard to accepting investment commitments.[627]

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624 In response to one commenter, we note that this would preserve the ability of funding portals to pay for search listings or advertisements in online social networks. *See* Cera Technology Letter.

625 *See* proposed Rule 402(b)(10) of Regulation Crowdfunding. *See also* discussion in Section II.C.3 above.

626 *See* proposed Rule 402(b)(11) of Regulation Crowdfunding.

627 As described above, we are proposing other measures that would prescribe the requirements for funding portals with respect to the maintenance and transmission of funds, including the use of a qualified third party to hold and transmit investor funds. *See* discussion in Section II.C.5.d above.

Although some commenters expressed the view that funding portals should be permitted to handle investor funds and securities in a limited capacity as the issuer's transfer agent or to be the holder of record,[628] we do not believe that these activities would be consistent with the statutory directive in Exchange Act Section 3(a)(80). In our view, a funding portal acting as custodian for securities through a book entry system likely would be engaged in handling or managing securities in violation of the statutory prohibition in Section 3(a)(80).[629]

- **Directing Transmission of Funds**

The proposed rules would provide that a funding portal could fulfill its obligations with respect to the maintenance and transmission of funds and securities, as set forth in proposed Rule 303, without violating the prohibition in Exchange Act Section 3(a)(80)(D).[630] Thus, subject to other applicable rules, a funding portal could direct investors where to transmit funds or remit payment in connection with the purchase of securities offered and sold in reliance on Section 4(a)(6).[631] It also could direct a qualified third party to release the proceeds of an offering to the issuer upon completion of the offering or to return investor proceeds when an investment commitment or offering is cancelled.[632] We believe that these discrete activities would facilitate

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628 *See* Crowdfunding Offerings Ltd. Letter 4; RocketHub Letter 1.

629 *Cf.* Exchange Act Section 3(a)(23) [15 U.S.C. 78c(a)(23)] (defining "clearing agency" as an intermediary who "acts as a custodian of securities in connection with a system for the central handling of securities" where the securities may be administered "by bookkeeping entry without physical delivery of securities certificates").

630 We believe the statutory requirements, and the rules we are proposing to implement such requirements, provide clear requirements for the protection of investor funds. In addition, the requirement for the funding portals to maintain a fidelity bond under proposed Rule 400(f) provides an additional protection with respect to investor funds. *See* discussion in Section II.D.1 above. *See also* proposed Rule 400(f) of Regulation Crowdfunding.

631 *See* proposed Rule 402(b)(12) of Regulation Crowdfunding.

632 *See* proposed Rule 402(b)(13) of Regulation Crowdfunding.

crowdfunding transactions without exceeding the scope of permissible activities, and without unduly raising investor protection concerns.

Request for Comment

216. Does the proposed safe harbor appropriately define the actions in which a funding portal may engage? Are there other activities that should be addressed in the safe harbor? Are there activities included in the proposed safe harbor that should be modified or eliminated? If so, which activities and why?
217. Are there any additional conditions that should apply to the activities covered under the proposed safe harbor? If so, which conditions, and why?
218. Exchange Act Section 3(a)(80) provides that a funding portal may not offer investment advice, and the proposed rules would provide a conditional safe harbor for certain activities that funding portals may engage in without violating the statutory prohibition on providing investment advice. Is the safe harbor sufficient, or should we provide additional guidance regarding the status of funding portals under the Investment Advisers Act of 1940? Why or why not? Please discuss.
219. Should the proposed safe harbor permit a funding portal to limit the offerings on its platform? If so, are the criteria set forth in the proposed rules appropriate? Why or why not? If not, what other criteria or conditions would be appropriate?
220. Are there any additional criteria that a funding portal should be permitted to use when highlighting issuers and offerings on its platform? If so, which ones and why? Should a funding portal be permitted to highlight issuers and offerings based on criteria that specifically relate to the activities of users on its site, such

as offerings that have been viewed by the largest number of visitors to the platform over a particular time period? Why or why not?

221. As a condition of the proposed safe harbor, should we require funding portals to clearly display, on their platforms, the objective criteria they use in limiting or highlighting offerings? Why or why not?

222. Under the proposed safe harbor, should we permit a funding portal to post news, such as market news and news about a particular issuer or industry, on its platform? Why or why not? If so, what restrictions, conditions or other safeguards should apply, in particular so that a funding portal would not be providing impermissible investment advice? For example, are there certain types of news or news feeds that should or should not be permitted, or should we restrict a funding portal from posting only positive news coverage? Should a funding portal be able to freely select the news stories it posts, or should there be some objective criteria? Please explain.

223. Are the proposed limitations on a funding portal advertising its past offerings appropriate? Should we consider other advertising limitations? Should the proposed advertising rules be modified in any other way?

224. Should we permit a funding portal to receive transaction-based compensation for referring potential investors to a registered broker-dealer? Why or why not? If so, should we impose disclosure requirements or other measures to mitigate potential conflicts? What should those requirements be and why? Should we permit a funding portal to receive transaction-based compensation from an affiliate? Why or why not?

225. In addition to transaction-based compensation, are there other types of compensation that we should prohibit funding portals from paying to persons who are not registered broker-dealers? Should we permit, as proposed, funding portals to enter into compensation arrangements with registered broker-dealers or with any other regulated entities? Why or why not? If so, what types of regulated entities should be included? Please explain.

226. Are there circumstances in which a funding portal could provide transfer agent services without handling investor funds or securities? If so, please describe.

227. Should the proposed safe harbor permit a funding portal to engage in any other activities in connection with the required communication channels? Why or why not? If so, which activities and why?

228. Should the proposed safe harbor include other types of activities that potentially could be construed as investment advice? If so, which ones and why? Would an exemption from the Investment Advisers Act of 1940 or other regulatory relief be appropriate in connection with such activities? Are there types of advice an issuer may seek from a funding portal, that would not be considered advice about the structure or content of the issuer's offering? Please explain.

229. Should the agreed-upon terms of an arrangement with a funding portal be required to be documented in a written agreement with the issuer? Are there certain terms that should be included?

230. Should the proposed safe harbor permit funding portals to provide a mechanism by which investors can rate an issuer or an offering? If so, what safeguards, if

any, should be required?[633] Should the Commission, as a condition of the safe harbor, limit the ability to rate to persons who have opened an account with the funding portal?[634]

4. Compliance

a. Policies and Procedures

The proposed rules would require a funding portal to implement written policies and procedures reasonably designed to achieve compliance with the federal securities laws and regulations thereunder, relating to its business as a funding portal.[635] Under the proposed rules, a funding portal would have discretion to establish, implement, maintain and enforce those policies and procedures based on its relevant facts and circumstances. We believe that it is important to provide this flexibility in order to accommodate the various business models funding portals may have while at the same time accomplishing the Commission's investor protection goals. We also recognize that FINRA or any other registered national securities association may have separate requirements in this regard. Inherent in the notion of reasonably designed compliance policies and procedures is that a funding portal would promptly update its policies and procedures to

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633 An intermediary that is a registered broker could provide a mechanism for investors to rate an issuer or offering. *But see Social Media Websites and the Use of Personal Devices for Business Communications*, FINRA Regulatory Notice 11-39 (Aug. 2011), *available at* *http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p124186.pdf* (noting that a firm is responsible under NASD Rule 2210 for third-party site content if the firm has adopted or has become entangled with the site's content).

634 Any person who promotes an issuer's offering for compensation, whether past or prospective, or who is a founder or an employee of an issuer that engages in promotional activities on behalf of the issuer on the intermediary's platform, must clearly disclose in all communications on the intermediary's platform, respectively, the receipt of compensation and that he or she is engaging in promotional activities on behalf of the issuer. *See* proposed Rule 302(c) of Regulation Crowdfunding.

635 *See* proposed Rule 403(a) of Regulation Crowdfunding. As a condition to exempting funding portals from the requirement to register as a broker or a dealer under Exchange Act Section 15(a)(1) (15 U.S.C. 78*o*(a)(1)), Exchange Act Section 3(h)(1)(C) provides that registered funding portals must comply with such other requirements as the Commission determines appropriate.

reflect changes in applicable rules and regulations, as well as its business practices and the changing marketplace.

Request for Comment

231. Should we specify requirements for funding portals' compliance policies and procedures? Why or why not? If so, what requirements and why?

232. Should we require funding portals to update their policies and procedures to reflect changes in applicable rules and regulations within a specified time period after the change occurs? If so, what time period would be appropriate (*e.g.*, 30 days, 60 days, six months)?

b. Anti-Money Laundering

The proposed rules require that funding portals comply with certain AML provisions,[636] as set forth in Chapter X of Title 31 of the Code of Federal Regulations.[637] We preliminarily believe that funding portals could play a critical role in detecting, preventing, and reporting money laundering and other illicit financing, such as market manipulation and fraud. As discussed in more detail below, we believe it is important for funding portals to comply with BSA requirements, because they would be engaged in a similar business as a category of registered broker-dealers – introducing brokers – which have BSA obligations.[638] Specifically, while a funding portal is prohibited by statute from handling, managing or possessing customer funds or securities, which means it cannot accept cash from customers or maintain custody of

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636 *See* proposed Rule 403(b) of Regulation Crowdfunding. *See also* proposed Rule 401(b) and discussion in Section II.D.2 above, which discusses how funding portals fall within the scope of Chapter X of Title 31 of the Code of Federal Regulations.

637 *See* note 562.

638 *See* 31 C.F.R 1023.100 *et seq.*

customer securities – and an introducing broker typically does not accept cash or maintain custody of customer securities – we believe that a funding portal, like an introducing broker, is in the best position to "know its customers," and to identify and monitor for suspicious and potentially illicit activity at the individual customer level, as compared to the qualified third party, which may not see such activity given its less direct contact with individual customers.[639] We also believe it is important for funding portals to comply with BSA requirements because they would be in engaged in the same business of effecting securities transactions for the accounts of others as registered broker-dealers, which have BSA obligations. To require otherwise could inadvertently steer potential money launders to funding portals.

Moreover, we expect that funding portals would often facilitate offerings of microcap or low-priced securities, which may be more susceptible to fraud and market manipulation.[640] We believe that imposing the monitoring and reporting requirements of the BSA on funding portals would establish a valuable oversight, prevention and detection mechanism. The Financial Action Task Force ("FATF"), an inter-governmental body whose objective is to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system, has also identified low-priced and privately-placed securities as potential

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639 *See, e.g.*, NASD (n/k/a FINRA), *NASD Provides Guidance To Member Firms Concerning Anti-Money Laundering Compliance Programs Required by Federal Law*, Special Notice to Members 02-21 (Apr. 2002), *available at https://www.finra.org/Industry/Regulation/Notices/2002/p003703* (stating that "introducing brokers generally are in the best position to 'know the customer,' and thus to identify potential money laundering concerns at the account opening stage, including verification of the identity of the customer and deciding whether to open an account for a customer.").

640 A number of the Commission's enforcement actions in the BSA area have involved broker-dealers failing to report suspicious activity involving microcap securities fraud. *See, e.g.*, *In the Matter of Gilford Securities, Incorporated, Ralph Worthington, IV, David S. Kaplan, and Richard W. Granahan*, Release No. 34-65450 (Sept. 30, 2011); *In the Matter of Elizabeth Pagliarini*, Release No. 34-63964 (Feb. 24, 2011).

vehicles for laundering money.[641] As explained by FATF, these securities pose a money laundering risk because they are often used to generate illicit assets through market manipulation, insider trading and fraud.[642] In addition, unlawfully acquired assets can be used to purchase these securities in order to resell them and create the appearance of legitimately sourced funds.[643] We believe that securities offered and sold in reliance on Section 4(a)(6) could be susceptible to money laundering because they are low priced, are placed in an offering that is exempt from registration and not subject to the filing review process of a registered offering. In addition, we expect that many of the issuers relying on the exemption in Section 4(a)(6) may be shell companies, which have been associated with a high risk of money laundering.[644] We believe that Congress was aware of these risks, which is why, in part, it chose to require that

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[641] *See* FINANCIAL ACTION TASK FORCE ("FATF"), *Money Laundering and Terrorist Financing in the Securities Sector* 20-21 (Oct. 2009) ("FATF Typology") (discussing the money laundering risks associated with low priced securities, private issuers and shell companies).

[642] *Id.* As explained in the FATF Typology, illicit actors "can either use existing shares that are already publicly traded or start a shell company for the express purpose of engaging in those illicit activities. In addition, criminal organizations also have been known to use illicit assets generated outside the securities industry to engage in market manipulation and fraud." *Id.*

[643] *Id.* "Moreover, criminal organizations can also initially invest in a private company that they can then use as a front company for commingling illicit and legitimate assets. They can then take this company public through an offering in the public securities markets, thus creating what appear to be legitimate offering revenues. Alternatively, criminal organizations can acquire a publicly traded company and use it to launder illicit assets." *Id.* The FATF Typology further highlighted the risk of shell companies that, for example, "can be established to accept payments from criminal organizations for non-existent services. These payments, which appear legitimate, can be deposited into depository or brokerage accounts and either wire transferred out of a jurisdiction or used to purchase securities products that are easily transferable or redeemable." *Id.* at 39.

[644] *See, e.g.*, Joint Release, *Guidance on Obtaining and Retaining Beneficial Ownership Information*, FIN-2010-G001 (Mar. 5, 2010) (noting that criminals, money launderers, tax evaders and terrorists may exploit the privacy and confidentiality surrounding some business entities, including shell companies and other vehicles designed to conceal the nature and purpose of illicit transactions and the identities of the persons associated with them); Financial Crimes Enforcement Network, *The Role of Domestic Shell Companies in Financial Crime and Money Laundering: Limited Liability Companies* (Nov. 2006), *available at* http://www.fincen.gov/news_room/rp/files/LLCAssessment_FINAL.pdf.

securities offered and sold in reliance on Section 4(a)(6) be sold through a regulated intermediary.[645]

The BSA[646] and its implementing regulations establish the basic framework for AML obligations imposed on financial institutions.[647] The BSA is intended to facilitate the prevention, detection and prosecution of money laundering, terrorist financing and other financial crimes. Below, we clarify which aspects of these regulations we anticipate would be relevant to funding portals, given the limited scope of their activities.[648]

Among other things, the BSA and its implementing regulations require a "broker or dealer in securities" (sometimes referred to in the regulations as a "broker-dealer") to: (1) establish and maintain an effective AML program ("AML Program Requirement");[649] (2) establish and maintain a Customer Identification Program ("CIP Requirement");[650] (3) monitor for and file reports of suspicious activity ("the SAR Requirement");[651] and (4) comply with requests for information from the Financial Crimes Enforcement Network ("FinCEN") (the "Section 314(a) Requirements").[652] For purposes of the BSA obligations, a "broker or dealer in

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645 158 CONG. REC. S1781 (daily ed. Mar. 19, 2012) (statement of Sen. Carl Levin) ("Senior citizens, state securities regulators, and others worry that this will give rise to money laundering and fraud risks.")

646 *See* BSA, note 562.

647 *See* 31 CFR Chapter X.

648 We also propose to impose on funding portals obligations that are analogous to those imposed on broker-dealers pursuant to Exchange Act Rule 17a-8 (17 CFR 240.17a-8), which requires broker-dealers to comply with the reporting, recordkeeping and record retention requirements of the BSA's implementing regulations, as found in Chapter X of Title 31 of the CFR. These proposed obligations are discussed in Section II.D.5 below, which also addresses other recordkeeping requirements we are proposing for funding portals. *See* proposed Rule 404(f) of Regulation Crowdfunding.

649 *See* 31 U.S.C. 5318(h). *See also* 31 CFR 1023.210; FINRA Rule 3310.

650 31 CFR 1023.220.

651 31 CFR 1023.320. *See also* FINRA Rule 3310.

652 31 CFR 1010.520.

securities" is defined as a "broker or dealer in securities, registered or required to be registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934, except persons who register pursuant to [S]ection 15(b)(11) of the Securities Exchange Act of 1934."[653] As discussed above in Section II.D.2.a, for purposes of Chapter X of Title 31 of the Code of Federal Regulations, a funding portal is "required to be registered" as a broker or dealer with the Commission under the Exchange Act.

Finally, we note that while other parties involved in transactions conducted pursuant to Section 4(a)(6) through a funding portal (such as a bank acting as a qualified third party to hold investor funds) have their own BSA obligations, again, as noted above, we believe that the funding portal, like an introducing broker, is in the best position to "know its customers," and to identify and monitor for suspicious and potentially illicit activity at the individual customer level.

While a funding portal would be required to comply with all of the provisions in the BSA and its implementing regulations that are applicable to broker-dealers, the Commission anticipates that, as a practical matter, a funding portal's BSA obligations would typically be limited, based on the relatively limited securities activities in which funding portals would be permitted to engage. For a typical transaction involving an individual U.S. investor, funding portal activities, for example, would not involve the maintenance of "correspondent accounts" with foreign financial institutions or the offer of "private banking accounts" that would trigger the corresponding due diligence obligations under the BSA.[654] While it is possible that a funding

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653 31 CFR 1010.100(h). As noted above, certain FinCEN regulations apply to a "broker-dealer," which is defined as a "person registered or required to be registered as a broker or dealer with the Commission under the Securities Exchange Act of 1934 (15 U.S.C. 77a *et seq.*), except persons who register pursuant to 15 U.S.C. 78*o*(b)(11)." 31 CFR 1023.100(b). Such broker-dealers also would meet the definition of "broker or dealers in securities" above.

654 *See* 31 CFR 1010.610 and 1010.620.

portal's activities could trigger other BSA obligations, we expect that the nature of a funding portal's business would typically implicate the AML Program Requirement, the CIP Requirement, the SAR Requirement and the information sharing provisions of the Section 314(a) Requirements. We, therefore, highlight these obligations below.

Brokers and funding portals, which as noted above meet the definition of "broker,"[655] can satisfy the AML Program Requirement by implementing and maintaining an AML program that complies with SRO rules.[656] Generally, under existing rules applicable to brokers, an AML program must be in writing and include, at a minimum: (1) policies, procedures and internal controls reasonably designed to achieve compliance with the BSA and its implementing rules; (2) policies and procedures that can be reasonably expected to detect and cause the reporting of transactions under 31 U.S.C. 5318(g) and the implementing regulations thereunder; (3) the designation of an AML compliance officer, including notification to the SROs; (4) ongoing AML employee training; and (5) an independent test of the firm's AML program, annually for most firms.[657]

FinCEN's BSA regulations also require brokers, and thus would require funding portals, to establish a written CIP that, at a minimum, includes procedures for: (1) obtaining customer identifying information from each customer prior to account opening; (2) verifying the identity

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655 *See* discussion in this section above and in Section II.D.2.a above.

656 31 CFR 1023.210 (providing that a broker-dealer is deemed to have satisfied the requirement to establish an AML program if it (1) implements and maintains an anti-money laundering program that complies with the rules, regulations or requirements of its SRO governing such programs; and (2) the rules, regulations or requirements of the SRO have been approved, if required, by the SEC).

657 *See, e.g.*, FINRA Rule 3310. FINRA's existing AML program rule applies to member broker-dealers. FINRA or any other national registered securities association may adopt an AML Program Requirement specific to funding portals. Consistent with the BSA, any such rule must require that the AML program include, at a minimum: the development of internal policies, procedures and controls; designation of a compliance officer, an ongoing employee training program and an independent audit function to test the program. *See* 31 U.S.C. 5318(h).

of each customer,[658] to the extent reasonable and practicable, within a reasonable time before or after account opening; (3) making and maintaining a record of obtained information relating to identity verification; (4) determining, within a reasonable time after account opening or earlier, whether a customer appears on any list of known or suspected terrorist organizations designated by Treasury;[659] and (5) providing each customer with adequate notice, prior to opening an account, that information is being requested to verify the customer's identity.[660]

The CIP rule provides that, under certain defined circumstances, brokers, which would include funding portals, may rely on the performance of another financial institution to fulfill some or all of the requirements of the broker's CIP.[661] In order for brokers (which would include funding portals) to rely on the other financial institution, for example, the reliance must be reasonable.[662] The other financial institution also must be subject to an AML compliance program rule and be regulated by a federal functional regulator.[663] Additionally, the broker and the other financial institution must enter into a contract, and the other financial institution must certify annually to the broker that it has implemented an AML program and that it will perform the specified requirements of the broker's CIP.[664]

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658 For purposes of the CIP requirements, a customer is generally defined as "a person that opens a new account." 31 CFR 1023.100(d).

659 To date, there are no designated government lists to verify specifically for CIP purposes.

660 31 CFR 1023.220.

661 31 CFR 1023.220(a)(6).

662 31 CFR 1023.220(a)(6)(i).

663 31 CFR 1023.220(a)(6)(ii).

664 31 CFR 1023.220(a)(6)(iii).

Under the SAR Requirement, brokers and funding portals, which as noted above meet the definition of "broker,"[665] must file a suspicious activity report if: (1) a transaction is conducted or attempted to be conducted by, at, or through a broker; (2) the transaction involves or aggregates funds or other assets of at least $5,000; and (3) the broker knows, suspects or has reason to suspect that the transaction: (i) involves funds or is intended to disguise funds derived from illegal activity, (ii) is designed to evade requirements of the BSA, (iii) has no business or apparent lawful purpose, and the broker knows of no reasonable explanation for the transaction after examining the available facts, or (iv) involves the use of the broker-dealer to facilitate criminal activity.[666] The suspicious activity must be reported on a form prescribed by FinCEN, which includes instructions.[667] Brokers, which would include funding portals, must maintain a copy of any suspicious activity report filed, as well as supporting documentation for a period of five years from the date of filing the report.[668] The report (and any information that would reveal its existence) must be kept confidential.[669]

Under the Section 314(a) Requirements, brokers, which would include funding portals, also must respond to mandatory requests for information made by FinCEN on behalf of federal law enforcement agencies.[670] Law enforcement agencies with criminal investigative authority are permitted to request that FinCEN solicit, on the agency's behalf, certain information from a financial institution, including brokers; FinCEN also may make similar requests on its own

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665 *See* discussion in this section above and in Section II.D.2.a above.

666 31 CFR 1023.320(a).

667 31 CFR 1023.320(b).

668 31 CFR 1023.320(d).

669 31 CFR 1023.320(e).

670 31 CFR 1010.520.

behalf or on behalf of certain components of Treasury.[671] Upon receiving such a request, a broker (which would include a funding portal) is required to search its records to determine whether it has accounts for, or has engaged in transactions with, any specified individual, entity or organization.[672] If the broker identifies an account or transaction identified with any individual, entity or organization named in the request, it must report certain relevant information to FinCEN.[673] Brokers also must designate a contact person (typically the firm's AML compliance officer) to receive the requests and must maintain the confidentiality of any request and any responsive reports to FinCEN.[674]

Request for Comment

233. We identified the AML Program, CIP, SAR and 314(a) Requirements as the most significant requirements that would most typically apply to funding portals, in light of the nature of their business. Under the proposed rules, however, funding portals would be subject to all BSA requirements applicable to registered brokers. Are there any other requirements under the BSA and its implementing regulations that should be clarified, with regard to application in the crowdfunding context, or excluded from application to funding portals? If so, which ones?

234. Is express compliance with the BSA by funding portals, as proposed, necessary to protect against the risk of money laundering, given that other regulated

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671 31 CFR 1010.520(b).

672 31 CFR 1010.520(b)(3).

673 31 CFR 1010.520(b)(3)(ii).

674 31 CFR 1010.520(b)(3)(iii) and (iv).

entities involved in transactions conducted pursuant to Section 4(a)(6), such as the qualified third party we propose to require be involved in the transmission of proceeds, are subject to the BSA? Please explain.

235. Is there another approach, other than the one we have proposed, to help protect against the risk of money laundering, that does not rely on BSA compliance? If so, please explain.

c. Privacy

Section 4A(a)(9) requires intermediaries to take such steps to protect the privacy of information collected from investors as the Commission shall, by rule, determine appropriate. One commenter suggested that the responsibility for storing confidential information should rest with the intermediary and that data should not be shared with, or stored by, any other organization.[675] The commenter recommended requiring intermediaries to store information in a secure fashion on a dedicated, secure server. The commenter also urged the Commission to identify, by rule or otherwise, an appropriate industry standard for protection of this data, perhaps looking to standards adopted in the legal and banking industries as examples. Another commenter suggested that a procedure should be established to allow the public to control the delivery and the amount of e-mails soliciting funds for crowdfunding projects.[676]

The proposed rules would implement the requirements of Section 4A(a)(9) by subjecting funding portals, as brokers, to the same privacy rules applicable to brokers.[677] Proposed Rule 403(c), therefore, would require funding portals to comply with Regulation S-P (Privacy of

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675 *See* RocketHub Letter 1.

676 *See* Bach Letter.

677 *See* proposed Rule 403(c) of Regulation Crowdfunding.

Consumer Financial Information and Safeguarding Personal Information),[678] Regulation S-AM (Limitations on Affiliate Marketing)[679] and Regulation S-ID (Identity Theft Red Flags)[680] (collectively, the "Privacy Rules").[681]

Regulation S-P governs the treatment of nonpublic personal information by brokers, among others.[682] It generally requires a broker to provide notice to investors about its privacy policies and practices; describes the conditions under which a broker may disclose nonpublic personal information about investors to nonaffiliated third parties; and provides a method for investors to prevent a broker from disclosing that information to most nonaffiliated third parties by "opting out" of that disclosure, subject to certain exceptions. Regulation S-AM allows a consumer, in certain limited situations, to block affiliates of covered persons (*i.e.*, brokers, dealers, investment companies and both investment advisers and transfer agents registered with the Commission) from soliciting the consumer based on eligibility information (*i.e.*, certain financial information, such as information regarding the consumer's transactions or experiences with the covered person) received from the covered person.[683] Regulation S-ID generally requires brokers to develop and implement a written identity theft prevention program that is

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678 *See Privacy of Consumer Financial Information (Regulation S–P)*, Release No. 34-42974 (June 22, 2000) [65 FR 40334 (June 29, 2000)].

679 *See Regulation S–AM: Limitations on Affiliate Marketing*, Release No. 34-60423 (Aug. 4, 2011) [74 FR 40398 (Aug. 11, 2009)].

680 *See Identity Theft Red Flags Rules*, Release No. 34-69359 (Apr. 10, 2013) [78 FR 23637 (Apr. 19, 2013)] ("*Identity Theft Red Flags Rules*") (adopted jointly with the Commodity Futures Trading Commission).

681 *See* 17 CFR 248.

682 *See* 17 CFR 248 Subpart A.

683 17 CFR 248 Subpart B.

designed to detect, prevent and mitigate identity theft in connection with certain existing accounts or the opening of new accounts.[684]

While we recognize that crowdfunding activities, like any Internet-based communications, could raise novel issues not already addressed in existing regulations and guidance, we believe that it is unnecessary to repeat identical, existing requirements, in a separate rule proposal only for funding portals, or to propose rules that would apply not only to crowdfunding, but to a broader set of technology-based activity. We believe that the requirements of the Privacy Rules would impose relatively minimal costs on funding portals,[685] but provide key investor protections, and that persons who deal with funding portals, as opposed to brokers, should not have to lose the benefit of those protections.

Although one commenter suggested the development of a procedure to allow the public to control the delivery and the amount of e-mails that solicit funds for crowdfunding projects,[686] we note that the definition of funding portal in Exchange Act Section 3(a)(80) and the proposed rules[687] prohibit a funding portal from soliciting investors for specific crowdfunding projects. Moreover, Section 4A(b)(2) and the proposed rules[688] prohibit issuers from advertising the terms of an offering, except for directing potential investors to the intermediary.[689] The proposed rules[690] also incorporate prohibitions on the transmission of personally identifiable information

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684 *See Identity Theft Red Flags Rules*, note 680.

685 *See* discussion in Section IV.C.2.1 below.

686 *See* Bach Letter.

687 *See* proposed Rule 300(c) of Regulation Crowdfunding.

688 *See* proposed Rule 204 of Regulation Crowdfunding.

689 *See* discussion in Section II.B.4 above.

690 *See* proposed Rules 305 and 402(b)(6) of Regulation Crowdfunding.

in connection with intermediaries' advertisements, referrals and payments to third parties.[691] We believe that these provisions, in combination with the Privacy Rules, address the commenter's concern. Although one commenter urged us not to permit intermediaries to store information with third parties,[692] we note that our recordkeeping rules applicable to brokers permit the use of third-party service providers for storing records.[693] We are proposing a similar requirement for funding portals, as discussed in Section II.D.5 below. A different requirement for funding portals would not be consistent with the requirements for brokers and may not be economically feasible for some intermediaries.

Request for Comment

236. Is it appropriate to implement the requirements of Section 4A(a)(9) by applying the requirements of the Privacy Rules to funding portals? Why or why not? Is the nature of a funding portal's activities such that a different requirement to protect privacy would be more appropriate? Please explain.

237. Are there specific considerations with respect to privacy and crowdfunding that are not already adequately addressed in the Privacy Rules? If so, what are they and how should we address them?

238. Should we provide additional guidance concerning the application of the Privacy Rules to funding portals? If so, which parts and why?

239. Under the proposed rules, funding portals would be required to collect information about their customers in order to comply with anti-money

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691 *See* discussion in Sections II.C.7 and II.D.3 above.

692 *See* RocketHub Letter 1.

693 *See* 17 CFR 240.17a-4(i).

laundering provisions, as brokers are required to do, as discussed above in relation to proposed Rule 402(b). At the same time, intermediaries would be required to take steps to protect the privacy of information collected from customers, as set forth in Section 4A(a)(9). Do our proposed rules achieve the appropriate balance between these two objectives? What other approaches would achieve an appropriate balance? Please explain.

d. Inspections and Examinations

Congress specified that funding portals must remain subject to our examination authority.[694] Under the proposed rules, a funding portal would be required to permit the examination and inspection of all of its business and business operations that relate to its activities as a funding portal, such as its premises, systems, platforms and records, by our representatives and by representatives of the registered national securities association of which it is a member.

Request for Comment

240. Are there any additional provisions that should be incorporated in the proposed rules regarding inspection and examination of funding portals? Please explain.

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694 As a condition to exempting funding portals from the requirement to register as broker-dealers under Exchange Act Section 15(a)(1) (15 U.S.C. 78c(a)(1)), Exchange Act Section 3(h)(1)(A) requires that registered funding portals remain subject to, among other things, our examination authority. *See* proposed Rule 403(d) of Regulation Crowdfunding.

5. Records To Be Created and Maintained by Funding Portals

The proposed rules would require a funding portal to create and maintain certain records.[695] We believe that it is important for funding portals to be subject to a recordkeeping requirement in order to create a meaningful audit trail of the crowdfunding transactions and communications. Without these records, the Commission and any registered national securities association would have difficulty examining a funding portal for compliance with the requirements of Regulation Crowdfunding, the BSA[696] and the federal securities laws.

The proposed rules would require a funding portal to make and preserve certain records for five years, with the records retained in a readily accessible place for at least the first two years.[697] The records would include those regarding investors who purchase or attempt to purchase securities through the funding portal, such as information relating to educational materials provided to investors, account opening and transactions (including notices of investment commitments and reconfirmations), as required under Subpart C. They also would include records relating to issuers that offer and sell, or attempt to offer and sell, securities through the funding portal and to persons having control with respect to those issuers. This proposed requirement would better enable regulators to gather information about the activities in

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695 *See* proposed Rule 404 of Regulation Crowdfunding. Exchange Act Section 3(h)(1)(C) permits us to impose, as part of our authority to exempt funding portals from broker registration, "such other requirements under [the Exchange Act] as the Commission determines appropriate."

696 In the release adopting Exchange Act Rule 17a-8 (17 CFR 240.17a-8), which requires broker-dealers to comply with the reporting, recordkeeping and record retention rules adopted under the BSA, the Commission noted that the "most effective means of enforcing compliance with the reporting and recordkeeping requirements is through on-site examinations of broker-dealer firms conducted by the Commission and the self-regulatory organizations . . . ." *See Recordkeeping by Brokers and Dealers*, Release No. 34-18321 (Dec. 10, 1981) [46 FR 61454 (Dec. 17, 1981)].

697 *See* proposed Rules 404(a)(1) through (9) of Regulation Crowdfunding.

which the funding portal has been engaged, as well as about the issuers and investors that use the funding portal for their crowdfunding transactions.

The proposed rules also would require a funding portal to maintain records of all communications that occur on or through its platform.[698] Some commenters expressed concerns about the ability of funding portals to track and store communications that take place outside of their platforms.[699] We believe that funding portals should be responsible to keep records of only the communications that occur on or through their platforms, including in the communication channels they are required to provide. We do not believe they should be responsible for keeping records of communications that take place exclusively outside of their platforms, such as on third-party social media sites or elsewhere on the Internet. The proposed rules also would require a funding portal to keep all records related to persons that use communication services provided by a funding portal to promote an issuer's securities or to communicate with potential investors.[700] These proposed requirements would help regulators to examine the funding portal for any potential connection with promoters, including associated persons that act as promoters, whose promotion or communication activities could cause the funding portal to lose its exemption from broker-dealer registration.

The proposed rules would require a funding portal to maintain records demonstrating its compliance with requirements of Subparts C (intermediary obligations) and D (funding portal requirements).[701] This proposed requirement would require a funding portal to keep all the

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698 *See id.*

699 *See* CFIRA Letter 13.

700 *See* proposed Rule 404(a)(3) of Regulation Crowdfunding.

701 *See* proposed Rule 404(a)(5) of Regulation Crowdfunding.

records it has created in the course of its business in order to comply with Regulation Crowdfunding. This requirement alone would not, however, require the creation of any records or proscribe the format or manner of any records. This proposed requirement would not only assist in regulators' compliance examinations, but also should assist funding portals in complying with the rules pertaining to their crowdfunding activities.

The proposed rules would require a funding portal to maintain all notices provided by the funding portal to issuers and investors generally through the funding portal's platform or otherwise.[702] This proposed requirement would assist regulatory examination of the funding portal for any communications to issuers or investors that could indicate violations of particular provisions of proposed Regulation Crowdfunding.

The proposed rules would require a funding portal to maintain records of all written agreements (or copies thereof) entered into by a funding portal, relating to its business as such.[703] This proposed requirement is intended to capture details of any funding portal arrangements and the funding portal's compliance with applicable requirements.

The proposed rules would require a funding portal to create and maintain daily, monthly and quarterly summaries of transactions effected through it.[704] The purpose of this proposed requirement is to help ensure that an historical and ongoing record exists of the transactions that

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702 These would include, but not be limited to: (1) notices addressing hours of funding portal operations (if any); (2) funding portal malfunctions; (3) changes to funding portal procedures; (4) maintenance of hardware and software; (5) instructions pertaining to access to the funding portal; and (6) denials of, or limitations on, access to the funding portal. *See* proposed Rule 404(a)(6) of Regulation Crowdfunding.

703 *See* proposed Rule 404(a)(7) of Regulation Crowdfunding.

704 These would include: (1) issuers for which the target offering amount has been reached and funds distributed; and (2) transaction volume, expressed in number of transactions, number of securities involved in a transaction and total amounts raised by and distributed to issuers, as well as total dollar amounts raised across all issuers, expressed in U.S. dollars. *See* proposed Rule 404(a)(8) of Regulation Crowdfunding.

have been conducted through the funding portal, especially given the high volume of transactions we expect to occur on funding portals' platforms.

The proposed rules would require a funding portal to make and keep a log of each offering, reflecting the progress of each issuer in meeting the target offering amount.[705] This proposed requirement is intended to support, or otherwise be compared against, information included on an issuer's filing of Form C-U.[706]

The proposed rules also would require that a funding portal make and preserve its organizational documents, during its operation as a funding portal and of any successor funding portal.[707] This proposed requirement is intended to ensure that these key documents are maintained for identification and verification purposes.

These recordkeeping requirements are similar to, but in many ways less extensive than, those for registered broker-dealers under Exchange Act Rule 17a-4(a).[708] Because funding portals would be engaged in a more limited range of activities than brokers and a relatively high proportion of funding portals would be new market entrants that may not have formal recordkeeping practices in place, the proposed requirements are relatively streamlined, compared to those for brokers. The proposed funding portal recordkeeping requirements would require only those documents that relate to the funding portal's business and would require the portal to

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705 *See* proposed Rule 404(a)(9) of Regulation Crowdfunding.

706 *See* discussion in Section II.B.1 above. *See also* Section II.C.5 above for a discussion of proposed Rule 303(a) of Regulation Crowdfunding.

707 These would include, but not be limited to: (1) partnership agreements; (2) articles of incorporation or charter; (3) minute books; and (4) stock certificate books (or other similar type documents). *See* proposed Rule 404(b) of Regulation Crowdfunding.

708 Exchange Act Rule 17a-4 provides more extensive details of the types of records required, and it also specifies different time periods for retention, namely three to six years, depending on the type of record. 17 CFR 240.17a-4(a).

retain them for five years, but in an easily accessible place for the first two years, for purposes of facilitating and ensuring timeliness of inspections. A funding portal would be required to produce, reproduce and maintain the required records in the original, non-alterable format in which they were created or as permitted under Exchange Act Rule 17a-4(f).[709] This flexibility should be appropriate for funding portals, because we believe that many of their documents would already be in electronic form. Thus, funding portals should not incur a significant additional burden for maintenance of those records. This flexibility also is consistent with the broker recordkeeping requirements under Exchange Act Rule 17a-4(f).

We recognize that a funding portal may find it cost-effective or otherwise appropriate to use the recordkeeping services of a third party. The proposed rules would allow third parties to prepare or maintain the required records on behalf of the funding portal, provided that there is a written agreement in place between the funding portal and the third party in which the third party states that the required records are the property of the funding portal and would be surrendered promptly on request by the Commission or the national securities association of which the

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709 *See* proposed Rule 404(c) of Regulation Crowdfunding. Permitted formats would include the use of electronic storage media that otherwise permits the funding portal to comply with its obligations under the proposed rules. 17 CFR 240.17a-4(f).

funding portal is a member.[710] The funding portal also would be required to file, with the registered national securities association of which it is a member, this written undertaking, signed by a duly authorized representative of the third party. We believe that this provision would help to ensure that records maintained or preserved by a third party would be readily available for examination.

Under the proposed rules, all records of a funding portal would be subject at any time, or from time to time, to such reasonable periodic, special or other examination by our representatives and representatives of the registered national securities association of which the funding portal is a member.[711] We believe that this requirement would facilitate our oversight of funding portals and crowdfunding activities, as Congress intended.[712]

Finally, the proposed rules would require that a funding portal comply with the reporting, recordkeeping and record retention requirements of Chapter X of Title 31 of the Code of Federal Regulations, a requirement analogous to that imposed on broker-dealers under Exchange Act

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710 *See* proposed Rule 404(d) of Regulation Crowdfunding. An agreement between a funding portal and a third party would not relieve the funding portal from its responsibility to prepare and maintain records, as required under proposed Rule 404 of Regulation Crowdfunding. The written undertaking would be required to include the following provision: "With respect to any books and records maintained or preserved on behalf of [name of funding portal], the undersigned hereby acknowledges that the books and records are the property of [name of funding portal], and hereby undertakes to permit examination of such books and records at any time, or from time to time, during business hours by representatives of the Securities and Exchange Commission, the national securities association of which the funding portal is a member, and to promptly furnish to the Commission and national securities association of which the funding portal is a member, a true, correct, complete and current hard copy of any, all, or any part of, such books and records." *See* proposed Rule 404(d) of Regulation Crowdfunding. This provision is consistent with the recordkeeping provisions applicable to brokers under Exchange Act Rules 17a-4(f) (17 CFR 17a-4(f)) and 17a-4(j) (17 CFR 240.17a-4(j)), but it is somewhat simplified to be more appropriate for funding portals.

711 *See* proposed Rule 404(e) of Regulation Crowdfunding.

712 *See* Exchange Act Section 3(h)(1)(A). *See also* 158 CONG. REC. S5474-03 (daily ed. July 26, 2012) (statement of Sen. Jeff Merkley) ("I would encourage the SEC and the relevant national securities association to engage in regular reviews and reports regarding developments in the crowdfunding marketplace. . . . Should problems arise, these authorities should act quickly, including use of their full rulemaking and enforcement authorities. . . . For [crowdfunding] to succeed long-term, it will require careful oversight, especially during the early stages.").

Rule 17a-8.[713] This requirement is intended to ensure that funding portals create and maintain an accurate record of their compliance with BSA obligations, including the requirement to maintain records of suspicious activity reports.[714] As noted above, we believe that it is important for funding portals to be subject to a recordkeeping requirement, along the same lines of the requirement applicable to brokers, to create a meaningful audit trail of the crowdfunding transactions and communications that occur on and through their platforms. Without these records, we, FINRA or any other registered national securities association, would have difficulty examining a funding portal for compliance with the requirements of Regulation Crowdfunding, the BSA[715] and the federal securities laws. Although under the proposed rules funding portals would be required to create and maintain certain records, we believe this particular rule is necessary to achieve consistent application of, and ability to examine and enforce, BSA requirements across all intermediaries, whether brokers or funding portals.

Request for Comment

241. We have proposed a variety of documents and data to be retained by a funding portal. Are these documents and data appropriate? Should other types of documents and data be required to be retained, and if so, which documents and data and why? Are any of the documents and data we propose to require be retained unnecessary, unclear or not sufficiently detailed? If so, which ones?

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713 17 CFR 240.17a-8.

714 We note that a funding portal's proposed obligation, under the BSA, to report suspicious activity includes an obligation to maintain the confidentiality of suspicious activity reports and any information that would reveal the existence of a suspicious activity report. *See generally* 31 CFR 1023.320.

715 *See* note 696.

Please explain. Should any of the proposed books and records requirements be modified? If so, please explain why.

242. What burdens or costs would the retention of such information entail? Is it appropriate to base the books and records requirements of funding portals on the books and records requirements for broker-dealers generally? Have we appropriately tailored the broker-dealer requirements for funding portals? If not, how should they be further modified? Would these tailored requirements create any competitive advantages for funding portals as compared to broker-dealers engaged solely in the same limited activities in which a funding portal may engage? Are there books and records requirements currently applicable to broker-dealers, but not included in the proposed rules, that should be included? Please provide examples of any such requirements or any suggested alternatives.

E. Miscellaneous Provisions

1. Insignificant Deviations from Regulation Crowdfunding

We are proposing to provide issuers a safe harbor for certain insignificant deviations from a term, condition or requirement of Regulation Crowdfunding.[716] To qualify for the safe harbor, the issuer relying on the exemption would have to show that: (1) the failure to comply with a term, condition or requirement was insignificant with respect to the offering as a whole; (2) the issuer made a good faith and reasonable attempt to comply with all applicable terms, conditions and requirements of Regulation Crowdfunding; and (3) the issuer did not know of the failure to comply, where the failure to comply with a term, condition or requirement was the

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716 *See* proposed Rule 502 of Regulation Crowdfunding.

result of the failure of the intermediary to comply with the requirements of Section 4A(a) and the related rules, or such failure by the intermediary occurred solely in offerings other than the issuer's offering.

The first two prongs of the safe harbor provision are modeled after a similar provision in Rule 508 of Regulation D,[717] and we believe a similar safe harbor is appropriate for offerings made in reliance on Section 4(a)(6). The offering exemption in Section 4(a)(6) was designed to help alleviate the funding gap and the accompanying regulatory concerns faced by startups and small businesses, many of which may not be familiar with the federal securities laws. We believe that issuers should not lose the Section 4(a)(6) exemption because of a failure to comply that is not significant with respect to the offering as a whole, so long as the issuer, in good faith, attempted to comply with the rules. We also propose to include the third prong of the safe harbor because, under the statute, an issuer could lose the exemption because of the failure of the intermediary to comply with the requirements of Section 4A(a). We believe that an issuer should not lose the offering exemption due to such failure by the intermediary, which likely would be out of the issuer's control, if the issuer did not know of such failure or such failure related to offerings other than the issuer's offering. Absent this safe harbor, we believe issuers may be hesitant to participate in offerings in reliance on Section 4(a)(6) due to uncertainty regarding their ability to rely on the exemption, which could undermine the facilitation of capital raising for startups and small businesses.

We believe that the potential harm to investors that might result from the applicability of this safe harbor would be minimal because the deviations must be insignificant to the offering as

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717 17 CFR 230.508.

a whole for the safe harbor to apply. In addition, the proposed rules would provide that notwithstanding this safe harbor, any failure to comply with Regulation Crowdfunding would nonetheless be actionable by the Commission.[718] We believe that this safe harbor would address concerns raised by one commenter and a member of Congress.[719] We also believe it appropriately would protect an issuer who made a diligent attempt to comply with the proposed rules from losing the exemption as a result of insignificant deviations from Regulation Crowdfunding.

Request for Comment

243. Is a safe harbor for certain insignificant deviations from a term, condition or requirement of Regulation Crowdfunding appropriate? If so, is the proposed safe harbor sufficiently broad or too broad? Are there additional conditions that should apply for an issuer to rely on the safe harbor? If so, what conditions and why?

244. Should we define the term "insignificant" or use a different term? Please explain. Should we use a standard requiring something other than "good faith and reasonable attempt" to comply with the requirements? If so, what standard and why? Is it appropriate for the safe harbor to cover the failure of the intermediary to comply with the requirements of Section 4A(a) if the issuer did not know of such failure or such failure occurred solely in offerings other than

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718 *See* proposed Rule 502(b) of Regulation Crowdfunding.

719 *See* 2012 SEC Government-Business Forum, note 29 (recommending that we provide a safe harbor for "innocent violations of procedural or disclosure requirements" in transactions relying on Section 4(a)(6)). *See also* 158 CONG. REC. S2230 (daily ed. Mar. 29, 2012) (statement of Sen. Scott Brown) ("[I]ssuers should not be held liable for misstatements or omissions that were made by mistake").

the issuer's offering? Why or why not?

245. Are there certain deviations that should never be considered insignificant for purposes of this safe harbor? Why or why not? Should we provide examples of deviations that we would consider significant? If so, what should those be (*e.g.*, failure to file the Form C: Offering Statement on EDGAR)?

2. Restrictions on Resales

Section 4A(e) provides that securities issued in reliance on Section 4(a)(6) may not be transferred by the purchaser for one year after the date of purchase, except when transferred: (1) to the issuer of the securities; (2) to an accredited investor; (3) as part of an offering registered with the Commission; or (4) to a family member of the purchaser or the equivalent, or in connection with certain events, including death or divorce of the purchaser, or other similar circumstances, in the discretion of the Commission. Section 4A(e) further provides that the Commission may establish additional limitations on securities issued in reliance on Section 4(a)(6).

The proposed rules track the provisions of Section 4A(e).[720] We also are proposing to include instructions in the rules to define "accredited investor" and a "member of the family of the purchaser or the equivalent." Under the proposed rules, the term "accredited investor" would have the same definition as in Rule 501(a) of Regulation D.[721]

The statute does not define "member of the family of the purchaser or the equivalent." We propose to define the phrase to mean a "child, stepchild, grandchild, parent, stepparent, grandparent, spouse or spousal equivalent, sibling, mother-in-law, father-in-law, son-in-law,

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720 *See* proposed Rule 501 of Regulation Crowdfunding.

721 17 CFR 230.501(a). *See also* note 38.

daughter-in-law, brother-in-law, or sister-in-law of the purchaser, and shall include adoptive relationships." This definition tracks the definition of "immediate family" in Exchange Act Rule 16a-1(e),[722] but with the addition of "spousal equivalent." We propose to include the term spousal equivalent to address the concept in Section 4A(e)(1)(D) of the "equivalent" of a member of the family of the purchaser. The proposed rules would define spousal equivalent to mean a cohabitant occupying a relationship generally equivalent to that of a spouse.[723] This is the same definition as in Rule 202(a)(11)(G)-1(d)(9) under the Investment Advisers Act of 1940.[724] We believe issuers and investors would benefit from definitions that are consistent with those already used in our rules, rather than creating a new definition, because issuers may be familiar with those terms and should benefit from existing Commission and staff guidance. The proposed rules also would provide that securities offered and sold in reliance on Section 4(a)(6) may be transferred during the initial one-year period to a trust controlled by the initial purchaser or to a trust created for the benefit of a member of the family of the purchaser or the equivalent. We believe allowing transfers in such cases would be consistent with the intent of the provision because the person that controls or benefits from the trust would otherwise be covered by the rules.

Request for Comment

246. Are the proposed limitations on resale appropriate? Why or why not? If not, what approach would be more appropriate and why? Should there be additional

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722 17 CFR 240.16a-1(e).

723 *See* proposed Instruction to paragraph (c) of proposed Rule 501 of Regulation Crowdfunding.

724 17 CFR 275.202(a)(11)(G)-1(d)(9). *See also Family Offices*, Release No. IA-3220 (Jun. 22, 2011) [76 FR 37983 (June 29, 2011)] (adopting release); *Family Offices*, Release No. IA-3098 (Oct. 12, 2010) [75 FR 63753 (Oct. 18, 2010)] (proposing release).

limitations on resale, especially after the first year? Why or why not? If so, what should they be and why? If an issuer no longer was in compliance with the ongoing reporting requirements[725] or was no longer in business, should we place restrictions on the resale of the issuer's securities or otherwise limit the ability of those shares to trade? If so, please describe the appropriate restrictions and explain how we could implement such restrictions.

247. To transfer securities to an accredited investor during the one-year period beginning when the securities are sold in reliance on Section 4(a)(6), the seller would need to have a reasonable belief that the purchaser is an accredited investor.[726] Is this approach appropriate? Why or why not?

248. Is the proposed use of the definition of "accredited investor" in Rule 501(a) of Regulation D appropriate? Why or why not? Should a different definition be used for purposes of Regulation Crowdfunding? Please explain.

249. Is the proposed definition of "member of the family of the purchaser or the equivalent" appropriate? Is it appropriate to track the definition of "immediate family" under Exchange Act Section 16 (with the addition of "spousal equivalent"), or would another definition be more appropriate? Should any persons be included or not included in the definition? Why or why not? Should we use a consistent definition throughout Regulation Crowdfunding even if it differs from similar rules in other Commission regulations? Why or why not?

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725 *See* Section II.B.2 above for a discussion of the ongoing reporting requirements.

726 *See* proposed Rule 501(b) of Regulation Crowdfunding.

3. Information Available to States

Under Section 4A(d), the Commission shall make available, or shall cause to be made available by the relevant intermediary, the information required under Section 4A(b) and such other information as the Commission, by rule, determines appropriate to the securities commission (or any agency or office performing like functions) of each State and territory of the United States and the District of Columbia.

One commenter suggested that all information filed with the Commission should be made available to state regulators.[727] Another commenter questioned whether open Internet access to the crowdfunding platforms would be sufficient, questioning a platform's ability to maintain or archive records from websites that are routinely updated.[728] Another commenter suggested that the requirement in Section 4A(d) should create an affirmative obligation for an intermediary only if a state regulator requests information in excess of what is provided to the Commission.[729]

We are proposing to require issuers to file on EDGAR the information required by Section 4A(b) and the related rules. Information filed on EDGAR is publicly available and would, therefore, be available to each state, territory and the District of Columbia. We believe this approach would satisfy the requirement to make the information available. Accordingly, we do not believe that it is necessary to propose to impose any additional obligations on intermediaries with respect to this requirement.

Request for Comment

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727 *See* Commonwealth of Massachusetts Letter.

728 *See* NASAA Letter.

729 *See* RocketHub Letter 1.

250. Would the availability of information on EDGAR satisfy the requirement to make the information available to each state, territory and the District of Columbia? Are there other means of making the information available? Should we impose any additional obligations on intermediaries with respect to this requirement? If so, what are they? For example, should we require issuers or intermediaries to provide this information directly to state regulators? Please explain.

4. Exemption from Section 12(g)

Section 303 of the JOBS Act amended Exchange Act Section 12(g) to provide that "the Commission shall, by rule, exempt, conditionally or unconditionally, securities acquired pursuant to an offering made under [S]ection 4[(a)](6) of the Securities Act of 1933 from the provisions of this subsection."

As amended by the JOBS Act, Section 12(g) requires, among other things, that an issuer with total assets exceeding $10,000,000 and a class of securities held of record by either 2,000 persons, or 500 persons who are not accredited investors, register such class of securities with the Commission.[730] Crowdfunding contemplates the issuance of securities to a large number of holders, which could increase the likelihood that Section 4(a)(6) issuers would exceed the thresholds for reporting in Section 12(g). Section 303 could be read to mean that securities acquired in a crowdfunding transaction would be excluded from the record holder count permanently, regardless of whether the securities continue to be held by a person who purchased

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[730] *See* Section 501 of the JOBS Act. In the case of an issuer that is a bank or a bank holding company, Exchange Act Section 12(g)(1)(B) (15 U.S.C. 78*l*(g)(1)(B)) requires, among other things, that the issuer, if it has total assets exceeding $10,000,000 and a class of securities held of record by 2,000 persons, register such class of securities with the Commission. *See* Section 601 of the JOBS Act.

in the crowdfunding transaction. An alternative reading could provide that securities acquired in a crowdfunding transaction would be excluded from the record holder count only while held by the original purchaser in the Section 4(a)(6) transaction, as a subsequent purchaser of the securities would not be considered to have "acquired [the securities] pursuant to an offering made under [S]ection 4[(a)](6)."

Commenters expressed concern that once the securities issued pursuant to Section 4(a)(6) are transferred, the exemption from Section 12(g) registration could cease to apply and any new holders of those securities would be included in the calculation of holders of record for purposes of Section 12(g), which could potentially require an issuer to register its securities with the Commission.[731] Another commenter noted that the prospect that resales could trigger registration requirements under the Exchange Act might provide an incentive for issuers to attempt in some way to restrict resale and transfer of the securities issued in the offering made in reliance on Section 4(a)(6), even after the lapse of the one year transfer limitation, which would be to the detriment of small crowdfunding investors seeking liquidity.[732] One commenter suggested that the exemption from Section 12(g) registration should attach to different 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, so long as the parties to

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731 *See* Liles Letter 1; NCA Letter (stating that the time and expense associated with registration of a class of securities could affect an issuer's working capital and business operations); CFIRA Letter 2 (stating that the need for additional capital to meet registration requirements would result in an issuer either having to borrow money, thus leveraging its business, or raising additional capital through a subsequent equity offering that would dilute existing stockholders); ABA Letter 2 (stating that a Section 12(g) exemption limited to the initial purchaser of securities would undermine the utility of such an exemption and that an initial purchaser should not be able to force an issuer to register under Section 12(g) simply by reselling his or her securities).

732 *See* Liles Letter 1.

the transaction are affiliates of the original issuer.[733] The same commenter suggested that the availability of the exemption be conditioned on the issuer complying with the ongoing reporting requirements and not having total assets at the last day of the fiscal year in excess of $25 million.[734]

Proposed Rule 12g-6 provides that securities issued pursuant to an offering made under Section 4(a)(6) would be permanently exempted from the record holder count under Section 12(g). An issuer seeking to exclude a person from the record holder count would have the responsibility for demonstrating that the securities held by the person were initially issued in an offering made under Section 4(a)(6). We believe that allowing issuers to sell securities pursuant to Section 4(a)(6) without becoming Exchange Act reporting issuers is consistent with the intent of Title III.[735] In this regard, we note that Title III provides for an alternative reporting system under which issuers would be required to file annual reports with the Commission.[736] We believe this is consistent with the proposal to permanently exempt securities issued in reliance on Section 4(a)(6) from the record holder count under Section 12(g). Section 303 of the JOBS Act does not extend the exemption from Section 12(g) to different securities issued in a subsequent restructuring, recapitalization or similar transaction, so we are not proposing to exempt such securities at this time, as one commenter suggested.[737] We also are not proposing to condition

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733 *See* ABA Letter 2.

734 *Id.*

735 *See* 158 CONG. REC. S1829 (daily ed. Mar. 20, 2012) (statement of Sen. Jeff Merkley) ("It also provides a very important provision so the small investors do not count against the shareholder number that drives companies to have to become a fully public company. That is critical and interrelates with other parts of the [crowdfunding] bill before us.").

736 *See* Section II.B.2 above for a discussion of the requirement to file annual reports.

737 *See* ABA Letter 2.

the exemption on the issuer's compliance with the ongoing reporting requirements or on the issuer not having total assets in excess of a certain amount, as the same commenter suggested.[738] We believe that the size of the issuer should not affect the availability of the exemption because conditioning the exemption on the issuer not exceeding a certain amount of total assets would impose an additional burden on successful issuers that unsuccessful issuers would not face, which in turn would discourage growth. We also believe that failure to comply with the ongoing reporting requirements could be better addressed as proposed by making the issuer ineligible to use the exemption under Section 4(a)(6),[739] rather than by requiring such issuer to register a class of securities under Section 12(g).[740]

Request for Comment

251. Should the Commission permanently exempt securities issued pursuant to an offering under Section 4(a)(6) from the record holder count under Section 12(g), as proposed? Why or why not? Should the Commission exempt securities issued under Section 4(a)(6) only when held of record by the original purchaser in the Section 4(a)(6) transaction, an 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? Why or why not? Are

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738 *See id.*

739 *See* proposed Rule 100(b)(6) of Regulation Crowdfunding.

740 We note, however, that making the issuer ineligible to use the exemption under Section 4(a)(6) if the issuer failed to comply with the ongoing reporting requirements could have a limited impact since it only would impact an issuer that intended to rely on the Section 4(a)(6) exemption for future offers and sales. *But see* Bradford note 1 ("The need to go back to investors for future funding should constrain self-dealing, opportunistic behavior by the entrepreneur.").

there other ways to implement Section 303 that may be more appropriate? Please explain.

252. One commenter suggested[741] that the Section 4(a)(6) exemption should survive and attach to different 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. While we are not proposing to implement this suggestion at this time, we invite commenters to discuss the advantages and disadvantages of this approach.

253. The same commenter suggested[742] that the availability of the exemption under Section 12(g)(6) should be conditioned on the issuer not having total assets, at the last day of the fiscal year with respect to which the Section 12(g) compliance determination is made (or a reasonable time before or after such date), in excess of $25 million. Should we condition the availability of the exemption under Section 12(g)(6) on the issuer not having total assets in excess of $25 million? If not $25 million, should the availability of the exemption be conditioned on total assets not exceeding some other amount (*e.g.*, $10 million, $50 million, etc.)? Should this determination be made as of the last day of the fiscal year or a different date? Please explain.

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741 *See* ABA Letter 2.

742 *See id.*

254. Should issuers that fail to comply with the ongoing reporting requirements[743] of Regulation Crowdfunding be disqualified from relying on the exemption under Section 12(g)(6), as suggested by one commenter?[744] Why or why not?

255. How would issuers be able to distinguish securities issued in a transaction exempt under Section 4(a)(6) from securities issued in other offerings? What would be the costs associated with making such a determination?

5. Scope of Statutory Liability

As noted above, Securities Act Section 4A(c) sets forth a liability provision for crowdfunding transactions under Section 4(a)(6).[745] Section 4A(c) provides that an issuer will be liable to a purchaser of its securities in a transaction exempted by Section 4(a)(6) 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, provided that the purchaser did not know of the untruth or omission, and the issuer does not sustain the burden of proof that such issuer did not know, and in the exercise of reasonable care could not have known, of the untruth or omission. Section 4A(c)(3) defines, for purposes of the liability provisions of Section 4A, an issuer as including "any person who offers or sells the security in such offering." On the basis of this definition, it appears likely that intermediaries, including funding portals, would be considered issuers for purposes of this liability provision. We believe that steps intermediaries

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743 *See* proposed Rules 202 and 203(b) of Regulation Crowdfunding and Section II.B.2 above for a discussion of the ongoing reporting requirements.

744 *See* ABA Letter 2.

745 The 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).

could take in exercising reasonable care in light of this liability provision would include establishing policies and procedures[746] that are reasonably designed to achieve compliance with the requirements of Regulation Crowdfunding, and that include the intermediary conducting a review of the issuer's offering documents, before posting them to the platform, to evaluate whether they contain materially false or misleading information.

Under this liability provision, an investor who purchases securities in a crowdfunding transaction may bring an action against the issuer to recover the consideration paid for the security, with interest, or damages if the person no longer holds the security. The statute further provides that actions brought under Section 4A(c) will be subject to the provisions of Securities Act Sections 12(b) and 13, as though the liability were created under Securities Act Section 12(a)(2).

6. Disqualification

Section 302(d) of the JOBS Act requires the Commission to establish disqualification provisions under which an issuer would not be eligible to offer securities pursuant to Section 4(a)(6) and an intermediary would not be eligible to effect or participate in transactions pursuant to Section 4(a)(6). Section 302(d)(2) specifies that the disqualification provisions must be "substantially similar" to the disqualification provisions contained in Rule 262 of Regulation A,[747] and they also must cover certain actions by state regulators enumerated in Section 302(d)(2). The disqualifying events listed in Rule 262 apply to the issuer and certain other persons associated with the issuer or the offering, including the issuer's predecessors and

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746 With respect to intermediaries that are funding portals, see proposed Rule 403(a) of Regulation Crowdfunding and the discussion in Section II.D.4 above.

747 17 CFR 230.262.

affiliated issuers; directors, officers and general partners of the issuer; beneficial owners of 10 percent or more of any class of the issuer's equity securities; promoters connected with the issuer; and underwriters and their directors, officers and partners. Rule 262 disqualifying events include:

- felony and misdemeanor convictions in connection with the purchase or sale of a security or involving the making of a false filing with the Commission (the same criminal conviction standard as in Section 302(d) of the JOBS Act) within the last five years in the case of issuers and 10 years in the case of other covered persons;
- injunctions and court orders within the last five years against engaging in or continuing conduct or practices in connection with the purchase or sale of securities, or involving the making of any false filing with the Commission;
- United States Postal Service false representation orders within the last five years;
- filing, or being named as an underwriter in, a registration statement or Regulation A offering statement that is the subject of a proceeding to determine whether a stop order should be issued, or as to which a stop order was issued within the last five years; and
- for covered persons other than the issuer:
    - being subject to a Commission order:
        - revoking or suspending their registration as a broker, dealer, municipal securities dealer or investment adviser;
        - placing limitations on their activities as such;
        - barring them from association with any entity; or
        - barring them from participating in an offering of penny stock; or

- being suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or national securities association for conduct inconsistent with just and equitable principles of trade.

The disqualifying events specifically required by Section 302(d)(2) are:

- final orders issued by state securities, banking, savings association, credit union and insurance regulators, federal banking regulators and the National Credit Union Administration that either:
    - bar a person from association with an entity regulated by the regulator issuing the order; engaging in the business of securities, insurance or banking; or engaging in savings association or credit union activities; or
    - are based on a violation of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct within a 10-year period ending on the date of the filing of the offer or sale; and
- felony and misdemeanor convictions in connection with the purchase or sale of a security or involving the making of a false filing with the Commission.

One commenter urged us to apply the same standards adopted by the Commission for Rule 506 of Regulation D[748] to this exemption.[749] Another commenter stated that searching for most disqualifying events could be achieved with automated or semi-automated inquiries to databases or data services, but other disqualifying events would be difficult to identify with those

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[748] *See* Securities Act Rule 506(d) [17 CFR 230.506(d)]. *See also Disqualification Adopting Release*, note 101.

[749] *See* NASAA Letter (stating that an offering made pursuant to Section 4(a)(6) also should be subject to disqualification based on the prior bad acts of the funding portal and its management).

types of inquiries and should be the responsibility of the issuer to address with representations and warranties.[750] One commenter stated that if a bankruptcy proceeding would be a disqualifying event, it should be limited to a bankruptcy proceeding of the issuer or the intermediary and not include a personal bankruptcy proceeding.[751] Another commenter recommended that the disqualification rules: (1) not be so broad as to affect "persons who may not be true bad actors – such as persons who consent to the entry of judgments which do not also include meaningful monetary or other penalties;" (2) not apply retroactively to cover disqualifying events prior to the adoption of the final rules; and (3) apply to other types of exempt offerings (including offerings made in reliance on Regulation A).[752]

a. Issuers and Certain Other Associated Persons

The disqualification provisions included in Section 302(d) of the JOBS Act are modeled on the disqualification provisions included in Section 926 of the Dodd-Frank Act, which required the Commission to adopt rules, "substantially similar" to Rule 262, that disqualify securities offerings involving certain "felons and other 'bad actors'" from reliance on Rule 506 of Regulation D.[753] On July 10, 2013, we adopted rules to implement Section 926 of the Dodd-Frank Act to disqualify certain securities offerings from reliance on Rule 506 of Regulation D.[754]

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750 *See* Applied Dynamite Letter (stating that certain disqualifying events have open-ended definitions that would make it difficult to satisfy with confidence: "any court of competent jurisdiction" having entered an order because there is no limit to the number of courts which may have, at some time, been competent to enter an order regarding an issuer; being "subject to" certain unpublished orders or injunctions such as a United States Postal Service false representation order; and the extension of disqualification events to predecessors and affiliated issuers because of the innumerable ways in which two companies might be deemed to be affiliated).

751 *See* Landon Letter 1.

752 *See* SEC Government-Business Forum, note 29.

753 *See* Dodd-Frank Act, note 38.

754 *See* *Disqualification Adopting Release*, note 101.

The proposed disqualification rules,[755] as they relate to issuers and certain other associated persons, are modeled on the Rule 506 disqualification rules, which, in turn, are substantially similar to the disqualification provisions in Rule 262.

i. Covered Persons

The proposed rules would apply the disqualification provisions to:

- the issuer and any predecessor of the issuer or affiliated issuer;
- any director, officer, general partner or managing member of the issuer;
- any 20 percent Beneficial Owner;
- any promoter connected with the issuer in any capacity at the time of the sale;
- any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with sales of securities in the offering (which we refer to as a "compensated solicitor"); and
- any director, officer, general partner or managing member of any such compensated solicitor.

These covered persons are substantially similar to those currently covered by the disqualification rules for Rules 262 and 506. The proposed rules would cover any "officer"[756] of the issuer, mirroring the coverage in Rule 262, rather than any "executive officer [and] other officer participating in the offering"[757] as it is currently covered in Rule 506. In adopting the

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755 *See* proposed Rules 503(a)-(c) of Regulation Crowdfunding.

756 Under Securities Act Rule 405, the term "officer" is defined as "a president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization." 17 CFR 230.405.

757 Under Securities Act Rule 405, the term "executive officer" is defined as a "president [of the registrant], any vice president of the registrant in charge of a principal business unit, division or function (such as sales,

Rule 506 disqualification rules, we noted that an "officer" test would be unduly burdensome and overly restrictive due to the larger and more complex organizations that are involved in many Rule 506 transactions as compared to the smaller entities that use Regulation A. We also noted that limiting the coverage of the Rule 506 disqualification rules to executive officers and officers who participate in the offering would lessen the potential compliance burden by limiting the number of covered persons. In contrast, we believe that the startups and small businesses that may seek to raise capital in reliance on Section 4(a)(6) generally will be smaller than the entities involved in Rule 506 transactions and, likely, smaller than the issuers of securities relying on Regulation A.[758] We also believe that the "officers" of many issuers relying on Section 4(a)(6) may be only a few individuals, with or without formal titles. As a result, we do not believe that an "officer" test would be more burdensome than the test used for Regulation A purposes, so we do not see a need to deviate from Rule 262 in this context.

The proposed rules also would cover persons who are 20 Percent Beneficial Owners. This threshold differs from the 10 percent threshold specified in Rule 262, but it is the same as the threshold in the Rule 506 disqualification rules. We believe that a 10 percent ownership threshold could impose an undue burden on participants in the Section 4(a)(6) marketplace. In this regard, the potential administrative complexity of monitoring the fluctuating ownership levels and the issuer's inability to control the actions of a shareholder who does not disclose disqualification would be greater under a 10 percent threshold scheme than under a 20 percent threshold scheme. This is the same concern that led us to change the 10 percent threshold in the

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administration or finance), any other officer who performs a policy making function or any other person who performs similar policy making functions for the registrant." 17 CFR 230.405.

758 There is no cap on the amount of proceeds that may be raised in an offering relying on Rule 506, and Regulation A limits offerings to $5 million.

Rule 506 disqualification rules. A 20 percent threshold would provide greater certainty and ease of compliance than a 10 percent threshold, and it also would be consistent with both the threshold specified in the Rule 506 disqualification rules and the disclosure requirements of Sections 4A(b)(1)(B) and 4A(b)(1)(H)(iii), which require certain disclosures about shareholders based on a 20 percent threshold.[759]

The proposed rules would include the category of compensated solicitor and any director, officer, general partner or managing member of any such compensated solicitor, currently in the Rule 506 disqualification rules.[760] Regulation A offerings may involve traditional underwritten offerings, but offers and sales made in reliance on Section 4(a)(6), similar to transactions under Rule 506, would not involve underwriters. Thus, the proposed disqualification rules would not apply to underwriters, but would substitute underwriters with the concept of compensated solicitor. The statute and the proposed rules would permit issuers offering and selling securities in reliance on Section 4(a)(6) to compensate persons to promote the issuer's offering through communication channels provided by the intermediary, subject to certain conditions.[761] We believe those individuals receiving compensation to promote the issuer's offering should be covered by the disqualification provisions because they would be subject to conflicts of interest in transactions pursuant to Section 4(a)(6), which would be substantially similar to those of underwriters in Regulation A transactions.[762]

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759 *See* discussion in Section II.B.1.a.i(a) above.

760 *See* proposed Rule 503(a) of Regulation Crowdfunding.

761 *See* Section 4A(b)(3) and proposed Rule 205 of Regulation Crowdfunding. *See also* Section II.B.5 above.

762 We note that the receipt of transaction-based compensation in connection with the offer and sale of a security could cause a person to be a broker required to register with us under Exchange Act Section 15(a)(1) (15 U.S.C. 78c(a)(1)).

Moreover, the proposed rules would provide that events relating to certain affiliated issuers are not disqualifying if they pre-date the affiliate relationship.[763] Rule 262(a)(5) currently provides that orders, judgments and decrees entered against affiliated issuers before the affiliation arose do not disqualify an issuer from reliance on Regulation A if the affiliated issuer is not: (1) in control of the issuer; or (2) under the common control of a third party that controlled the affiliated issuer at the time such order, judgment or decree was entered. The proposed rules would include a substantially similar provision but would clarify that it applies to all potentially disqualifying events that pre-date affiliation. We believe this is appropriate because the current placement of this language within paragraph (5) of Rule 262(a) may incorrectly suggest that it applies only to Postal Service false representation orders. This is the same approach we took in the Rule 506 disqualification rules. As in Rule 506(d), the proposed rules would not treat entities differently if they have undergone a change of control or other remedial measures.[764] This should avoid undue complexity in applying the proposed rules, while also avoiding potential abuse by bad actors that may falsely claim to have undergone a change of control.[765]

Request for Comment

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763 *See* proposed Rule 503(c) of Regulation Crowdfunding.

764 *See Disqualification Adopting Release*, note 101 (declining to provide different treatment for entities that have undergone a change of control or other remedial measures, such as a change of policy whereby an issuer would have implemented policies and procedures, designed to prevent the occurrence of the kinds of activities that gave rise to disqualification, and such policies and procedures would have been approved by a regulator or a court).

765 Entities that have undergone a change of control or a change of policy could, however, seek a waiver of the disqualification upon a proper showing that there has been a change of control and the persons responsible for the activities resulting in a disqualification are no longer employed by the entity or exercise influence over such entity. *See* Section II.E.6.a.iv below for a discussion of waivers.

256. Should we eliminate or modify any of the proposed categories of covered persons? If so, which ones and why? Would doing so still result in a rule substantially similar to Rule 262? Should we disqualify additional categories of covered persons? If so, which ones and why?

257. The proposed rules would apply to officers of the issuer, mirroring Rule 262, rather than executive officers and other officers participating in the offering, as in Securities Act Rule 506(d). Is this approach appropriate? Why or why not?

258. Should persons compensated to promote the issuer's offering through communication channels provided by the intermediary be covered persons, as is the case for the Rule 506 disqualification rules? Why or why not? Would doing so result in a rule substantially similar to Rule 262?

259. The proposed disqualification rules would cover persons who are 20 Percent Beneficial Owners. Is the 20 percent beneficial ownership threshold appropriate? Why or why not? Should the proposed disqualification rules cover persons based on a 10 percent ownership threshold, as in Rule 262? Why or why not?

260. Should orders, judgments and decrees entered against affiliated issuers not be disqualifying if they pre-date the affiliate relationship, as proposed? Should we, as proposed, expand this treatment to entities that have undergone a change of control or a change of policy? Why or why not?

ii. Disqualifying Events

(a) Criminal Convictions

Section 302(d)(2)(B)(ii) provides for disqualification if any covered person "has been convicted of any felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the Commission." This essentially mirrors Rule 262(a)(3), which covers criminal convictions of issuers, and Rule 262(b)(1), which covers criminal convictions of other covered persons. There are, however, two differences between the felony and misdemeanor conviction provisions of Section 302(d)(2)(B)(ii) and Rule 262. First, Section 302(d)(2)(B)(ii) does not include a specific time limit (or "look-back period") on convictions that trigger disqualification, while Rule 262 provides a five-year look-back period for criminal convictions of issuers and a 10-year look-back period for criminal convictions of other covered persons. In light of the time limits on criminal convictions under Rule 262, we are proposing the same five-year and 10-year look-back periods so the proposed rules would be substantially similar to the existing rules. Second, unlike Rule 262(b)(1), Section 302(d) does not include a reference to criminal convictions "arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer or investment adviser." We are not aware of any legislative history that explains why this type of conviction was not mentioned in Section 302(d). However, because such convictions are covered in Rule 262, we believe that rules substantially similar to the existing rules should cover them.

The proposed rules are based on Rule 262 and differ from the Rule 506 disqualification rules in that the look-back period would be measured from the date of the requisite filing with the Commission, rather than the date of the relevant sale.[766] We noted in the proposing release

766 *See* proposed Rule 503(a)(1) of Regulation Crowdfunding.

for the Rule 506 disqualification rules[767] that measuring from the date of the requisite filing, as in Rule 262, would not be appropriate in the context of Rule 506 because no filing is required to be made with the Commission before an offer or sale is made in reliance on Regulation D.[768] Because the proposed rules would require issuers offering securities in reliance on Section 4(a)(6) to file with the Commission the information required by Section 4A(b),[769] the proposed rules would measure the look-back period based on the filing date, similar to Rule 262, rather than the date of sale.

(b) Court Injunctions and Restraining Orders

Under Rule 262(a)(4), an issuer is disqualified from reliance on Regulation A if it, or any predecessor or affiliated issuer, is subject to a court injunction or restraining order against "engaging in or continuing any conduct or practice in connection with the purchase or sale of any security or involving the making of any false filing with the Commission." Similarly, under Rule 262(b)(2), an issuer is disqualified from reliance on Regulation A if any other covered person is subject to such a court injunction or restraining order or to one "arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer or investment adviser." Disqualification is triggered by temporary or preliminary injunctions and restraining orders that are currently in effect, as well as by permanent injunctions and restraining orders entered within the last five years.[770]

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767 *See Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings*, Release No. 33-9211 (proposed May 25, 2011) at 18 [76 FR 31518, 31523 (June 1, 2011)].

768 *See also Disqualification Adopting Release*, note 101.

769 *See* Sections II.B.1 and II.B.3 above for a discussion of the disclosure and filing requirements.

770 The look-back period means that disqualification no longer arises from a permanent injunction or restraining order after the requisite amount of time has passed, even though the injunction or order may still be in effect. In addition, because disqualification is triggered only when a person "is subject to" a relevant

The proposed rules are substantially similar to these two provisions, but in a simplified, combined format.[771] The proposed rules would include the same coverage and look-back periods that apply under the disqualification provisions for Rules 262 and 506, except that the look-back period would be measured from the date of the requisite filing with the Commission, consistent with the approach in Rule 262. The proposed rules also would not impose due process requirements (such as notice and an opportunity to appear) or require that all appeals be exhausted or the time for appeal be expired, as a condition to disqualification. This is the same approach as under the disqualification provisions for Rules 262 and 506. We believe that the risk that disqualification may arise from ex parte proceedings could be better addressed through the waiver process,[772] rather than through additional requirements for factual inquiry that would affect all offerings. As for appealable orders, we believe that suspending disqualification during the pendency of a potentially lengthy appeals process could significantly undermine the intended protections in the rules, and therefore, the proposed rules would disqualify covered persons during the pendency of the appeals.

With regard to who would be viewed as subject to an order, we believe the proposed rules should be applied consistently with the way the staff has applied Rule 262. For disqualification purposes, the staff has interpreted Rule 262 to limit those considered "subject to" an order to only the persons specifically named in the order. Others who are not specifically named but who come within the scope of an order (such as, for example, agents, attorneys and

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injunction or order, injunctions and orders that have expired or are otherwise no longer in effect are not disqualifying, even if they were issued within the relevant look-back period.

771 *See* proposed Rule 503(a)(2) of Regulation Crowdfunding.

772 *See* Section II.E.6.a.iv below for a discussion of the waiver process.

persons acting in concert with the named person) would not be treated as "subject to" the order for purposes of disqualification.

(c) Final Orders of Certain Regulators

Section 302(d)(2)(B) provides that the disqualification rules for transactions made in reliance on Section 4(a)(6) must disqualify any covered person that:

(i) is subject to a final order of a State securities commission (or an agency or officer of a State performing like functions), a State authority that supervises or examines banks, savings associations, or credit unions, a State insurance commission (or an agency or officer of a State performing like functions), an appropriate Federal banking agency, or the National Credit Union Administration, that—

(I) bars the person from—

(aa) association with an entity regulated by such commission, authority, agency, or officer;

(bb) engaging in the business of securities, insurance, or banking; or

(cc) engaging in savings association or credit union activities; or

(II) constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct within the 10-year period ending on the date of filing of the offer or sale.

Section 302(d)(2)(B) is substantively identical to Exchange Act Section 15(b)(4)(H) and Section 203(e)(9) of the Investment Advisers Act of 1940 ("Advisers Act"). Section 302(d)(2)(B) contains a 10-year look-back period for final orders based on violations of laws and regulations that prohibit fraudulent, manipulative and deceptive conduct, while the Exchange Act and Advisers Act provisions have no time limit for such orders.

The proposed rules would reflect the text of Section 302(d)(2)(B) with two clarifications.[773] First, the proposed rules would specify that an order must bar the covered person "at the time of the filing of the information required by Section 4A(b) of the Securities Act of 1933," to clarify that a bar would be disqualifying only for as long as it has continuing effect. Second, the proposed rules would require that orders must have been "entered" within the look-back period, to clarify that the date of the order, and not the date of the underlying conduct, was relevant for that determination. We believe these clarifications would eliminate potential ambiguities and allow for more appropriate application of the rules. These clarifications also are consistent with the approach in the Rule 506 disqualification rules, except that under Securities Act Rule 506(d), the order must bar the covered person at the time of the relevant sale, rather than at the time of the filing, because no filing is required to be made with the Commission prior to the time of a sale made pursuant to Rule 506.

The proposed rules also would include the U.S. Commodity Futures Trading Commission ("CFTC") in the list of regulators whose regulatory bars and other final orders will trigger disqualification. This is consistent with the approach in the Rule 506 disqualification rules. As we noted in the adopting release for Securities Act Rule 506(d),[774] the conduct that would typically give rise to CFTC sanctions is similar to the type of conduct that would result in disqualification if it were the subject of sanctions by another financial regulator. For that reason, CFTC orders trigger consequences under other Commission statutes[775] (for example, both registered broker-dealers and investment advisers may be subject to Commission disciplinary

773 *See* proposed Rule 503(a)(3) of Regulation Crowdfunding.

774 *Disqualification Adopting Release*, note 101.

775 *See, e.g.*, Exchange Act Section 15(b)(4)(D) [15 U.S.C. 78*o*(b)(4)(D)] and Advisers Act Section 203(e)(5) [15 U.S.C. 80b-3(e)(5)].

action based on violations of the Commodity Exchange Act[776]). We believe that including CFTC orders would make the disqualification rules for transactions made in reliance on Section 4(a)(6) more internally consistent, treating relevant sanctions similarly for disqualification purposes, which should enhance the effectiveness of the disqualification rules to screen out felons and bad actors.

In our view, bars are orders issued by one of the specified regulators that have the effect of barring a person from: (1) associating with certain regulated entities; (2) engaging in the business of securities, insurance or banking; or (3) engaging in savings association or credit union activities. We believe that any such order that has one of those effects would be a bar, regardless of whether it uses the term "bar."[777] Under the proposed rules, a disqualifying order is one that bars the person "at the time of the filing of the information required by Section 4A(b) of the Securities Act of 1933" from one or more of the specified activities. Thus, for example, a person who was barred permanently, with the right to apply to reassociate after three years, would be disqualified until such time as he or she successfully applied to reassociate, assuming that the bar had no continuing effect after reassociation. Bars would be disqualifying for as long as they are in effect but no longer, matching the period of disqualification to the duration of the regulatory sanction. The treatment of regulatory bars and orders[778] is different in one relevant respect from court injunctions and restraining orders.[779] Court injunctions and restraining orders would be subject to a five-year look-back period, which would function as a cut-off (*i.e.*,

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776 7 U.S.C. 1 *et seq.*

777 Orders that do not have any of those effects are not bars, although they may be disqualifying "final orders."

778 *See* proposed Rule 503(a)(3) of Regulation Crowdfunding.

779 *See* proposed Rule 503(a)(2) of Regulation Crowdfunding.

injunctions and restraining orders issued more than five years before the filing required by Section 4A(b) would no longer be disqualifying, even if they are still in effect or permanent). This is the same approach as under the Rules 262 and 506 disqualification rules, and we do not believe that the shift from Regulation A and Rule 506 offerings to offerings pursuant to Section 4(a)(6) justifies extending the time period for disqualifications associated with court injunctions and restraining orders.

The proposed rules would define a "final order" as "a written directive or declaratory statement issued by a federal or state agency, described in proposed Rule 503(a)(3) of Regulation Crowdfunding, under applicable statutory authority that provides for notice and an opportunity for hearing, which constitutes a final disposition or action by that federal or state agency."[780] This definition is based on the definition that FINRA uses in forms related to Exchange Act Section 15(b)(4)(H), which is identical to provisions of Section 302(d). Section 302(d) provides that disqualification must result from final orders of the relevant regulators that are "based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct." The proposed rules would not, similar to the Rule 506 disqualification rules, limit "fraudulent, manipulative or deceptive conduct" to matters involving scienter. Scienter is not a requirement under Exchange Act Section 15(b)(4)(H) or Advisers Act Section 203(e)(9). Commission orders are issued under these sections based only on the existence of a relevant state or federal regulatory order. The Commission has stated that, while the degree of scienter involved is a factor in determining what sanction is appropriate,[781] the Commission can order sanctions even

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780 The federal or state agencies described in proposed Rule 503(a)(3) of Regulation Crowdfunding are the ones identified in Section 302(d)(2)(B)(i), with the addition of the CFTC.

781 *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

where scienter is not an element of the underlying state antifraud law violation.[782] We do not believe it would be appropriate to limit the provision to matters involving scienter absent a clear statutory directive to do so, particularly when the relevant language has been construed in other contexts not to be so limited. Moreover, imposing such a limitation may result in excluding regulatory orders that are explicitly mandated to be covered by the new rules.

(d) Commission Disciplinary Orders

Rule 262(b)(3) of Regulation A disqualifies an issuer if any covered person is subject to a Commission order "entered pursuant to [S]ection 15(b), 15B(a), or 15B(c) of the Exchange Act, or [S]ection 203(e) or (f) of the Investment Advisers Act." Under these provisions (other than Section 15B(a), discussed below), the Commission has authority to order a variety of sanctions against registered brokers, dealers, municipal securities dealers and investment advisers and their associated persons, including suspension or revocation of registration, censure, limiting their activities, imposing civil money penalties and barring individuals from being associated with specified entities and from participating in the offering of any penny stock.

The proposed rules are based on Rule 262(b)(3) but would not include the reference to Section 15B(a) (the basic registration requirements for municipal securities dealers).[783] Section 15B(a) is not generally a source of sanctioning authority, and we do not believe it is appropriate to refer to it in the context of the proposed disqualification rules. This is consistent with the approach in the Rule 506 disqualification rules. Under the proposed rules, the disqualification would continue only for as long as some act is prohibited or required to be performed pursuant to the order (with the consequence that censures and orders to pay civil money penalties, assuming

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782 *See In the Matter of Mitchell M. Maynard and Dorice A. Maynard*, Release No. IA-2875 (May 15, 2009).

783 *See* proposed Rule 503(a)(4) of Regulation Crowdfunding.

the penalties are paid in accordance with the order, would not be disqualifying, and a disqualification based on a suspension or limitation of activities would expire when the suspension or limitation expires).

(e) Certain Commission Cease-and-Desist Orders

Section 302(d) mandates that disqualification result from final orders issued within a 10-year period by the state and federal regulators identified in Section 302(d)(2)(B)(i). These regulators include state authorities that supervise banks, savings associations or credit unions; state insurance regulators; appropriate federal banking agencies; and the National Credit Union Administration. The Commission is not included in the list of regulators, and orders issued in stand-alone Commission cease-and-desist proceedings[784] are not disqualifying under Rule 262.[785] The reason for this omission appears to be largely historical: the Commission did not have authority to bring cease-and-desist proceedings when Rule 262 was originally adopted, and the rule has not been amended to take that authority into account. We believe that adding certain Commission cease-and-desist orders to the disqualification provisions would further enhance the investor protection intent of the disqualification provisions. This approach also would be consistent with the disqualification provisions for Rule 506. We believe an injunctive or

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[784] In cease-and-desist proceedings, the Commission can issue orders against "any person," including entities and individuals outside the securities industry, imposing sanctions such as penalties, accounting and disgorgement or officer and director bars. In contrast, administrative proceedings generally are limited to regulated entities and their associated persons.

[785] The disqualification provisions under Rule 262 also do not cover other types of Commission actions. For example, the Commission has authority under Section 9(b) of the Investment Company Act to bring proceedings against "any person" and may impose investment company bars, civil penalties and disgorgement under Sections 9(d) and (e) of the Investment Company Act. 15 U.S.C. 80a-9(b), (d) and (e). The Commission also has authority under Rule 102(e) of its Rules of Practice to censure persons (such as accountants and attorneys) who appear or practice before it, or to deny them the privilege of appearing before the Commission temporarily or permanently. 17 CFR 201.102(e). Orders under these sections are not disqualifying under Rule 262.

restraining order issued by a federal court and a Commission cease-and-desist order arising out of the same legal violation demonstrate equally disqualifying conduct and should have the same consequences under our proposed disqualification rules. We believe that the determination of disqualification should not depend on whether a particular enforcement action is brought in court or through a Commission cease-and-desist proceeding. Commission cease-and-desist orders would be an additional disqualification trigger not provided for in Section 302(d). In our view, Section 302(d) does not limit the existing authority we previously used to create other bad actor provisions, and based on the foregoing reasons, we believe it would be appropriate to add Commission cease-and-desist orders to the disqualification triggers.

The proposed rules, consistent with the approach for the Rule 506 disqualification rules, would not include administrative cease-and-desist orders that do not require any showing or finding of scienter, with one exception.[786] The proposed disqualification trigger only would cover Commission orders to cease and desist from violations and future violations of the scienter-based anti-fraud provisions of the federal securities laws (including, without limitation, Securities Act Section 17(a)(1),[787] Exchange Act Section 10(b)[788] and Rule 10b-5 thereunder,[789] Exchange Act Section 15(c)(1)[790] and Advisers Act Section 206(1)[791]). The only additional disqualification trigger not requiring scienter would be Section 5 violations.[792] Section 5

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786 *See* proposed Rule 503(a)(5) of Regulation Crowdfunding.

787 15 U.S.C. 77q(a)(1).

788 15 U.S.C. 78j(b).

789 17 CFR 240.10b-5.

790 15 U.S.C. 78*o*(c)(1).

791 15 U.S.C. 80b-6(1).

792 15 U.S.C. 77e.

imposes a strict liability standard, which does not require a finding of scienter.[793] As a matter of policy, we do not believe that the exemption from registration under Section 4(a)(6) should be made available to persons whose prior conduct has resulted in an order to cease and desist from violations of the registration requirements of Section 5.

A disqualification based on a Commission cease-and-desist order would be subject to the same five-year look-back period that applies to court restraining orders and injunctions, rather than the 10-year look-back that is mandated to apply to other final regulatory orders under Section 302(d), which would provide consistent Commission treatment of cease-and-desist orders with court orders that we seek. This approach is also consistent with the Rule 506 disqualification rules.

(f) Suspension or Expulsion from SRO Membership or Association with an SRO Member

Rule 262(b)(4) disqualifies an offering if any covered person is suspended or expelled from membership in, or suspended or barred from association with a member of, a self-regulatory organization or "SRO" (*e.g.*, a registered national securities exchange or national securities association) for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade.[794]

The proposed rules would include a reference to a registered affiliated securities association[795] and would apply the standard to all covered persons,[796] but they would not

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793 *See SEC v. Ross*, 504 F.3d 1130, 1137 (9th Cir.2007); *Swenson v. Engelstad*, 626 F.2d 421, 424 (5th Cir. 1980); *SEC v. N. Am. Research and Dev. Corp.*, 424 F.2d 63, 81-82 (2d Cir.1970); *SEC v. Pearson*, 426 F.2d 1339, 1343 (10th Cir.1970).

794 *See* 17 CFR 230.262(b)(4).

795 An association of brokers and dealers may be registered as an affiliated securities association under Exchange Act Section 15A. 15 U.S.C. 78*o*-3.

otherwise change the substance of Rule 262(b)(4).[797] Including these changes is the same approach as in the Rule 506 disqualification rules.

(g) Stop Orders and Orders Suspending the Regulation A Exemption

Paragraphs (a)(1) and (2) of Rule 262 disqualify an offering if the issuer, or any predecessor or affiliated issuer, has filed a registration statement or Regulation A offering statement that was the subject of a Commission refusal order, stop order or order suspending the Regulation A exemption within the last five years, or is the subject of a pending proceeding to determine whether such an order should be issued.[798] Similarly, paragraphs (c)(1) and (2) of Rule 262 disqualify an offering if any underwriter of the securities proposed to be issued was, or was named as, an underwriter of securities under a registration statement or Regulation A offering statement that was the subject of a Commission refusal order, stop order or order suspending the Regulation A exemption within the last five years, or is the subject of a pending proceeding to determine whether such an order should be issued.[799]

The proposed rules would incorporate the substance of paragraphs (a)(1), (a)(2), (c)(1) and (c)(2) of Rule 262 in a single paragraph that applies to all covered persons,[800] resulting in rules that are substantially similar to Rule 262. This is the same as the approach in the Rule 506 disqualification rules.

(h) United States Postal Service False Representation Orders

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796 Rule 262(b)(4) does not apply to issuers, their predecessors or affiliated issuers. 17 CFR 230.262(b)(4).

797 *See* proposed Rule 503(a)(6) of Regulation Crowdfunding.

798 17 CFR 230.262(a)(1) and (2).

799 17 CFR 230.262(c)(1) and (2).

800 *See* proposed Rule 503(a)(7) of Regulation Crowdfunding.

Paragraphs (a)(5) and (b)(5) of Rule 262 disqualify an offering if the issuer or another covered person is subject to a United States Postal Service false representation order, entered within the preceding five years, or to a temporary restraining order or preliminary injunction with respect to conduct alleged to have violated the false representation statute that applies to U.S. mail.[801]

The proposed rules would incorporate the substance of paragraphs (a)(5) and (b)(5) of Rule 262 in a single paragraph,[802] resulting in rules that are substantially similar to Rule 262. This is the same as the approach in the Rule 506 disqualification rules.

Request for Comment

261. Should we eliminate or modify any of the proposed disqualification events? If so, which ones and why? Should additional events be disqualifying events? If so, what should constitute a disqualifying event and why?

262. The proposed disqualification for certain criminal convictions contemplates a look-back period of five years for criminal convictions of issuers (including predecessors and affiliated issuers) and 10 years for other covered persons. Should we modify the proposed five- and 10-year look-back periods? If so, what should the look-back periods be? Should the look-back periods be

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801 Paragraph (a)(5) of Rule 262 relates to issuers and their predecessors and affiliated issuers, and paragraph (b)(5) of Rule 262 relates to other covered persons. Disqualification results if any covered person "is subject to a United States Postal Service false representation order entered under 39 U.S.C. 3005, within 5 years prior to the filing of the offering statement, or is subject to a temporary restraining order or preliminary injunction entered under 39 U.S.C. 3007 with respect to conduct alleged to have violated 39 U.S.C. 3005." [17 CFR 230.262(a)(5) and (b)(5)].

802 *See* proposed Rule 503(a)(8) of Regulation Crowdfunding.

measured from the date of the requisite filing with the Commission, as proposed, or the date of the relevant sale? Why?

263. Should we expand or narrow the scope of the coverage of criminal convictions? Why or why not?

264. Is the proposed coverage and look-back period for disqualification events relating to court injunctions and restraining orders appropriate? Why or why not? Should we impose any due process requirements as a condition to disqualification? If so, what should those requirements be and why? Should we expand or narrow our proposed approach of who would be viewed as subject to an order? Why or why not?

265. Are the proposed disqualification provisions relating to final orders of certain regulators appropriate? Why or why not? The proposed rules would add the CFTC to the list of regulators whose regulatory bars and other final orders will trigger disqualification. Is this addition appropriate? Why or why not? Should we define or provide additional guidance about what constitutes a "bar"? Why or why not? Is our proposed definition of "final order" appropriate? If not, why not and what should it be? Should we limit "fraudulent, manipulative or deceptive conduct" to matters involving scienter? Why or why not?

266. Are the proposed disqualification provisions relating to Commission disciplinary orders appropriate? Why or why not? Should the disqualification continue only for as long as some act is prohibited or required to be performed pursuant to the order, as proposed, or should we impose a look-back period for Commission

disciplinary orders? If we should impose a look-back period, how long should that look-back period be (*e.g.* five years, 10 years)?

267. The proposed disqualification provisions would make certain Commission cease-and-desist orders a disqualifying event. Is this approach appropriate? Why or why not? Should we create a new disqualification trigger for orders of any other regulator not identified in Section 302(d)? If so, which regulator and why?

268. Are the proposed disqualification provisions relating to suspension or expulsion from SRO membership or association with an SRO member appropriate? Why or why not?

269. Are the proposed disqualification provisions relating to stop orders and orders suspending the Regulation A exemption appropriate? Why or why not?

270. Are the proposed disqualification provisions relating to United States Postal Service false representation orders appropriate? Why or why not?

iii. Reasonable Care Exception

The proposed rules would include an exception from disqualification for offerings in which the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed because of the presence or participation of another covered person.[803] This is the same as the approach in the Rule 506 disqualification rules. The proposed reasonable care exception should help address the potential difficulty for issuers in

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[803] *See* proposed Rule 503(b)(4) of Regulation Crowdfunding.

establishing whether any covered persons are the subject of disqualifying events,[804] particularly given that there is no central repository that aggregates information from all the federal and state courts and regulatory authorities that would be relevant in determining whether covered persons have a disqualifying event in their past. We are proposing a reasonable care exception out of concern that the benefits of the new exemption under Section 4(a)(6) – which, among other things, is intended to alleviate the funding gap and accompanying regulatory concerns faced by startups and small businesses in connection with raising capital in relatively low dollar amounts – may otherwise be substantially reduced. Issuers may be reluctant to offer or sell securities in reliance on an exemptive rule if the exemption could later be found, despite the issuer's exercise of reasonable care, not to have been available. On the other hand, issuers must have a responsibility to screen bad actors out of their offerings made in reliance on Section 4(a)(6). We believe that providing a reasonable care exception would help to preserve the intended benefits of the Section 4(a)(6) exemption and avoid creating an undue burden on capital-raising activities, while giving effect to the disqualification provisions. Although Rule 262 does not contain a reasonable care exception, we believe that even with its inclusion, the proposed rules would be substantially similar to Rule 262.

We are proposing that in order for an issuer to establish that it had exercised reasonable care, it would need to make a factual inquiry into whether any disqualifications existed. The nature and scope of the factual inquiry would vary based on the circumstances of the issuer and the other offering participants. For example, we believe that issuers should have an in-depth knowledge of their own officers and directors, which could be gained through the recruiting

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804 *See also* Applied Dynamite Letter (discussing difficulties associated with satisfying certain disqualification criteria with confidence).

process and in the course of performing their duties. When relevant inquiry has already been made, further steps may not be required in connection with a particular offering. In the absence of other factors, factual inquiry by means of questionnaires or certifications, perhaps accompanied by contractual representations, covenants and undertakings, may be sufficient. If the circumstances give an issuer reason to question the veracity or accuracy of the responses to its inquiries, we believe reasonable care would require the issuer to take further steps or undertake additional inquiry to provide a reasonable level of assurance that no disqualifications apply.

The timeframe for inquiry also should be reasonable in relation to the circumstances of the offering and the participants. The objective would be for the issuer to gather information that is complete and accurate as of the time of the relevant transactions without imposing an unreasonable burden on the issuer or the other offering participants. With that in mind, we would expect issuers to determine the appropriate cut-off dates to apply when they make a factual inquiry, based upon the particular facts and circumstances of the offering and the participants involved, to determine whether any covered persons are subject to disqualification before seeking to rely on the exemption.

Request for Comment

271. Is it appropriate to have a reasonable care exception from disqualification? Why or why not?

272. In order for an issuer to establish that it had exercised reasonable care, the proposed rules would require the issuer to make a factual inquiry into whether any disqualifications existed. Is this approach appropriate? Why or why not? Should we include in the proposed rules additional guidance on what types of

factual inquiries should be undertaken under the reasonable care standard? If so, what should that guidance include? Should we create a cut-off date to apply when issuers make a factual inquiry? If so, what should that cut-off date be?

iv. Waivers

The proposed rules would include a waiver provision based on Rule 262 under which the Commission could grant a waiver of disqualification if it determined that the issuer had shown good cause "that it is not necessary under the circumstances that the [registration] exemption . . . be denied." Depending on the specific facts, we believe a number of circumstances (such as a change of control, change of supervisory personnel, absence of notice and opportunity for hearing and relief from a permanent bar for a person who does not intend to apply to reassociate with a regulated entity) could be relevant to the evaluation of a waiver request. The Commission has delegated authority to the Director of the Division of Corporation Finance to grant disqualification waivers under Regulation A.[805] Given the expectation of a short timeframe for crowdfunding offerings conducted pursuant to Section 4(a)(6), we are sensitive to the timeliness of the waiver application process and the risk that a lengthy review process may disadvantage issuers seeking speedy access to capital. We believe the staff has managed the process of granting waivers from Regulation A and Rule 505 disqualification appropriately in the past. Accordingly, we are proposing to clarify the existing delegation of authority to the Director of the Division of Corporation Finance by amending it to cover disqualification waivers under

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805 *See* Rule 30-1(b) of our Rules of Organization and Program Management [17 CFR 200.30-1(b)].

Section 4(a)(6).[806] This also is the same approach we took in the context of waivers for the Rule 506 disqualification rules.

The proposed rules would provide that disqualification would not arise if, before the filing of the information required by Section 4A(b), the court or regulatory authority that entered the relevant order, judgment or decree advises in writing, whether contained in the relevant judgment, order or decree or separately to the Commission or its staff, that disqualification under Section 4(a)(6) should not arise as a consequence of such order, judgment or decree. Because disqualification would not arise in those circumstances, no waiver would be needed. This automatic exception from disqualification is similar to that in NASAA's approved Model Accredited Investor Exemption ("MAIE"), adopted in 1997, and Uniform Limited Offering Exemption ("ULOE"), adopted in 1983 and again in 1989. Under both the MAIE and ULOE, disqualification is waived if, among other things, the regulator issuing the relevant order determines that disqualification is not necessary under the circumstances.[807] We believe that including this automatic exception from disqualification is appropriate because it allows the relevant authorities to determine the impact of their roles, and it conserves Commission resources (which might otherwise be devoted to consideration of waiver applications) in cases where the relevant authority determines that disqualification from offerings made in reliance on Section 4(a)(6) is not warranted. This is the same as the approach in the Rule 506 disqualification rules.

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806 *See* proposed paragraph (d) to Rule 30-1 of our Rules of Organization and Program Management.

807 *See* MAIE paragraph (D)(2)(b), *available at* http://www.nasaa.org/wp-content/uploads/2011/07/24-Model_Accredited_Investor_Exemption.pdf; Peter M. Fass and Derek A. Wittner, *Blue Sky Practice for Public and Private Direct Participation Offerings*, Appendix 9A, paragraph B.6 (Thompson Reuters/West 2008).

Request for Comment

273. The proposed rules contemplate that the Commission could grant a waiver of disqualification under certain circumstances. Is this approach appropriate? Why or why not? What should constitute "good cause" for purposes of seeking a waiver? Are there specific circumstances under which a waiver is appropriate (*e.g.* change of control, change of supervisory personnel, absence of notice and opportunity for a hearing)? If so, what are they?

274. Should we delegate authority to the Director of the Division of Corporation Finance to grant disqualification waivers under Section 4(a)(6), as proposed? Why or why not?

275. Is it appropriate to include an automatic exception from disqualification where the relevant authority concludes that disqualification under Section 4(a)(6) should not arise as a consequence of such order, judgment or decree, as proposed? If not, why not? Should we expand or limit this automatic exception? Please explain.

v. Transition Issues

The proposed rules would specify that disqualification under Section 4(a)(6) would not arise as a result of events occurring before the effective date of Regulation Crowdfunding, when adopted.[808] This is consistent with the approach we took with respect to the Rule 506 disqualification rules. We believe this approach would address concerns about the potential unfairness of a retroactive application of the disqualification provisions, such as to persons who

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[808] *See* proposed Rule 503(b)(1) of Regulation Crowdfunding.

settled actions prior to the enactment of the JOBS Act and the adoption of rules to implement the JOBS Act.

In lieu of imposing disqualification for pre-existing events, the proposed rules would require disclosure in the offering materials of matters that would have triggered disqualification had they occurred after the effective date of proposed Regulation Crowdfunding.[809] We believe this disclosure would put investors on notice of events that would, but for the timing of such events, disqualify offerings under Section 4(a)(6) that they are evaluating as potential investments. We also believe that this disclosure is particularly important because, as a result of the implementation of Section 302(d), investors may have the impression that all bad actors would now be disqualified from participating in offerings under Section 4(a)(6). We expect that issuers would give reasonable prominence to the disclosure to ensure that information about pre-existing bad actor events would be appropriately presented in the total mix of information available to investors. If disclosure of a pre-existing, otherwise disqualifying event is required and not adequately provided to an investor, we do not believe relief would be available under the proposed rules,[810] which provide that insignificant deviations from Regulation Crowdfunding requirements would not necessarily result in loss of the exemption.

Request for Comment

276. Should we impose disqualification for all pre-existing events, regardless of whether they occurred before the effectiveness of the final rules, or only for events after effectiveness? Why or why not? Should we treat different types of pre-existing events differently? Why or why not? If so, in either case, how

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809 *See* proposed Rule 201(u) of Regulation Crowdfunding.

810 *See* proposed Rule 502 of Regulation Crowdfunding.

should we address concerns about the fairness of retroactive application of the disqualification provisions to actions that took place prior to the enactment of the JOBS Act and the adoption of rules implementing the JOBS Act?

277. The proposed rules would specify that disqualification under Section 4(a)(6) would not arise as a result of events occurring before the effective date of proposed Regulation Crowdfunding. Should we limit disqualification to events occurring after the enactment of the JOBS Act instead? Why or why not?

278. Is it appropriate to require disclosure of matters that would have triggered disqualification had they occurred after the effective date of proposed Regulation Crowdfunding? Is there a better method of putting investors on notice of bad actor involvement? If so, what method? If disclosure of a pre-existing triggering event is required and not adequately provided to an investor, should relief for insignificant deviations from Regulation Crowdfunding requirements be available? Why or why not?

b. Intermediaries and Certain Other Associated Persons

As noted above, Section 302(d)(1)(B) requires the Commission to establish disqualification provisions under which an intermediary would not be eligible to effect or participate in transactions conducted pursuant to Securities Act Section 4(a)(6). Section 302(d)(2) requires that the disqualification provisions we propose be substantially similar to the provisions of Securities Act Rule 262, which applies to issuers. Exchange Act Section 3(a)(39)[811] currently defines the circumstances in which a broker would be subject to a "statutory

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[811] 15 U.S.C. 78c(39).

disqualification" with respect to membership or participation in a self-regulatory organization such as FINRA or any other registered national securities association. We believe that the definition of "statutory disqualification" under Section 3(a)(39) is substantially similar to, while somewhat broader than, the provisions of Rule 262.[812]

The proposed rules would prohibit any person subject to a statutory disqualification as defined in Exchange Act Section 3(a)(39) from acting as, or being an associated person of, an intermediary unless permitted to do so by Commission rule or order.[813] The term "subject to a statutory disqualification" has an established meaning under Exchange Act Section 3(a)(39) and defines circumstances that would subject a person to a statutory disqualification with respect to membership or participation in, or association with a member of, a self-regulatory organization.[814] Because funding portals, like broker-dealers, would be members of FINRA or

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812 There are certain differences between Exchange Act Section 3(a)(39) and Rule 262. For example, while Rule 262 refers to orders that had been entered into within five years prior to a filing, there is no similar time restriction in Section 3(a)(39). Unlike Rule 262, Section 3(a)(39) extends disqualification to persons who, by their conduct while associated with brokers or dealers (among other types of regulated entities), have been found to be a cause of any effective, relevant suspension, expulsion or order. Section 3(a)(39) also subjects persons to disqualification if they had been convicted of, in addition to certain specified offenses related to securities and funds, any felony within ten years of filing to apply for membership or participation in, or to become associated with a member of, an SRO; the comparable provisions of Rule 262 are, in contrast, limited to felonies or misdemeanors relating to the purchase or sale of securities. Section 3(a)(39) covers suspensions, expulsions and orders by both U.S. and non-U.S. regulators and SROs (or their equivalents), whereas Rule 262 covers suspensions, expulsions and orders by only U.S.-registered SROs, as well as orders, judgments and decrees of any court of competent jurisdiction. Finally, Rule 262 disqualifies a person, while Section 3(a)(39) does not, for being subject to a U.S. Postal Service false representation order, or subject to a temporary restraining order or preliminary injunction, entered under 39 U.S.C. 3005 or 39 U.S.C. 3007, respectively, within 5 years prior to a filing. Despite these differences, we believe that Section 3(a)(39) and Rule 262 are substantially similar in particular with regard to the persons and events they cover, their scope and their purpose.

813 *See* proposed Rule 503(d) of Regulation Crowdfunding.

814 Events that could result in a statutory disqualification for an associated person under Section 3(a)(39) include, but are not limited to: certain misdemeanor and all felony criminal convictions; temporary and permanent injunctions issued by a court of competent jurisdiction involving a broad range of unlawful investment activities; expulsions (and current suspensions) from membership or participation in an SRO; bars (and current suspensions) ordered by the Commission or an SRO; denials or revocations of registration by the CFTC; and findings by the Commission, CFTC or an SRO that a person: (1) "willfully" violated the

any other registered national securities association, we anticipate that they would take appropriate steps to check the background of any person seeking to become associated with them, including whether such person is subject to a statutory disqualification. In addition, we propose to clarify that associated persons of intermediaries engaging in transactions in reliance on Section 4(a)(6) must comply with Exchange Act Rule 17f-2, relating to the fingerprinting of securities industry personnel. Exchange Act Rule 17f-2 would apply to all brokers, including registered funding portals. The proposed instructions to Rule 503(d) would clarify that Rule 17f-2 requires that, unless subject to an exemption, every broker shall require that each of its partners, directors, officers and employees be fingerprinted and shall submit, or cause to be submitted, the fingerprints of such persons to the Attorney General of the United States or its designee for identification and appropriate processing. We believe that consistent standards for all intermediaries would assist FINRA or any other registered national securities association in monitoring compliance and enforcing its rules across its members.

We are proposing to apply to intermediaries the standard of Section 3(a)(39) rather than Rule 262 or the disqualification rules we are proposing for issuers, in part because the Section 3(a)(39) standard is already an established one among financial intermediaries and their regulators. We believe that the practices that have evolved around the Section 3(a)(39) standards have evolved in a manner appropriate to intermediaries, and that to impose a new or different standard only for those intermediaries that engage in transactions in reliance on Section 4(a)(6), could create confusion and unnecessary burdens on market participants. Unnecessary burdens

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federal securities or commodities laws, or the Municipal Securities Rulemaking Board (MSRB) rules; (2) "willfully" aided, abetted, counseled, commanded, induced or procured such violations; or (3) failed to supervise another who commits violations of such laws or rules. 15 U.S.C. 78c(a)(39).

would arise in particular for brokers that act as intermediaries in transactions in reliance on Section 4(a)(6), as they and their associated persons would become subject to two distinct standards for disqualification. Consistent standards for all brokers and funding portals would also assist FINRA or any other registered national securities association in monitoring compliance and enforcing its rules across its members.

Request for Comment

279. Is the standard for "subject to a statutory disqualification" as defined in Exchange Act Section 3(a)(39) appropriate for purposes of establishing disqualification provisions for intermediaries in crowdfunding transactions made in reliance on Section 4(a)(6)? Why or why not? If another standard would be appropriate, why should that standard be used instead of Section 3(a)(39)? If we were to use another standard for funding portals, should we also use that standard for brokers' crowdfunding activities? Or, should brokers adhere to the Section 3(a)(39) standard for all their activities, including crowdfunding?

280. Should we instead propose rules that mirror the disqualification rules we are proposing for issuers? If we were to take this approach, would any particular disqualification provision need to be tailored for intermediaries engaging in crowdfunding transactions? Are there unintended consequences of having different disqualification standards for issuers and for intermediaries? Please explain.

281. Should any of the differences between Rule 262 and Section 3(a)(39) be addressed? Why or why not? If so, how should we address them?

282. Should we permit intermediaries to determine how best to screen associated persons to ensure they are not subject to a statutory disqualification? Why or why not? If so, should we propose particular standards, or a level of care, applicable to this screening?

283. Should we prescribe specific steps that an intermediary must take to ascertain whether an associated person should be prohibited from participating in or effecting crowdfunding transactions in reliance on Section 4(a)(6)? If so, what should those steps be?

284. Should we permit intermediaries to reasonably rely on the representations of associated persons regarding statutory disqualification if the intermediary otherwise has conducted a background check on the associated person?

F. General Request for Comment

We request and encourage any interested person to submit comments regarding the proposed rules and form amendments, specific issues discussed in this release and other matters that may have an effect on the proposed rules. We particularly welcome comments from issuers, investors, state regulators and other market participants. With regard to any comments, we note that such comments are of particular assistance to us if accompanied by supporting data and analysis of the issues addressed in those comments. We urge commenters to be as specific as possible.

III. Economic Analysis

Title III sets forth a comprehensive regulatory structure for startups and small businesses to raise capital through securities offerings using the Internet through crowdfunding. In particular, Title III provides an exemption from registration for certain offerings of securities by adding Securities Act Section 4(a)(6). In addition, Title III:

- adds Securities Act Section 4A, which requires, among other things, that issuers and intermediaries that facilitate transactions between issuers and investors provide certain information to investors and potential investors, take certain actions and provide notices and other information to the Commission;
- adds Exchange Act Section 3(h), which requires the Commission to adopt rules to exempt, either conditionally or unconditionally, funding portals from having to register as brokers or dealers pursuant to Exchange Act Section 15(a)(1);
- includes disqualification provisions under which an issuer would not be able to avail itself of the exemption for crowdfunding if the issuer or other related parties, including an intermediary, were subject to a disqualifying event; and
- adds Exchange Act Section 12(g)(6), which requires the Commission to adopt rules to exempt from Section 12(g), either conditionally or unconditionally, securities acquired pursuant to an offering made in reliance on Section 4(a)(6).

As discussed in detail above, we are proposing Regulation Crowdfunding to implement the requirements of Title III. The proposed rules would implement the new exemption for the offer and sale of securities pursuant to the requirements of Section 4(a)(6) and provide a framework for the regulation of issuers and intermediaries, which includes brokers and funding portals engaging in such transactions. The proposed rules also would exempt securities offered and sold in reliance on Section 4(a)(6) from the registration requirements of Exchange Act Section 12(g).

We are mindful of the costs imposed by, and the benefits to be obtained from, our rules. Securities Act Section 2(a) and Exchange Act Section 3(f) require us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation. Exchange Act Section 23(a)(2) requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition and to not adopt any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. The discussion below addresses the economic effects of the proposed rules, including the likely costs and benefits of proposed Regulation Crowdfunding, as well as the likely effect of the proposed rules on efficiency, competition and capital formation. Given the specific language of the statute and our understanding of Congress's objectives, we believe that it is appropriate for the proposed rules to follow the statutory provisions closely. We nonetheless also rely on our discretionary authority to propose certain additional provisions. While the costs and benefits of the proposed rules in large part stem from the statutory mandate of Title III, certain costs and benefits are affected by the discretion we propose to exercise in connection with implementing this mandate. For purposes of this economic analysis, we address the costs and benefits resulting from the mandatory statutory provisions and our exercise of discretion together, because the two types of benefits and costs are not separable.

We request comment on all aspects of our economic analysis, including the potential costs and benefits of the proposed rules.

A. Economic Baseline

The baseline for our economic analysis of proposed Regulation Crowdfunding, including the baseline for our consideration of the effects of the proposed rules on efficiency, competition and capital formation, is the situation in existence today, in which startups and small businesses seeking to raise capital through securities offerings must register the offer and sale of securities under the Securities Act unless they can rely on an existing exemption from registration under the federal securities laws. Moreover, under existing requirements, intermediaries intending to facilitate such transactions generally are required to register with the Commission as broker-dealers under Exchange Act Section 15(a). Finally, under existing exemptions from the registration requirements of the Securities Act, small investors may be limited in their ability to participate in offerings of securities of nonpublic companies.[815]

1. Existing Funding Sources Available to Startups and Small Businesses

The potential economic impact of the proposed rules, including their effect on efficiency, competition and capital formation, will depend on how the crowdfunding method of raising capital compares to existing methods that startups and small businesses currently use for raising capital. Startups and small businesses can potentially tap a variety of financing sources in the capital markets: debt, equity or hybrid security offerings; registered or unregistered offerings; and bank loans. The figure below plots the capital raising by various sources for the period 2009-2012.[816] As evident from the data, significant fundraising in the capital markets takes place

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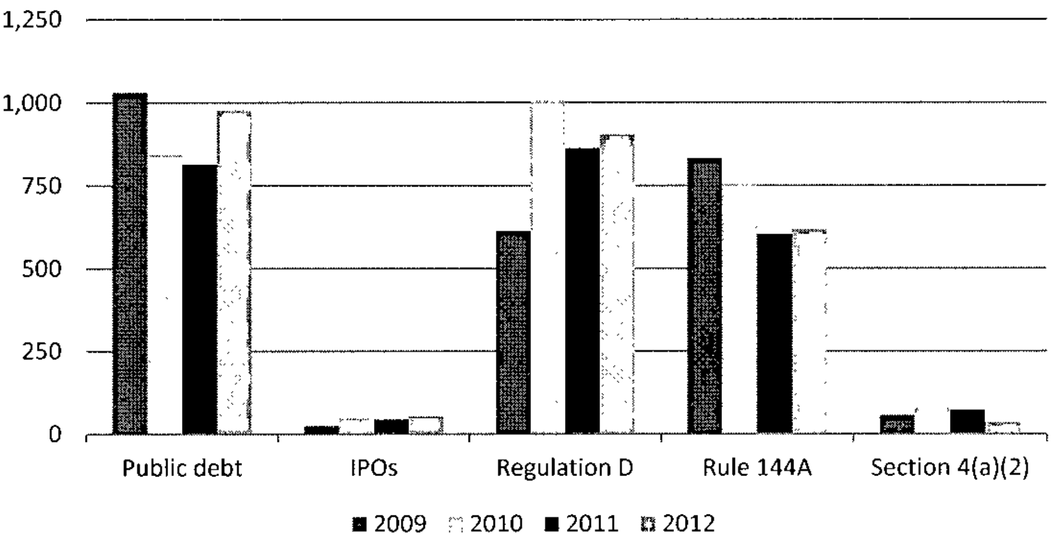
815 For example, only up to 35 non-accredited investors are allowed to participate in the most frequently used Regulation D exemption, Securities Act Rule 506(b) (17 CFR 230.506(b)), and these investors must meet certain sophistication requirements.

816 These statistics are based on a review of Form D electronic filings with the Commission – specifically, the "total amount sold" as reported in the filings – and data regarding other types of offerings (*e.g.*, public debt offerings and Rule 144A offerings) from Securities Data Corporation's New Issues database (Thomson

via public debt, Regulation D offerings (which include equity, debt and hybrid security offerings) and Rule 144A offerings (which include predominantly debt securities).



Startups and small businesses seeking to raise capital can register the offer and sale of securities under the Securities Act. Registered offerings, however, are generally too costly to be viable alternatives for startups and small businesses. In particular, issuers conducting registered offerings must usually pay underwriter commissions, which are, on average, 7% for initial public offerings, 5.4% for follow-on equity offerings and between 0.9% and 1.5% for issuers raising capital through public bond issuances.[817] Issuers conducting registered offerings also must pay

Financial). *See* Vladimir Ivanov and Scott Bauguess, *Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009-2012* (July 2013) ("*Ivanov/Bauguess Study*"), *available at* http://www.sec.gov/divisions/riskfin/whitepapers/dera-unregistered-offerings-reg-d.pdf. Data on new bank loans per year is not available.

817 *See, e.g.*, Hsuan-Chi Chen and Jay R. Ritter, *The Seven Percent Solution*, 55 J. FIN. 1105–1131 (2000); Shane A. Corwin, *The Determinants of Underpricing for Seasoned Equity Offers*, 58 J. FIN. 2249–2279 (2003); Lily Hua Fang, *Investment Bank Reputation and the Price and Quality of Underwriting Services*, 60 J. FIN. 2729–2761 (2005); Stephen J. Brown, Bruce D. Grundy, Craig M. Lewis and Patrick Verwijmeren, *Convertibles and Hedge Funds as Distributors of Equity Exposure*, 25 REV. FIN. STUD. 3077-3112 (2012).

Commission registration fees and FINRA or any other registered national securities association filing fees, legal and accounting fees and expenses, transfer agent and registrar fees, costs associated with periodic reporting requirements and other regulatory requirements and various other fees. Two surveys concluded that the average cost of achieving initial regulatory compliance for an initial public offering is $2.5 million, followed by an ongoing compliance cost, once public, of $1.5 million per year.[818] Hence, for an issuer seeking to raise less than $1 million, a registered offering is not economically feasible if it would cost an estimated $2.5 million, on average, to achieve initial regulatory compliance for an initial public offering.[819]

The alternative to raising capital via registered offerings is for startups and small businesses to offer and sell securities by relying on an existing exemption from registration under the federal securities laws. For example, they could rely on current exemptions from registration under the Securities Act, such as Section 3(a)(11), Section 4(a)(2),[820] Regulation D[821] and Regulation A.[822] While we do not have complete data on offerings relying on an exemption under Section 3(a)(11) or Section 4(a)(2), certain data available from Regulation D and Regulation A filings allow us to gauge how frequently issuers use these exemptions when raising capital. Based on Regulation D filings by non-fund issuers[823] from 2009 to 2012, there are a substantial number of issuers who choose to raise capital by relying on Rule 506 even though

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818 *See* IPO Task Force, *Rebuilding the IPO On-Ramp*, at 9 (Oct. 20, 2011), *available at* http://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf ("IPO Task Force").

819 *See id.*

820 Securities Act Section 4(a)(2) provides that the provisions of the Securities Act shall not apply to "transactions by an issuer not involving a public offering."

821 Regulation D provides a nonexclusive safe harbor from registration for certain types of securities offerings.

822 Regulation A provides a conditional exemption from registration for certain small issuances.

823 These are issuers that are not pooled investment vehicles.

their offering size would qualify for an exemption under Rule 504 or Rule 505.[824] With the recent amendment to Rule 506 of Regulation D that permits an issuer to engage in general solicitation or general advertising in offering and selling securities pursuant to Rule 506, subject to certain conditions,[825] we expect to see an even higher percentage of issuers relying on that rule. As shown in the table below reporting the number of Regulation D and Regulation A offerings by non-fund issuers, from 2009 to 2012, relatively few issuers rely on Regulation A.

	Offering size			
	< $1 Million	$1-5 million	$5-50 million	>$50 million
Rule 504	1,997	--	--	--
Rule 505	705	229	--	--
Rule 506	19,424	11,957	8,103	1,268
Regulation A	2	14	--	--

Note: Data comes from Form D and Form 1-A filings from 2009 to 2012. We consider only new offerings and exclude offerings with amount sold reported as $0 on Form D. We also use the maximum amount indicated in Form 1-A to determine offering size for Regulation A offerings.

Each of these exemptions, however, includes restrictions that may limit its suitability for startups and small businesses. The table below lists the main requirements of these exemptions. For example, the exemption under Securities Act Section 3(a)(11) is limited to intrastate offerings,[826] and an issuer seeking to offer and sell securities pursuant to Regulation A may be required to register in all 50 states if it intends to offer and sell the securities in all 50 states using

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824 This tendency could, in part, be attributed to two features of Rule 506: Blue Sky law preemption and an unlimited offering amount. *See also* U.S. Government Accountability Office, *Factors That May Affect Trends in Regulation A Offerings*, GAO-12-839 (Jul. 3, 2012), *available at* http://www.gao.gov/products/GAO-12-839 ("GAO Report").

825 *See General Solicitation Adopting Release*, note 12.

826 Under Securities Act Section 3(a)(11), except as expressly provided, the provisions of the Securities Act (including the registration requirement under Securities Act Section 5) do not apply to a security that is "part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory."

the Internet. An issuer relying on Regulation A also would need to file with the Commission an offering document, which, coupled with the potential review of such document by the staff, has been cited as a reason why Regulation A is not widely used.[827] Issuers of securities pursuant to Securities Act Section 4(a)(2) and Rules 504, 505 and 506(b) under Regulation D generally may not engage in general solicitation and general advertising to reach potential investors, which also could place a significant limitation on offerings by startups and small businesses. Although an issuer may avoid the restriction on general solicitation and general advertising by using the services of a financial intermediary, those services may be costly.[828] While Rule 506 under Regulation D preempts the applicability of state laws regarding the offer and sale of securities and new Rule 506(c) permits general solicitation and general advertising, an issuer seeking to rely on Rule 506(c) would be limited to selling securities only to accredited investors.[829]

Type of Offering	Dollar Limit	Manner of Offering	Issuer and Investor Requirements	Filing Requirement	Restriction on Resale	Blue Sky Exemption
Section 3(a)(11)	None.	No limitation other than to maintain intrastate character of offering.	All issuers and investors must be resident in state. No limitation on number.	None.	Rests within the state (generally a one-year period for resales within state).	Need to comply with state blue sky law by registration or state exemption.
Section 4(a)(2)	None.	No general solicitation or advertising.	All issuers and investors must meet sophistication and access to information test so as not to	None.	Restricted securities.	Need to comply with state blue sky law.

827 *See* Rutheford B. Campbell, Jr., *Regulation A: Small Businesses' Search for "A Moderate Capital"*, 31 DEL. J. CORP. L. 77, 106 (2006). *See also* GAO Report, note 824.

828 An internal study by our Division of Economic and Risk Analysis covering 2009 to 2012 found that the average sales commission for Regulation D offerings for up to $1 million was 6.5%, almost three times larger than that for offerings of more than $50 million (1.9%). *See Ivanov/Bauguess Study*, note 816.

829 *See General Solicitation Adopting Release*, note 12.

			need protection of registration.			
Regulation A	$5,000,000 within prior 12 months, but no more than $1,500,000 by selling security holders.	"Testing the waters" permitted before filing Form 1-A. Sales permitted after Form 1-A qualified.	No requirements.	File test the waters documents, Form 1-A, any sales material and Form 2-A report of sales and use of proceeds with the Commission.	None; freely resalable.	Need to comply with state blue sky law.
Rule 504 Regulation D	$1,000,000 within prior 12 months.	No general solicitation or advertising unless registered in a state requiring use of a substantive disclosure document or sold under state exemption for sales to accredited investors with general solicitation.	No requirements.	File Form D with the Commission not later than 15 days after first sale. Filing not a condition of the exemption.	Restricted unless registered in a state requiring use of a substantive disclosure document or sold under state exemption for sale to accredited investors with general solicitation.	Need to comply with state blue sky law by registration or state exemption.
Rule 505 Regulation D	$5,000,000 within prior 12 months.	No general solicitation or advertising.	Unlimited accredited investors and 35 non-accredited investors.	File Form D with the Commission not later than 15 days after first sale. Filing not a condition of the exemption.	Restricted securities.	Need to comply with state blue sky law.
Rule 506 Regulation D	None.	No general solicitation or advertising under Rule 506(b). General solicitation and general	Under Rule 506(b), unlimited accredited investors and 35 non-accredited investors. Under Rule 506(c), all	File Form D with SEC not later than 15 days after first sale. Filing not a condition of the	Restricted securities.	Exempt as "covered security" pursuant to Securities Act Section 18 [15 U.S.C. 77r].

		advertising permitted under Rule 506(c), provided all purchasers are accredited investors.	purchasers must be accredited investors.	exemption.		

2. Current Sources of Funding for Startups and Small Businesses that Could Be Substitutes or Complements to Crowdfunding

At present, startups and small businesses can raise capital through several sources that could be close substitutes or complements to crowdfunding transactions that rely on Section 4(a)(6). These sources are either based on unregistered securities offerings or involve lending by financial institutions.

a. Family and Friends

Family and friends are sources through which startups and small businesses can raise capital. This source of capital is usually available early in the lifecycle of a small business, before the business approaches arm's-length formal financial channels.[830] Among other things, family and friends may donate funds, loan funds or acquire an equity stake in the business. A recent study of the financing choices of startups finds that most of the capital supplied by friends and family is in the form of loans.[831] In contrast to a commercial lender that, for example, would need to assess factors such as the willingness and ability of a borrower to repay the loan and the viability of its business, family and friends may be willing to assist based primarily or solely

830 *See* Paul Gompers and Josh Lerner, THE VENTURE CAPITAL CYCLE (MIT Press 2006) ("Gompers"); Alicia M. Robb and David T. Robinson, *The Capital Structure Decisions of New Firms*, REV. FIN. STUD. (forthcoming), *available at* http://rfs.oxfordjournals.org/content/early/2012/07/07/rfs.hhs072.full.pdf+html ("Robb").

831 *See* Robb, note 830.

upon personal relationships. Family and friends, however, may be able to provide only a limited amount of capital compared to other sources. In addition, financial arrangements with family and friends may not be an optimal source of funding if any of the parties is untrained in the structuring of loan agreements, equity investments or in related areas of accounting. Unfortunately, there is no available data on these financing sources that could allow us to quantify their magnitude and compare them to other current sources of capital.

b. Commercial Loans, Peer-to-Peer Loans and Microfinance

Startups and small businesses also may seek loans from financial institutions.[832] A recent study of the financing choices of startups suggests that they resort to bank financing early in their lifecycle.[833] The study finds that businesses rely heavily on external debt sources such as bank financing in the first year after being formed, which comes mostly in the form of personal and commercial bank loans, business credit cards and credit lines. Another recent report, however, suggests that bank lending to small businesses fell by $100 billion from 2008 to 2011 and that by 2012, less than one-third of small businesses reported having a business bank loan.[834] Our analysis of lending data from FDIC-insured depository institutions from June 30, 2006 until June

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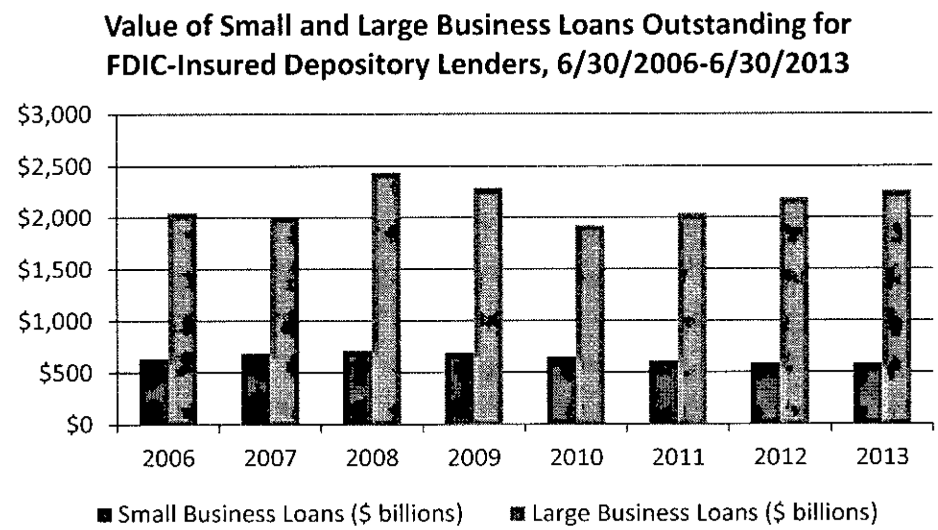
832 Using data from the 1993 Survey of Small Business Finance, one seminal study indicates that financial institutions account for approximately 27% of small firms' borrowings. *See* Allen N. Berger and Gregory F. Udell, *The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets in the Financial Growth Cycle*, 22 J. BANKING & FIN. 613 (1998). *See also* 1987, 1993, 1998 and 2003 Surveys of Small Business Finances, *available at* http://www.federalreserve.gov/pubs/oss/oss3/nssbftoc.htm. The Survey of Small Business Finances was discontinued after 2003. Using data from the Kauffman Foundation Firm Surveys, one study finds that 44% of startups use loans from financial institutions. *See* Rebel A. Cole and Tatyana Sokolyk, *How Do Start-Up Firms Finance Their Assets? Evidence from the Kauffman Firm Surveys* (2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2028176.

833 *See* Robb, note 830.

834 *See* The Kauffman Foundation, *2013 State of Entrepreneurship Address* (Feb. 5, 2013), *available at* http://www.kauffman.org/uploadedFiles/DownLoadableResources/SOE%20Report_2013pdf.pdf. The report cautions against prematurely concluding that banks are not lending enough to small businesses as the sample period of the study includes the most recent recession.

30, 2013 also shows that both small business loans (those for up to a $1 million) and large business loans (those greater than $1 million) experienced a decline from the peak in 2008.[835] Small business loans, however, declined continuously over the period by approximately 18% from 2008 until 2013. Large business loans, on the other hand, range from a high of $2,440 billion in 2008 to a low of $1,924 billion in 2010. The figure shows that this segment of the loan market has shown steady increases since 2010.



Additionally, although covering the pre-recessionary period, a Federal Reserve Board staff study analyzing data from the 2003 Survey of Small Business Finance suggests that 60 percent of small businesses have outstanding credit in the form of a credit line, a loan or a capital lease.[836] These loans were borrowed from two types of financial institutions – depositary and

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835 We define business loans to include commercial and industrial loans and commercial real estate loans. *See* Federal Deposit Insurance Corporation, *Statistics on Banking*, *available at* http://www2.fdic.gov/SDI/SOB/.

836 *See* Federal Reserve Board, *Financial Services Used by Small Businesses: Evidence from the 2003 Survey of Small Business Finances* (October 2006), *available at* http://www.federalreserve.gov/pubs/bulletin/2006/smallbusiness/smallbusiness.pdf ("2003 Survey").

non-depositary institutions (*e.g.*, finance companies, factors or leasing companies).[837] Lines of credit were the most widely used type of credit.[838] Other types of loans included mortgage loans, equipment loans and motor vehicle loans.[839]

Various loan guarantee programs of the Small Business Administration ("SBA") make credit more accessible to small businesses by either lowering the interest rate of the loan or enabling a market-based loan that a lender would not otherwise be willing to provide, absent a guarantee.[840] Although the SBA does not itself act as a lender, the agency guarantees a portion of loans made and administered by commercial lending institutions. SBA loan programs include 7(a) loans,[841] CDC/504 loans[842] and Microloans.[843] For example, in fiscal year 2011, the SBA approved approximately $30.5 billion in 7(a) and CDC/504 loans, which were distributed to approximately 54,500 small businesses.[844] The SBA, however, currently accounts for a small

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837 *See* Rebel Cole, *What Do We Know About the Capital Structure of Privately Held Firms? Evidence from the Surveys of Small Business Finance* (Working Paper) (Feb. 2013), *available at* http://onlinelibrary.wiley.com/doi/10.1111/fima.12015/pdf.

838 *See* 2003 Survey, note 836 (estimating that 34% of small businesses use lines of credit).

839 *Id.*

840 Numerous states also offer a variety of small business financing programs, such as Capital Access Programs, collateral support programs and loan guarantee programs. These programs are eligible for support under the State Small Business Credit Initiative, *available at* http://www.treasury.gov/resource-center/sb-programs/Pages/ssbci.aspx.

841 15 U.S.C. 631 *et seq*. The 7(a) loans provide small businesses with financing guarantees for a variety of general business purposes through participating lending institutions.

842 15 U.S.C. 695 *et seq*. The CDC/504 loans are made available through "certified development companies" or "CDCs", typically structured with the SBA providing 40% of the total project costs, a participating lender covering up to 50% of the total project costs and the borrower contributing 10% of the project costs.

843 15 U.S.C. 631 *et seq*. The Microloan program provides small, short-term loans to small businesses and certain types of not-for-profit childcare centers. The maximum loan amount is $50,000, but the average microloan is about $13,000. *See Microloan Program,* U.S. Small Business Administration, *available at* http://www.sba.gov/content/microloan-program.

844 *See* U.S. Small Business Administration, *FY 2013 Congressional Budget Justification And FY 2011 Annual Performance Report* ("*2011 Annual Performance Report*"), *available at* http://www.sba.gov/sites/default/files/files/1-508%20Compliant%20FY%202013%20CBJ%20FY%202011%20APR%281%29.pdf.

part of the overall small business lending in the United States, administering less than 2 percent of all small business loans.[845]

Many startups and small businesses may find loan requirements imposed by financial institutions difficult to meet and may not be able to rely on these institutions to secure funding. For example, financial institutions generally require a borrower to provide collateral and/or a guarantee,[846] which startups, small businesses and their owners may not be able to provide. Collateral may be required even for loans guaranteed by the SBA.

Another source of debt financing for startups and small businesses is peer-to-peer lending, which, according to one study, began developing in 2005.[847] Peer-to-peer lending websites facilitate debt transactions by directly connecting borrowers and lenders over the Internet. While data on the size of the overall industry is sparse, peer-to-peer lending was estimated to have reached approximately $647 million in 2009 and was expected to grow to $5.8 billion by 2010.[848] Although this source of funding is small relative to the role of financial institutions, peer-to-peer lending sites may offer small businesses more flexibility with regard to pricing, terms of credit, repayment schedules and other conditions. Moreover, peer-to-peer lending sites may not require borrowers to post collateral or a guarantee, and some market

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845 One article notes that as of September 2012, the SBA managed 318,396 ($79 billion) loans, while there were 17,249,884 ($646 billion) small-business loans on the books of banks insured by the FDIC. By this measure, the SBA managed 1.85% (12.23% in dollar volume) of all small-business loans. *See* Ami Kassar, *Putting the S.B.A. Into Perspective*, N.Y. TIMES, Sept. 14, 2012, *available at* http://boss.blogs.nytimes.com/2012/09/14/putting-the-s-b-a-into-perspective/. The SBA recently proposed rule amendments to increase eligibility for loans under the SBA's business loan programs. *See* SBA 504 and 7(a) Regulatory Enhancements, 13 CFR 120 (proposed Feb. 25, 2013).

846 Approximately 92% of all small business debt to financial institutions is secured, and about 52% of that debt is guaranteed, primarily by the owners of the firm. *See* Berger, note 832.

847 *See* Ian Galloway, *Peer-to-Peer Lending and Community Development Finance*, Federal Reserve Bank of San Francisco (Working Paper) (2009), *available at* http://www.frbsf.org/publications/community/wpapers/2009/wp2009-06.pdf.

848 *Id.*

participants offer a secondary market for loans originated on their own sites.[849] At least one of the existing peer-to-peer platforms sells third-party issued securities to multiple individual investors, thus improving the liquidity of these securities.[850] Like any traditional lending arrangement, however, borrowers on peer-to-peer lending sites are required to make fixed regular payments to their lenders, which might make it a less attractive option for small businesses with negative cash flows and short operating histories, both of which may make it more difficult for such businesses to demonstrate their ability to repay loans.

Microfinance also is another source of debt financing for startups and small businesses. Microfinance consists of small, working capital loans provided by microfinance institutions ("MFIs") that are invested in microenterprises or income-generating activities.[851] The typical users of microfinance services and, in particular, of microcredits are family-owned enterprises or self-employed, low-income entrepreneurs, such as street vendors, farmers, service providers, artisans and small producers, who live close to the poverty line in both urban and rural areas.[852]

The microfinance market has evolved and grown considerably in the past decades. While data on the size of the overall industry is sparse, in 2008, it was estimated that there were between 7,000 and 10,000 MFIs globally that supplied an estimated $15 to $25 billion in loans.[853] In the U.S., there were about 362 MFIs who disbursed 9,100 loans for a total value of

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849 *Id.*

850 *Id.* We note that under current law, this activity would require broker-dealer registration.

851 *See* Craig Churchill and Cheryl Frankiewicz, *Making Microfinance Work: Managing for Improved Performance*, Geneva International Labor Organization (2006).

852 *See* Joanna Ledgerwood, *Microfinance Handbook: An Institutional and Financial Perspective*, Washington DC, World Bank Publications (1999).

853 *See* Sam Daley-Harris, *State of Microcredit Summit Campaign Report 2009*, Washington DC, Microcredit Summit Campaign (2009).

$100 million.[854] On average, U.S. microloans are relatively larger with lower interest rates than those of microloans in developing countries. One distinctive characteristic of the U.S. model of microfinance is that MFIs provide borrowers not only with funds, but also with educational services to build entrepreneurial and leadership skills.[855]

c. Venture Capitalists and Angel Investors

Startups and small businesses also may seek funding from venture capitalists ("VCs") and angel investors. Entrepreneurs seek VC and angel financing usually after they have exhausted other sources of capital that generally do not require the entrepreneurs to relinquish control rights (for example, personal funds and funds from family and friends, if available).

As the chart below shows, according to data from the National Venture Capital Association, in 2012, VCs invested approximately $27 billion in approximately 3,800 deals that included seed, early-stage, expansion, and late-stage companies.[856]

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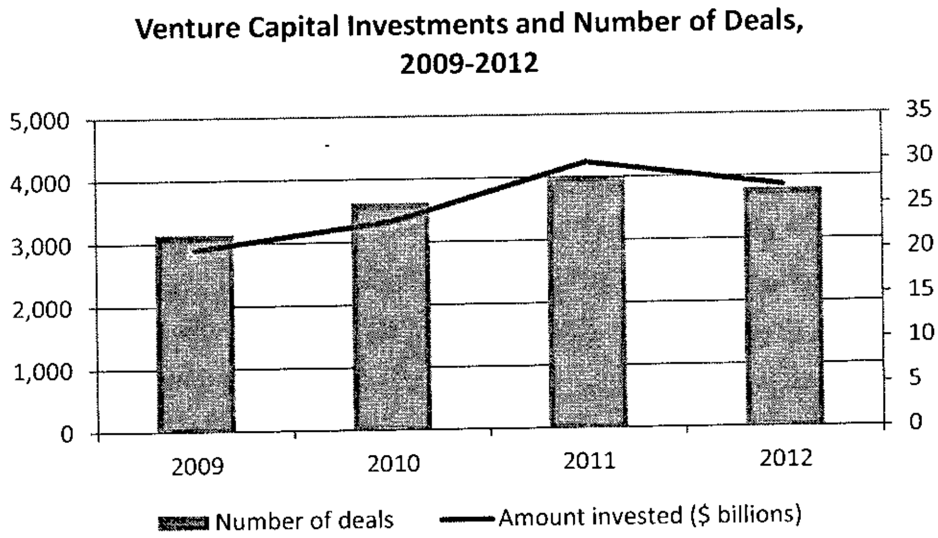
854 *See* FIELD at the Aspen Institute, *Key Data on the Scale of Microlending in the U.S.* (February 2011).

855 *Id.* at 4 and 13.

856 *See* National Venture Capital Association, *Recent Stats & Studies*, *available at* http://www.nvca.org/index.php?option=com_content&view=article&id=344&Itemid=103.



Some startups, however, may struggle to attract funding from VCs because VCs tend to invest in startups with certain characteristics. A defining feature of VCs is that they tend to focus exclusively on startup companies with high-growth potential and a high likelihood of going public after a few years of financing. VCs also tend to invest in companies that have already used some other sources of financing, tend to be concentrated in certain geographic regions (*e.g.*, California and Massachusetts) and often require their investments to have an attractive business plan, meet certain growth benchmarks or fill a specific portfolio or industry niche.[857] In addition, when investing in companies, VCs tend to acquire significant control rights (*e.g.*, board seats, rights of first refusal, etc.), which they gradually relinquish as the company approaches an initial public offering.[858]

According to a trade association, the Angel Capital Association, in 2006, the 5,632 accredited angel investors in its member groups made 947 investments in 512 companies,

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857 *See* Gompers, note 830.

858 *See* Steven N. Kaplan and Per Stromberg, *Financial Contracting Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 REV. ECON. STUD. 281-316 (2003).

providing startups with a total of $228.8 million.[859] A study suggests that angel investors tend to invest in younger companies than VCs.[860] We do not have more detailed data on the amount of angel investments in more recent years.

d. Current Crowdfunding Practices

Currently in the United States, crowdfunding activity generally is lending-based, "reward-based" or "donation-based," as defined by a recent crowdfunding industry report.[861] The report defines reward-based crowdfunding as a model where funders receive a "reward," such as a token or a manufactured product sample, and it defines donation-based crowdfunding as a model where funders donate to causes that they want to support, with no expected compensation or return on their investment. Many of the current domestic crowdfunding offerings relate to individual projects and may not have a defined or sustained business model commensurate with typical issuers of securities. The industry report finds that more than half of all projects on one of the largest domestic crowdfunding sites during the period 2009 through 2011 involved film and musical endeavors.[862]

According to the industry report, approximately $1.5 billion in financing was raised through crowdfunding platforms during 2011, with over half of that amount raised in the United States, although only approximately $174 million was attributable to "equity-based" (or the

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859 *See* Scott Shane, *The Importance of Angel Investing in Financing the Growth of Entrepreneurial Ventures*, 2 Q. J. OF FIN. (2012).

860 *See* Gompers, note 830.

861 *See* Massolution, *Crowdfunding Industry Report: Market Trends, Composition and Crowdfunding Platforms* (Abridged) (May 2012), *available at* http://www.crowdsourcing.org/document/crowdfunding-industry-report-abridged-version-market-trends-composition-and-crowdfunding-platforms/14277 ("Massolution"). Lending-based crowdfunding includes peer-to-peer lending, a funding source that is discussed above. *Id.*

862 *Id.*

equity model of crowdfunding) and "reward-based" crowdfunding.[863] The industry report further states that equity-based crowdfunding is the fastest-growing of all the crowdfunding categories, at a 114% compound annual growth rate ("CAGR") in 2011.[864] According to the report, the rapid growth in equity-based crowdfunding has been driven largely by European platforms.[865]

According to the industry report, most current crowdfunding projects solicit low levels of funding, with the average successful project receiving less than $10,000.[866] The industry report also states that, in 2011, equity-based offerings were, on average, much larger than donation-based offerings, with 68% of total funds raised on equity-based crowdfunding platforms drawing $50,000 or more in financing, suggesting that the types of ventures financed through equity-based crowdfunding could be different than those financed through other crowdfunding methods.[867] Because the prohibition on general solicitation and general advertising (which was recently lifted for offerings made in reliance on Rule 506(c) of Regulation D[868]) would have

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863 One observer stated that most of the $1.5 billion in financing cited in the Massolution industry report was attributable to "donation-based" and "lending-based" crowdfunding. *See* Felix Salmon, *Annals of Dubious Statistics, Crowdfunding Edition*, REUTERS (July 27, 2012), *available at* http://blogs.reuters.com/felix-salmon/2012/07/27/annals-of-dubious-statistics-crowdfunding-edition. Another observer reported that Massolution CEO Carl Esposti clarified that the amount directly attributed to reward-based and equity-based crowdfunding is $174 million. *See* Liz Gannes, *Widely Cited Crowdfunding Market Estimates Are Probably Too Optimistic*, ALLTHINGSD (July 28, 2012), *available at* http://allthingsd.com/20120728/crowdfunding-market-nearly-10-times-smaller-than-widely-cited-estimate.

864 *See* Massolution, note 861 at 17. By comparison, "reward-based" crowdfunding had a 79% CAGR in 2011, while "lending-based" crowdfunding and "donation-based" crowdfunding had CAGRs of 50% and 41%, respectively.

865 *Id.*

866 *Id.* at 20-21.

867 *Id.* at 20-21.

868 *See General Solicitation Adopting Release*, note 12.

made equity-based crowdfunding difficult in the United States, we assume that the data for equity-based crowdfunding comes from offerings outside the United States.

We are unaware of any domestic issuers and investors that are currently participating in securities-based crowdfunding offerings on Internet-based crowdfunding platforms that are operating outside of the United States (other than offerings made in reliance on Rule 506(c) of Regulation D), although we recognize that these platforms may represent an additional source of funding for startups and small businesses.

3. Survival Rates for Startups and Small Businesses

Startups and small businesses that lack tangible assets or business experience needed to obtain conventional financing might turn to securities-based crowdfunding in reliance on Section 4(a)(6) as an attractive potential source of financing. There is broad evidence that many of these potential issuers are likely to fail after receiving funding. For example, a 2010 study reports that of a random sample of 4,022 new high-technology businesses started in 2004, only 68% survived by the end of 2008.[869] Other studies also have documented high failure rates for small newly listed companies. For example, the ten-year delist rate for newly listed firms during the period 1981-1991 is 44.1%, compared to 16.9% for newly listed firms in the 1970s.[870]

Similarly, other studies suggest that startups and small businesses financed by venture capitalists also tend to have high failure rates. One study finds that for 16,315 VC-backed companies that received their first institutional funding round between 1980 and 1999,

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869 *See* Alicia Robb, E.J. Reedy, Janice Ballou, David DesRoches, Frank Potter and Zhanyun Zhao, *An Overview of the Kauffman Firm Survey: Results from the 2004-2008 Data*, Kauffman Foundation ("Kauffman Firm Survey"), *available at* http://www.kauffman.org/uploadedFiles/kfs_2010_report.pdf.

870 *See* Eugene F. Fama and Kenneth R. French, *New Lists: Fundamentals and Survival Rates*, 73 J. OF FIN. ECON. 229-269 (2004).

approximately one-third failed after the first funding round.[871] Additionally a recent study of more than 2,000 companies that received at least $1 million in venture funding, from 2004 through 2010, finds that almost three-quarters of these companies failed.[872] These failure rates are high, despite the involvement of sophisticated investors like VCs that are likely better equipped than the average retail investor to deal with uncertainty and risk associated with investments in startups and that generally specialize in selecting firms with good prospects, have direct access to management, have board representation and have at least some degree of control over operating decisions.

Because we expect that issuers that would engage in offerings made in reliance on Section 4(a)(6) would potentially be in an earlier stage of business development than the businesses included in the above studies, we believe that issuers that engage in securities-based crowdfunding may have higher failure rates than those in the studies cited above.[873]

4. Market Participants

The proposed rules will have their most significant impact on the market for the financing of startups and small businesses. The number of participants in this market and the amounts raised through alternative sources indicate that this is a large market. In 2011, there were almost 5 million small businesses, defined by the U.S. Census Bureau as having fewer than 500 paid employees.[874] In the same year, FDIC-insured depositary institutions held approximately $626

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871 *See* Yael V. Hochberg, Alexander Ljungqvist and Yang Lu, *Whom You Know Matters: Venture Capital Networks and Investment Performance*, 62 J. OF FIN. 251-301 (2007).

872 *See* Deborah Gage, *The Venture Capital Secret: 3 Out of 4 Start-Ups Fail*, WALL ST. J., Sept. 19, 2012.

873 *See* Rajshree Agarwal and Michael Gort, *Firm and Product Life Cycles and Firm Survival*, 92 AM. ECON. REV. 184–190 (2002) ("Agarwal").

874 *See* U.S. Department of Commerce, United States Census Bureau, *Business Dynamics Statistics, Data: Firm Characteristics* (2011), *available at* http://www.census.gov/ces/dataproducts/bds/data_firm.html.

billion in small business loans,[875] and VCs contributed an additional $30 billion of capital to startups and small businesses.[876]

We analyze the economic effect of the proposed rules on the following parties: (1) issuers, typically startups and small businesses seeking to raise capital by issuing securities; (2) intermediaries, through which issuers seeking to engage in transactions in reliance on Section 4(a)(6) will offer and sell their securities; (3) investors who purchase or may consider purchasing securities in such offerings; and (4) other capital providers, broker-dealers and finders who currently participate in private offerings. The potential economic impact of the proposed rules will depend on how these market participants respond to the proposed rules. Each party is discussed in further detail below.

a. Issuers

The proposed rules would permit certain entities to raise capital by issuing securities for the first time. The number, type and size of the potential issuers that would seek to use crowdfunding to offer and sell securities in reliance on Section 4(a)(6) is uncertain, but data regarding current market practices may help identify the number and characteristics of potential issuers.

Although it is not possible to predict the number of future securities offerings that might rely on Section 4(a)(6), particularly because rules governing the process are not yet in place, we estimate that the number could be in the thousands per year. We base this estimate on the current number of businesses pursuing similar levels of financing through alternate capital

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875 Small business loans are defined as loans secured by nonfarm nonresidential properties and commercial and business loans of $1,000,000 or less. *See* Federal Deposit Insurance Corporation, note 835.

876 *See* National Venture Capital Association, *Recent Stats & Studies*, *available at* http://www.nvca.org/index.php?option=com_content&view=article&id=344&Itemid=103.

raising methods: small business loans, reward-based and donation-based crowdfunding and Regulation D offerings. According to the SBA's fiscal year 2011 annual performance report, 54,500 small businesses received funding in 2011 through SBA's main lending programs, 7(a) and 504 loans.[877] A crowdfunding industry report estimates that there were 430,920 donation-based or reward-based campaigns in the U.S., which we estimate were conducted by 181,440 unique issuers.[878] Finally, a large number of Regulation D offerings are within the offer limits established for crowdfunding under Section 4(a)(6). According to filings made with the Commission, from 2009 to 2012, there were 25,274 new Regulation D offerings with offer sizes of $1 million or less. These offerings involved 19,652 unique issuers. When excluding hedge funds and investment companies, entities that generally would not be eligible to raise capital in reliance on the exemption in Section 4(a)(6),[879] the number of unique issuers was 15,616. Among these issuers, 24% reported no revenue, while approximately 20% had revenues of less than $1 million.[880] Approximately 92% of these issuers were organized as either a corporation or a limited liability company.

It is expected that many future issuers of securities in crowdfunding offerings would have otherwise raised capital from one of these alternative sources of financing, while others would

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877 *See 2011 Annual Performance Report*, note 844.

878 The estimated number of campaigns is based on 532,000 successful fundraising campaigns in North America, 90% of which were in the U.S. and most of which (90%) were either rewards-based or donation-based. According to the industry report, 69% of issuers engaged in one to two campaigns, 26% in three to five campaigns and 5% in more than five campaigns. To estimate the number of unique issuers, we used the midpoint from the first two groupings and assumed that issuers in the third grouping engage in six campaigns. The number of unique issuers is thus estimated as follows: $(90\% \times 90\% \times 532{,}000) / ((69\% \times 1.5) + (26\% \times 4) + (5\% \times 6)) = 181{,}440$. *See* Massolution, note 861.

879 *See* discussion in Section II.A.3 above.

880 These percentages could be higher because almost 45% of the Regulation D issuers declined to disclose their size.

have been financed by friends and family or not financed at all. Hence, while the total number of businesses using these alternative funding sources provides a basis for the potential number of issuers offering and selling securities in reliance on Section 4(a)(6) in the future, we cannot know how many of these businesses would elect securities-based crowdfunding in reliance on Section 4(a)(6) once it becomes available, nor can we know how many future businesses may not be financed at all. Further, SBA loan programs and other government contracting programs classify "small businesses" as those with fewer than 500 employees,[881] and we expect that some of these businesses might be too large for crowdfunding in reliance on Section 4(a)(6) to be an effective capital-raising option. Separately, many of the current rewards-based or donations-based crowdfunding projects likely entail applications that may not be suitable to a long-lived security issuance (*e.g.*, certain artistic endeavors or artistic projects). Nevertheless, these data show that the potential number of businesses that might seek to offer and sell securities in reliance on Section 4(a)(6) is large, particularly when compared to the current number of Exchange Act reporting issuers, which is less than 10,000.[882]

We believe that many potential issuers of securities through crowdfunding would be startups and small businesses that are close to the "idea" stage of the business venture and that have business plans that are not sufficiently well-developed or do not offer the profit potential or business model to attract VCs or angel investors that otherwise specialize in investing in high

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881 *See, e.g.*, 13 CFR 121.406(b) (a non-manufacturing business may qualify as a small business concern under Small Business Administration regulations, in part, if it does not exceed 500 employees); 7 CFR 3403.2 (defining small business concern under U.S. Department of Agriculture regulations, in part, as a concern that has not more than 500 employees).

882 In fiscal year 2012, there were approximately 9,140 reporting companies. U.S. Securities and Exchange Commission, *FY 2014 Congressional Budget Justification, 2014 Annual Performance Plan, FY 2012 Annual Performance Report*, at 80, *available at* http://www.sec.gov/about/reports/secfy14congbudgjust.pdf.

risk ventures. In this regard, a study of one large platform revealed that relatively few companies on that platform operate in technology sectors that typically attract VC investment activity.[883]

b. Crowdfunding Intermediaries

Section 4(a)(6)(C) requires that an offer and sale of securities in reliance on Section 4(a)(6) be conducted through a registered funding portal or a broker. Registered brokers, both those that are already registered with the Commission and those that would register, might wish to facilitate securities-based crowdfunding transactions. New entrants that do not wish to register as brokers might decide to register as funding portals to facilitate securities-based crowdfunding transactions in reliance on Section 4(a)(6). Donation-based or reward-based crowdfunding platforms with established customer relations might seek to leverage these relations and register as funding portals, or register as or associate with registered broker-dealers. Although the number of potential intermediaries that would fill these roles is uncertain, practices of existing brokers and crowdfunding platforms provide insight into how the market might develop.

As of December 2012, there were 4,450 broker-dealers registered with the Commission, with average total assets of approximately $1.1 billion per broker-dealer. The aggregate total assets of these registered broker-dealers are approximately $4.9 trillion. Of these registered broker-dealers, 410 also are dually registered as investment advisers.

Existing crowdfunding platforms are diverse and actively involved in financing, allowing thousands of projects to search for capital. A recent industry survey of crowdfunding platforms

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883 *See* Ethan R. Mollick, *The Dynamics of Crowdfunding: An Exploratory Study* (Working Paper) (June 26, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2088298.

reports that 191 platforms were estimated to be operating in the U.S. as of 2012.[884] Additionally, based on 135 participants in the survey worldwide (including the U.S.), 15% of platforms were engaged in equity-based crowdfunding, 11% in lending-based crowdfunding, 27% in donation-based crowdfunding and 47% in reward-based crowdfunding.[885] Moreover, the industry survey stated that current crowdfunding portals typically charge entrepreneurs a listing fee that is based on how large the target amount is and/or upon reaching the target. According to the survey, fees from survey participants worldwide ranged from 2% to 25%, with an average of 7% in North America and Europe.[886]

We do not know at present which market participants would become intermediaries under Section 4(a)(6) after final rules are adopted, but we believe that existing crowdfunding platforms might seek to leverage their already-existing Internet-based platforms, brand recognition and user bases to facilitate offerings in reliance on Section 4(a)(6).[887] Industry participants have suggested that they expect three to four of the crowdfunding platforms that currently have the majority of market share in rewards-based and donation-based crowdfunding to obtain the majority of market share in the newly-developed securities-based crowdfunding market that relies on Section 4(a)(6).[888]

Under the statute and the proposed rules, funding portals are constrained in the services they could provide, and persons (or entities) seeking the ability to participate in activities

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884 *See* Massolution, note 861 at 16.

885 *Id.* at 17.

886 *Id.* at 23.

887 For example, a recent crowdfunding industry report suggests that funding portal reputation is important in the crowdfunding market, especially for equity-based crowdfunding. *See id.*

888 For information on Commission staff discussions with industry participants, *see Meetings with SEC Officials*, *available at* http://www.sec.gov/comments/jobs-title-iii/jobs-title-iii.shtml#meetings.

unavailable to funding portals, such as offering investment advice or holding, managing, possessing or otherwise handling investor funds, would instead need to register as brokers or investment advisers, depending on their activities. Although we believe, based on conversation with industry participants, that initially, upon adoption of the final rules, more new registrants would register as funding portals than as broker-dealers, our conversations with industry participants[889] indicate that market competition to offer broker-dealer services as part of intermediaries' service capabilities might either drive more broker-dealer growth in the longer term or provide registered funding portals with the incentive to form long-term partnerships with registered broker-dealers. For example, crowdfunding platforms could have incentives to partner with broker-dealers because of broker-dealers' experience in providing recommendations or investment advice, as well as broker-dealers' access to investors.[890] There is anecdotal evidence that these partnerships are already forming under existing regulations, and one report predicted that in the first quarter of 2013, two to three dozen crowdfunding portals would partner with broker-dealers to start conducting private offerings under Regulation D in anticipation of securities-based crowdfunding.[891]

c. Investors

It is unclear what types of investors would participate in offerings made in reliance on Section 4(a)(6), but based on the profile of investors in the current domestic reward-based and donation-based crowdfunding market, we believe that many investors affected by the proposed

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889 *Id.*

890 *See* Mohana Ravindranath, *Crowdfunding platform ships product samples to potential investors*, WASH. POST, Nov. 29, 2012.

891 *See* David Drake, *Rich Man's Crowd Funding*, FORBES, Jan. 15, 2013. *See also* Mohana Ravindranath, *Quickly adapting to crowdfunding laws*, WASH. POST, Sept. 7, 2012; J.J. Colao, *In the Crowdfunding Gold Rush, This Company Has a Rare Edge*, FORBES, June 5, 2013.

rules would likely be individual retail investors who currently do not have broad access to investment opportunities in early-stage ventures, either because they do not have the necessary accreditation or sophistication to invest in most private offerings or because they do not have sufficient funds to participate as angel investors. Offerings made in reliance on Section 4(a)(6) might provide retail investors with additional investment opportunities, although the extent to which they invest in such offerings would likely depend on their view of the potential return on investment as well as the risk for fraud.

In contrast, larger, more sophisticated or well-funded investors may be less likely to invest in offerings made in reliance on Section 4(a)(6). The relatively low investment limits set by the statute for crowdfunding investors might make these offerings less attractive for professional investors, including VCs and angel investors.[892] While an offering made in reliance on Section 4(a)(6) could bring an issuer to the attention of these investors, it is possible that professional investors would prefer, instead, to invest in a Rule 506 offering, which is not subject to the investment limitations applicable to offerings made in reliance on Section 4(a)(6).

d. Other Capital Providers, Broker-Dealers and Finders in Private Offerings

The proposed rules might affect the capital providers that currently finance small private businesses: small business lenders, VCs, family and friends and angel investors. The current scope of fundraising done by these capital providers is discussed above. As discussed below, the

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892 An observer suggests that, unlike angels, VCs may be less interested in crowdfunding because, if VCs rely on crowdfunding sites for their deal flow, it would be difficult to justify charging a 2% management fee and 20% carried interest to their limited partners. *See* Ryan Caldbeck, *Crowdfunding – Why Angels, Venture Capitalists And Private Equity Investors All May Benefit*, FORBES, Aug. 7, 2013.

magnitude of the impact would depend on whether crowdfunding in reliance on Section 4(a)(6) emerges as a substitute or a complement to these financing sources.

In addition, issuers conducting private offerings might currently use broker-dealers to help them with various aspects of the offering and to help ensure compliance with the ban on general solicitation and advertising that exists for most private offerings. Private offerings also could involve finders who connect issuers with potential investors for a fee.[893] These private offering intermediaries also may be affected by the proposed rules because once these rules come into effect, issuers might no longer need the services of those broker-dealers and finders. Although we are unable to predict the exact size of the market for broker-dealers and finders in private offerings that are comparable to those that the proposed rules would permit,[894] data on the use of broker-dealers and finders in the Regulation D markets suggest that they may not currently play a large role in private offerings. Only 13% of all new Regulation D offerings from 2009 to 2012 used an intermediary such as a broker-dealer or a finder.[895] Approximately 11% of new offerings reported sales commissions greater than zero, while approximately 3% reported finder fees greater than zero. The use of a broker-dealer or a finder increased with offering size; they participated in 13% of offerings for up to $1 million and 18% of offerings for more than $50 million. Moreover, broker-dealer commissions and finder fees tend to decrease with offering size. Unlike the gross spreads in registered offerings, the differences in commissions for Regulation D offerings of different sizes are large: the average commission paid by issuers

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893 Depending on their activities, these persons may need to be registered as broker-dealers.

894 *See* The Task Force on Private Placement Broker-Dealers, ABA Section of Business Law, *Report and Recommendations of the Task Force on Private Placement Broker-Dealers,* 60 BUS. LAW. 959, 969-70 (2005) ("Task Force on Private Placement Broker-Dealers").

895 *See Ivanov/Bauguess Study*, note 816.

conducting offerings of up to $1 million (6.5%) is almost three times larger than the average commission paid by issuers conducting offerings of more than $50 million (1.9%). Similarly, the average finder's fee for offerings of up to $1 million is approximately 6.1%, compared to 1.4% for offerings of more than $50 million. We base these estimates, however, only on the Regulation D market. It is possible that issuers engaging in other types of private offerings (*e.g.*, those relying on Section 4(a)(2)), for which we do not have data, might use broker-dealers and finders more frequently and have different fee structures.

B. Analysis of Proposed Rules

As noted above, we are sensitive to the costs and benefits of the proposed rules, as well as the impact that the proposed rules would have on efficiency, competition and capital formation. In enacting Title III, Congress established a framework for a new type of exempt offering and required us to adopt rules to implement that framework. To the extent that crowdfunding rules are successfully utilized, the crowdfunding provisions of the JOBS Act should provide startups and small businesses with the means to raise relatively modest amounts of capital, from a broad cross section of potential investors, through securities offerings that are exempt from registration under the Securities Act. They also should permit small investors to participate in a wider range of securities offerings than may be available currently.[896] Specifically, the statutory provisions and the proposed rules address several challenges specific to financing startups and small businesses, including, for example, accessing a large number of

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[896] *See, e.g.*, 158 CONG. REC. S1781 (daily ed. Mar. 19, 2012) (statement of Sen. Carl Levin) ("Right now, the rules generally prohibit a company from raising very small amounts from ordinary investors without significant costs.").

potential investors, the regulatory requirements associated with issuing a security, protecting investors and making such securities offerings cost-effective for the issuer.

In the sections below, we analyze the costs and benefits associated with the proposed crowdfunding regulatory regime, as well as the potential impacts of such a regulatory regime on efficiency, competition and capital formation, in light of the background discussed above.

1. Broad Economic Considerations

In this release, we discuss costs and benefits that are related to the proposed rules. Many of these costs and benefits are difficult to quantify or estimate with any degree of certainty, especially considering that Section 4(a)(6) provides a new method for raising capital in the United States. Some costs are difficult to quantify or estimate because they represent transfers between various market participants. For instance, costs to issuers could be passed on to investors and costs to intermediaries could be passed on to issuers and investors. These difficulties in estimating and quantifying are exacerbated by the limited public data that indicates how issuers, intermediaries and investors would respond to these new investment opportunities.

The discussion below highlights several general areas where uncertainties regarding the new crowdfunding market might affect the potential costs and benefits of the proposed rules. It also highlights the potential effects on efficiency, competition and capital formation, as well as our ability to quantify relevant benefits and costs. In light of these uncertainties, we encourage commenters to provide data and analysis to help further quantify or estimate the potential benefits and costs of these proposed rules.

The extent to which the statute and the proposed rules would affect capital formation and the cost of capital to issuers depends in part on the issuers that choose to participate. In particular, if the offering exemption under Section 4(a)(6) only attracts issuers that are otherwise able to raise capital through alternative venues (*e.g.*, offerings relying on an exception from registration under Securities Act Section 3(a)(11), Securities Act Section 4(a)(2), Regulation A or Regulation D), the statute and the proposed rules could result in a redistribution of capital flow, which would enhance allocative efficiency but have a limited impact on the aggregate level of capital formation.[897] In addition, the degree to which the proposed rules would affect capital formation depends on the implementation of other provisions of the JOBS Act that may alter existing options for small companies to raise capital. For example, Title II allows issuers relying on the exemption in Securities Act Rule 506(c) to use general solicitation and general advertising, while Title IV envisions a modified Regulation A offering exemption with a higher dollar limit.

Notwithstanding these alternatives, we believe that the Section 4(a)(6) offering exemption would likely represent a new source of capital for many issuers that currently have difficulty raising capital and that would continue to have difficulty raising capital when other JOBS Act provisions are implemented. Startups and small businesses usually have smaller and more variable cash flows than larger more established companies, and internal financing from their own business operations tends to be limited and unstable. Moreover, these businesses tend to have smaller asset bases[898] and, thus, less collateral for traditional bank loans. Startups and small businesses, which are widely viewed to have more financial constraints than publicly-

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897 For example, a recent GAO report on Regulation A offerings suggests that a significant decline in the use of this funding alternative after 1997 could be partially attributed to a shift in offerings to Rule 506 offerings under Regulation D, as a result of the preemption of state securities laws for Rule 506 offerings that occurred in 1996. *See* GAO Report, note 824.

898 *See, e.g.*, John Asker, Joan Farre-Mensa and Alexander Ljungqvist, *Corporate Investment and Stock Market Listing: A Puzzle?* (European Corporate Governance Institute Finance Working Paper, June 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1603484.

traded companies and large private companies, could therefore benefit significantly from a securities-based crowdfunding market. We believe that the statute, as it would be implemented by the proposed rules, could increase both capital formation and the efficiency of capital allocation. The extent to which such issuers would use the Section 4(a)(6) offering exemption , however, is difficult to assess.

If startups and small businesses find alternative capital raising options more attractive than securities-based crowdfunding, the impact of Section 4(a)(6) on capital formation could be limited. Even so, the availability of securities-based crowdfunding as a financing option could increase competition among suppliers of capital, resulting in a potentially lower cost of capital for all issuers, including those that choose not to use securities-based crowdfunding.

For issuers that pursue offerings in reliance on Section 4(a)(6), establishing an initial price might be challenging. Although the statute requires certain issuer disclosures and the proposed rules are intended to help investors evaluate the viability of the issuer and the initial offering, these disclosures may be insufficient for investors to determine an appropriate price since there would be no underwriter of the offering and the issuer may not otherwise be skilled in valuation. It is not clear, therefore, how an initial offering price would be reached for many of the securities offered, nor how investors would be protected against poor initial valuations.[899] These potential difficulties might limit investor participation in offerings made in reliance on Section 4(a)(6) and mitigate some of the associated benefits of capital formation.

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899 There also is a chance that valuations that emerge are inaccurate. For example, there is vast literature documenting that, on average, IPOs are significantly underpriced relative to their initial prices on the secondary market. For a review of the theory and evidence of IPO underpricing, *see* Jay Ritter and Ivo Welch, *A Review of IPO Activity, Pricing, and Allocations*, 57 J. FIN. 1795-1828 (2002). *See also* Ivo Welch, *Sequential Sales, Learning, and Cascades*, 47 J. FIN. 695-732 (1992) (analyzing the risk of herding among investors when shares are sold sequentially).

Uncertainty surrounding exit strategies for investors in crowdfunding offerings also might limit the benefits. In particular, it is unlikely that purchasers in crowdfunding transactions would be able to follow the typical path to liquidity that investors in other exempt offerings follow. For instance, investors in a VC-backed startup might eventually sell their securities in an initial public offering on a national securities exchange or to another company in an acquisition.[900] We anticipate that most businesses engaging in offerings in reliance on Section 4(a)(6) are unlikely to progress directly to an initial public offering on a national securities exchange given their small size,[901] and investors might lack adequate strategies or opportunities to eventually divest their holdings.[902] A sale of the business would require the issuer to have a track record in order to attract investors with the capital willing to buy the business. Moreover, the likely broad geographical dispersion of crowdfunding investors might make shareholder coordination difficult, although the electronic means may mitigate any difficulties. Even if an issuer could execute a sale or otherwise offer to buy back or retire the securities, it might be difficult for investors to determine whether the issuer was offering a fair market price. These uncertainties might limit the use of the Section 4(a)(6) exemption.

The potential benefits of the proposed rules also might depend on how investors respond to potential liquidity issues unique to the securities-based crowdfunding market. It is currently

900 *See* Gompers, note 830.

901 As noted, under the statute and the proposed rules, businesses relying on Section 4(a)(6) would be limited to raising an aggregate of $1 million during a 12-month period. By contrast, as noted in the IPO Task Force report, the size of an initial public offering generally exceeds $50 million. *See* IPO Task Force, note 818.

902 In contrast, given the required qualifications and capital amount limits, Regulation D offerings may generally attract issuers that are more knowledgeable and better capitalized. Moreover, such offerings are likely to have a larger proportion of accredited investors because, in contrast to securities-based crowdfunding, there are no limitations on individual investment amounts. As a result, we believe that Regulation D issuers and investors are more likely to have potential exit strategies in place.

unclear how securities offered and sold in reliance on Section 4(a)(6) would be transferred in the secondary market after the one-year restricted period ends, and investors who purchased securities in reliance on Section 4(a)(6) and who seek to divest their securities would be unlikely to find a liquid market.[903] Shares might migrate to the over-the-counter market or to trading platforms that trade shares of private companies.[904] It is possible that secondary trading costs for investors might be substantial, effective and quoted spreads might be wide, and price volatility might be high compared to those of listed securities.[905] Illiquidity is a concern for other exempt offerings and small registered offerings. However, because investors purchasing securities in reliance on Section 4(a)(6) might be less sophisticated than investors in other private offerings due to the fact that there would be no investor qualification requirements, we expect that they would face additional challenges in addressing the impact of illiquidity, either in finding a suitable trading venue or negotiating with the issuer for an alternative retirement provision. The potentially high degree of illiquidity associated with securities purchased in reliance on Section

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903 Academic studies have shown that the over-the-counter market is less liquid than the national exchanges. *See* Christie, *Market Microstructure of the Pink Sheets*, 33 J. BANKING & FIN. 1,326-1,339 (2009); Andrew Ang, Assaf Shtauber and Paul Tetlock, *Asset Pricing in the Dark: The Cross Section of OTC Stocks*, REV. FIN. STUD. (forthcoming).

904 Given the services that funding portals are permitted to provide under the statute and the proposed rules, investors would not be able to use funding portals to trade in securities offered and sold in reliance on Section 4(a)(6) in a secondary market.

905 Academic studies show that reducing the information transparency about an issuer increases the effective and quoted spreads of its shares, reduces share price and increases price volatility. Specifically, percentage spreads triple and volatility doubles when NYSE issuers are delisted to the Pink Sheets. *See* Jonathan Macey, Maureen O'Hara and David Pompilio, *Down and Out in the Stock Market: The Law and Finance of the Delisting Process*, 51 J.L. & ECON 683-713 (2008). When NASDAQ issuers delist and subsequently trade on the OTC Bulletin Board and/or the Pink Sheets, share volume declines by two-thirds, quoted spreads more than double, effective spreads triple and volatility triples. *See* Jeffrey H. Harris, Venkatesh Panchapagesan and Ingrid M. Werner, *Off But Not Gone: A Study of NASDAQ Delistings*, Fisher College of Business Working Paper No. 2008-03-005 and Dice Center Working Paper No. 2008-6 (Mar. 4, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=628203. One factor that may alleviate transparency concerns is the fact that issuers that sold securities in an offering made in reliance on Section 4(a)(6) would have an ongoing reporting obligation, so disclosure of information about the issuer would continue to be required.

4(a)(6) might prevent investors from investing in businesses through such offerings, thus limiting potential capital formation.

Even with the mandated disclosures, unsophisticated investors purchasing securities issued in reliance on Section 4(a)(6) also may face certain expropriation risks, potentially limiting the upside of their investment, even when they select investments in successful ventures. This could occur if issuers issue securities with certain features (*e.g.*, callable securities or securities with differential control rights) or have insider-only financing rounds or financing rounds at reduced prices (the so-called "down rounds") that could have the effect of diluting an investor's interest or otherwise diminishing the value of the securities offered and sold in reliance on Section 4(a)(6). Investors purchasing securities issued in reliance on Section 4(a)(6) might not have the experience or the market power to negotiate various anti-dilution provisions, right of first refusal, tag-along rights, superior liquidation preferences and rights upon a change in control that have been developed by institutional and angel investors as protections against fundamental changes in a business.[906] If these or similar types of protections are absent, the expropriation risk could discourage some potential investors from participating in offerings made in reliance on Section 4(a)(6), potentially hindering efficiency, competition and capital formation.

The proposed rules also might have an effect on broker-dealers and finders participating in private offerings. Some issuers that previously relied on broker-dealers and finders to assist with raising capital through private offerings may, instead, begin to rely on the Section 4(a)(6) exemption to find potential investors. The precise impact of the proposed rules on these

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906 *See* Kaplan, note 858.

intermediaries would depend on whether (and, if so, to what extent) issuers switch from using existing exemptions to using the exemption provided by Section 4(a)(6) or whether the proposed rules primarily attract new issuers. If a significant number of issuers switch from raising capital under existing private offering exemptions to relying on the exemption provided by Section 4(a)(6), this likely would negatively affect the revenue of finders in the market for private offerings, while intermediaries under Section 4(a)(6) likely would gain from the potential losses in revenue that finders may face. This may disadvantage finders, but competition may ultimately lead to more efficient allocation of capital.

Using information from the Regulation D market allows us to quantify at least some of these potential losses. For example, from 2009 to 2012, the estimated cumulative dollar amount of finder fees charged for Regulation D offerings of up to $1 million was approximately $18 million, covering 437 offerings.[907] In a similar vein, from 2009 to 2012, the estimated cumulative dollar amount of commissions charged by broker-dealers for Regulation D offerings of up to $1 million was approximately $76.6 million, covering 1,480 offerings.[908] Thus, to the extent that issuers rely on Section 4(a)(6) to offer and sell securities in lieu of relying on Regulation D, the dollar amount of commissions and finder fees generated would be reduced, unless broker-dealers and finders provide new services that such issuers are willing to pay. For example, under the statute, broker-dealers would be able to operate portals. If securities-based crowdfunding primarily attracts new issuers to the market, the impact on broker-dealers and

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907 We use data from new Form D filings and include in the analysis only filings with an offer amount greater than zero. We also exclude indefinite offerings because, for those, we cannot determine the offer size.

908 Since we do not have data on broker-dealer and finder participation in other types of private offerings (*e.g.*, Section 4(a)(2) offerings), it is possible that the impact of crowdfunding in those offerings could be different than the impact on broker-dealers and finders in Regulation D offerings.

finder revenue could be negligible and the proposed rules may even have a positive effect on their revenues by revealing more potential clients for them. Additionally, greater investor interest in private company investment might increase capital formation, creating new opportunities for broker-dealers and finders that otherwise would have been unavailable.

Rules implementing Section 4(a)(6) also could encourage current participants in the securities-based crowdfunding market to diversify their funding models to attract a broader group of issuers and to provide additional investment opportunities for investors. For example, donation-based crowdfunding platforms that currently offer investment opportunities in micro-loans generally do not permit donors to collect interest on their investments because of concerns that this activity would implicate the federal securities laws unless an exemption from registration is available.[909] Under the proposed rules, these platforms might choose to permit businesses to offer securities that would provide investors with the opportunity to obtain a return on investment. This could broaden their user base and attract a group of investors different from those already participating in reward-based or donation-based crowdfunding. It is likely that some registered broker-dealers will find it profitable to enter the securities-based crowdfunding market and operate funding portals as well. Such an entry will increase the competition among intermediaries and likely lead to lower costs for issuers.

However, many projects that are well suited for reward-based or donation-based crowdfunding (*e.g.*, because they have finite lives, their payoffs to investors could come before the project is completed, they could be contingent on the project's success, etc.) may have little in common with startups and small businesses that are well suited for an offering in reliance on

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909 *See, e.g.*, *Deutsche Bank Microcredit Development Fund, Inc.*, SEC No-Action Letter (Apr. 8, 2012).

Section 4(a)(6). As a result, diversification among existing platforms might not always be optimal or preferred, particularly if complying with the proposed rules proves disproportionately costly compared to the amount of potential capital to be raised.

2. Crowdfunding Exemption

a. Limitation on Capital Raised

The statute imposes certain limitations on the total amount of securities that may be sold by an issuer during the 12-month period preceding the date of the transaction made in reliance on Section 4(a)(6). Specifically, Section 4(a)(6)(A) provides for a maximum aggregate amount of $1 million sold in reliance on the exemption during the 12-month period.[910]

The limitation on the amount that may be raised could benefit investors by reducing the potential for dilution or fraud. However, we recognize that the cap on the maximum amount that may be sold in reliance on Section 4(a)(6) also could prevent certain issuers from raising all the capital they need to make their businesses viable, which in turn could result in lost opportunities. It also is likely to reduce efficiency to the extent that resources cannot be channeled to productive use. Due to the lack of data, however, we are not able to quantify the size of the efficiency loss. We are proposing, however, to allow issuers to conduct other exempt offerings that would not necessarily be integrated with the offering made in reliance on Section 4(a)(6), as long as the issuer satisfies the requirements of the exemption relied upon for the particular offering. We could have selected an alternative that would have aggregated the amounts offered in reliance on Section 4(a)(6) with the amounts offered pursuant to other exempt offerings. Under such an alternative, the amounts raised in other exempt offerings would count toward the

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910 *See also* proposed Rule 100(a)(1) of Regulation Crowdfunding.

maximum offering amount under Section 4(a)(6). Compared to this alternative, the ability of issuers to conduct other exempt offerings that would not count toward the maximum offering amount under Section 4(a)(6) might alleviate some of the concerns that certain issuers would not be able to raise sufficient capital.

b. Investment Limitations

The statute and the proposed rules also impose certain limitations on the aggregate dollar amount of securities that may be sold to any investor in reliance on Section 4(a)(6) during the preceding 12 months.[911] These provisions would cap the potential investment and, consequently, the potential losses for any single investor. Offerings made in reliance on Section 4(a)(6) would not be subject to review by Commission staff prior to the sale of securities, but the aggregate investment limits would provide some measure of protection for investors.

We recognize that the investment caps would limit the potential upside for investors. This might particularly affect the decisions of those with large portfolios who might be able to absorb losses and understand the risks associated with risky investments. For these investors, the $100,000 aggregate cap might limit their incentive to participate in the securities-based crowdfunding market, compared to other types of investments, potentially depriving the securities-based crowdfunding market of more experienced and knowledgeable investors and possibly impeding capital formation. Limiting the participation of such investors would be likely to negatively affect the informational efficiency of the securities-based crowdfunding market because sophisticated investors are better able to accurately price such offerings. These investors

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911 *See* Section 4(a)(6)(B). *See also* proposed Rule 100(a)(2) of Regulation Crowdfunding.

also could add value to the discussions taking place through an intermediary's communication channels about a potential offering by providing their views on financial viability.

The aggregate cap on investments also could limit the ability of investors to diversify within the securities-based crowdfunding market. As securities-based crowdfunding investments might have inherently high failure rates,[912] investors who do not diversify their investments across a number of offerings could face an increased risk of incurring large losses, relative to their investments, even when they investigate offerings thoroughly. By comparison, VC firms typically construct highly diversified portfolios with the understanding that many ventures fail, resulting in a complete loss of some investments, but with the expectation that those losses will be offset by the large upside of the relatively fewer investments that succeed.[913] The securities-based crowdfunding market is expected to involve earlier-stage financing compared to venture capital financing, and therefore, the chances of investment success may be lower.[914] The statutory thresholds for overall securities-based crowdfunding investments under Section 4(a)(6) might limit an investor's ability to choose a sufficiently large number of investments to offset this risk and to recover the due diligence costs of sufficiently investigating individual investments. One potential solution to this diversification problem would be to invest smaller amounts in more ventures. The drawback is that the costs associated with identifying and reviewing investment opportunities are, to a large extent, fixed.

c. Issuer Eligibility

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912 *See* discussion in Section III.A.3 above.

913 *See* John Cochrane, *The Risk and Return of Venture Capital*, 75 J. OF FIN. ECON. 3 (2005).

914 *See* Agarwal, note 873.

The statute and the proposed rules exclude certain categories of issuers from eligibility to rely on Section 4(a)(6) to engage in crowdfunding transactions.[915] We are proposing to exclude three additional categories of issuers, beyond those identified in the statute, from being eligible to rely on Section 4(a)(6) to engage in crowdfunding transactions. First, we propose to exclude issuers that would be disqualified from relying on Section 4(a)(6) pursuant to the disqualification provisions of Section 302(d) of the JOBS Act.[916] Second, we propose to exclude issuers that sold securities in reliance on Section 4(a)(6) and have not filed with the Commission and provided to investors the ongoing annual reports required by Regulation Crowdfunding during the two years immediately preceding the filing of the required offering statement.[917] This additional exclusion would not impose any additional burdens and costs on an issuer that the issuer would not have already incurred had it complied with the ongoing reporting requirements as they came due. Further, the requirement that a delinquent issuer prepare two annual reports at one time should provide updated and current information to investors without requiring an issuer to become current in its reporting obligations. As a result, we believe that this exclusion would incentivize issuers to comply with its ongoing reporting requirements, if they intend to rely again on Section 4(a)(6) to raise additional capital, which would allow investors to make more informed investment decisions. We also recognize that conditioning an issuer's Section 4(a)(6) eligibility on the requirement that issuers provide ongoing reports for only the previous two-years may deprive investors of information in some periods that might otherwise have negative effects on the price formation and liquidity of the securities in the secondary market. The

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915 *See* Section 4A(f). *See also* proposed Rule 100(b) of Regulation Crowdfunding.

916 *See* proposed Rule 100(b)(4) of Regulation Crowdfunding.

917 *See* discussion in Section II.A.4 above.

potential damage to an issuer's reputation resulting from being delinquent, however, may provide the issuer with sufficient incentive to consistently comply with the ongoing reporting requirements.

Third, we propose to exclude a company that has no specific business plan or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies. This proposed ineligibility requirement will have only a marginal effect on issuer participation and capital formation because the startups and small businesses seeking the exemption would generally have, even in the early stage of their development, a business plan specific enough to distinctly differentiate them from companies with no specific business plan.

3. Issuer Requirements

We recognize that there are benefits and costs associated with the statutory requirements and the proposed rules, including the disclosure requirements, pertaining to issuers. While the estimated costs to issuers are discussed in further detail elsewhere in this section, the following table summarizes these costs:

	Offerings of $100,000 or less	Offerings of more than $100,000, but not more than $500,000	Offerings of more than $500,000
Compensation to the intermediary[918]	$2,500 - $7,500	$15,000 - $45,000	$37,500 - $112,500
Costs per issuer for obtaining EDGAR access codes on Form ID[919]	$60	$60	$60
Costs per issuer for preparation and filing of Form C for each offering[920]	$6,000	$6,000	$6,000
Costs per issuer for preparation and filing of the progress updates on Form C-U[921]	$400	$400	$400
Costs per issuer for preparation and filing	$4,000	$4,000	$4,000

918 *See* discussion in Section III.B.4 below. For purposes of the table, we estimate the range of compensation that an issuer would pay the intermediary assuming the following: (1) the compensation would be calculated as a percentage of the offering amount ranging from 5% to 15% of the total offering amount; and (2) the issuer is offering $50,000, $300,000 and $750,000, which are the mid-points of the offering amounts under each of the respective columns. The compensation paid to the intermediary may, or may not, cover services to an issuer in connection with the preparation and filing of the proposed filings identified in this table.

919 *See* Section IV.C.1.d below for a discussion of the hourly burdens for obtaining EDGAR access codes on Form ID. We estimate, for purposes of the Paperwork Reduction Act, the cost of outside counsel at a rate of $400 an hour. We recognize that the costs of retaining outside professionals may vary depending on the nature of the professional service and that many small issuers are likely to face substantially lower costs. Small issuers also may choose to prepare the proposed forms without seeking the assistance of outside counsel. The table shows only those costs we attribute to outside professionals, for purposes of this analysis, as we believe internal costs would vary greatly among issuers.

920 *See* proposed Rule 203(a)(1) of Regulation Crowdfunding. *See also* Section IV.C.1.a below for a discussion of the hourly burdens for preparing and filing Form C for each offering. For purposes of the table, we estimate that 25 percent of the hourly burden would be carried by outside professionals retained by the issuer at an average cost of $400 per hour.

921 *See* proposed Rule 203(a)(3) of Regulation Crowdfunding. *See also* Section IV.C.1.a below for a discussion of the hourly burdens for preparing and filing the progress updates on Form C-U. For purposes of the table, we estimate that the hourly burden would be carried by outside professionals retained by the issuer at an average cost of $400 per hour.

of annual report on Form C-AR[922]			
Costs for annual review or audit of financial statements per issuer[923]	Not required	$14,350	$28,700
Costs per issuer for preparation and filing of Form C-TR to terminate reporting[924]	$600	$600	$600

a. General Disclosure Requirements

The statute and the proposed rules related to issuer disclosures are intended to reduce the information asymmetries that currently exist between small businesses and potential investors. Small private businesses typically do not disclose information as frequently or as extensively as public companies, if at all. Moreover, unlike public companies, small private businesses are not required to hire an independent third party to validate the information disclosed. When information about a company is difficult to obtain or the quality of the information is uncertain, investors are at risk of making poorly-informed investment decisions regarding that company.

Such information asymmetries might be especially acute in the securities-based crowdfunding market because the market includes startups and small businesses that have significant risk factors and that might have characteristics that have led them to be rejected by other potential funding sources, including banks, VCs and angel investors. In addition, the

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922 *See* proposed Rule 203(b)(1) of Regulation Crowdfunding. *See also* Section IV.C.1.b below for a discussion of the hourly burdens for preparing and filing each annual report on Form C-AR. For purposes of the table, we estimate that 25 percent of the hourly burden would be carried by outside professionals retained by the issuer at an average cost of $400 per hour.

923 *See* proposed Rule 201(t) of Regulation Crowdfunding. *See also* Section II.B.1.a.ii above.

924 *See* proposed Rule 203(b)(2) of Regulation Crowdfunding. *See also* Section IV.C.1.c below for a discussion of the hourly burdens for preparing and filing Form C-TR. For purposes of the table, we estimate that the hourly burden would be carried by outside professionals retained by the issuer at an average cost of $400 per hour.

securities-based crowdfunding market may attract unsophisticated retail investors who may not have the resources necessary to effectively monitor issuers. For instance, some issuers might use capital to fund riskier projects than what was disclosed to investors, or they might not make best efforts to achieve their stated business objectives. If investors in securities-based crowdfunding are unable to monitor such issuers because of limited information or credible third-party validation of this information, they might eventually seek higher yields or choose to withdraw from the securities-based crowdfunding market altogether, thus increasing the cost of capital to issuers and impeding capital formation. In addition, investors in offerings made in reliance on Section 4(a)(6) might make relatively small investments. The potential dispersed investor base may make it difficult for investors to solve collective action problems.

The statute and the proposed rules seek to reduce information asymmetries by requiring issuers to file specified disclosures with the Commission for offerings made in reliance on Section 4(a)(6) on the offer date and on an annual basis thereafter.[925] Issuers also would be required to provide these disclosures to investors, and in the case of offering documents, to potential investors and the relevant broker or funding portal. The proposed disclosure requirements described above[926] are more extensive than those required under existing offering exemptions. For example, although the current requirements under Regulation A require similar initial financial disclosures, they do not require periodic reporting.[927] Issuers using the Rule 504 exemption under Regulation D to raise up to $1 million do not need to provide audited financial

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925 *See* Section 4A(b). *See also* proposed Rules 201, 202 and 203 of Regulation Crowdfunding.

926 *See* Section II.B.1 above.

927 Securities Act Rule 257 (17 CFR 230.257), however, requires issuers conducting offerings pursuant to Regulation A to file Form 2-A (17 CFR 239.91) with the Commission at certain intervals to report sales and the use of proceeds until termination, completion or final sale of securities in the offering or until the proceeds have been applied, whichever is later.

statements and there are no periodic disclosure requirements. Regulation D offerings under Rules 505 and 506 for up to $2 million require issuers to provide audited current balance sheets to non-accredited investors (and unaudited statements of income, cash flows and changes in stockholders' equity), but there are no periodic reporting requirements. The disclosure requirements in the proposed rules should benefit investors by enabling them to better evaluate the issuer and the offering, monitor how the issuer is doing over time and be aware of when the issuer may terminate its ongoing reporting obligations. This would allow investors with various risk preferences to invest in the offerings best suited for their risk tolerance, thus improving allocative efficiency.

The disclosure requirements also could improve informational efficiency in the market. Specifically, the required disclosure would provide investors with a useful benchmark to evaluate other private issuers both within and outside of the securities-based crowdfunding market.[928] Additionally, disclosure by issuers engaging in crowdfunding transactions in reliance on Section 4(a)(6) could inform financial markets more generally by providing information about new consumer trends and new products, thus creating externalities that benefit other types of investors and issuers.

We recognize, however, that the proposed disclosure requirements also would have associated limitations and costs, including the direct costs of preparation, certification (when necessary) and dissemination of the disclosure documents. We note that, under the statute, the disclosure requirements for offerings made in reliance on Section 4(a)(6) are more extensive, in

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928 *See* Christian Leuz and Peter Wysocki, *Economic Consequences of Financial Reporting and Disclosure Regulation: A Review and Suggestions for Future Research*, (Working Paper, University of Chicago) (2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105398.

terms of breadth and frequency, than those for other private offerings. The statute also provides us with the discretion to impose additional requirements on issuers engaging in crowdfunding transactions, and in some cases, the proposed rules would require issuers to disclose information in addition to the information specifically listed in the statute.[929] For example, we are proposing to require disclosure of any indebtedness of the issuer[930] because we believe that servicing debt could place additional pressures on a company in the early stages of development and this information would be important to investors. The proposed rules also would require disclosure of any prior securities-based crowdfunding or other exempt offerings conducted within the past three years.[931] In some cases, an issuer might have previously engaged in crowdfunding in reliance on Section 4(a)(6) and may be returning for additional funding. We believe that it would be important to investors to know whether the prior securities-based crowdfunding or other offerings of securities were successful, and if so, the amount raised in these prior offerings. Compared to the disclosure requirements under existing private offering exemptions, this information would better inform investors about the capital structure of an issuer, might provide insight into how prior offerings were valued and could enable investors to more fully assess the issuer and the potential risks associated with the current offering.

We recognize that the additional information required by the discretionary requirements would increase the disclosure costs to issuers, but we believe that this would improve investor decision-making and ultimately benefit issuers with viable investment opportunities by improving price efficiency in the securities-based crowdfunding market. Although we recognize

929 *See* Section 4A(b)(5). *See also* Section II.B.1.a.i(g) for a description of the additional disclosure requirements.

930 *See* proposed Rule 201(p) of Regulation Crowdfunding.

931 *See* proposed Rule 201(q) of Regulation Crowdfunding.

that requiring less disclosure would impose lower compliance costs, we believe that the additional disclosure requirements we are proposing strike the appropriate balance between enhancing the ability of issuers relying on Section 4(a)(6) to raise capital and enabling investors to make informed investment decisions. Additionally, disclosure might have indirect costs to the extent that information disclosed by issuers relying on Section 4(a)(6) could be used by their competitors. Requiring significant levels of disclosure at an early stage of an issuer's lifecycle might affect an issuer's competitive position and might limit the use of the exemption in Section 4(a)(6) by issuers who are especially concerned with confidentiality. It also is possible that these disclosure costs would make other types of private offerings more attractive to potential securities-based crowdfunding issuers. For example, the recent changes to Rule 506 of Regulation D,[932] which allow for general solicitation, subject to certain conditions, are likely to increase its attractiveness and, thus, may divert potential issuers from crowdfunding.

In addition, under the statute and the proposed rules, issuers that complete a crowdfunding transaction in reliance on Section 4(a)(6) would be subject to ongoing reporting requirements,[933] which are not required under other private offering exemptions and which might increase compliance costs. The ongoing reporting, however, might provide a liquidity benefit for secondary sales of the issuers' securities.

b. Financial Condition and Financial Statement Disclosure Requirements

With respect to the statutory requirement to provide disclosure about the issuer's financial condition, the proposed rules would require narrative disclosure addressing the issuer's

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[932] *See General Solicitation Adopting Release*, note 12.

[933] *See* Section 4A(b)(4). *See also* proposed Rule 202 of Regulation Crowdfunding.

historical results of operations, in addition to information about its liquidity and capital resources.[934] We expect that this discussion would inform investors about the financial condition of the issuer, without imposing significant costs, because the issuer should already have such information readily available. In addition, the proposed rules would not prescribe the content or format for this information.

With respect to the requirement to provide financial statements, the proposed rules would implement the tiered financial disclosure requirements specified by the statute, which are based on the aggregate amount of securities offered and sold during the preceding 12-month period, inclusive of the offering amount in the offering for which disclosure is being provided.[935] Although the disclosure requirements would provide investors with more information than might otherwise be obtained in private offerings, the disclosures might create additional costs for those issuers who have limited financial and accounting expertise necessary to produce the financial disclosures envisioned by the statute and the proposed rules. In this respect, the statute anticipates a level of development among issuers that might not be present in the relevant securities-based crowdfunding market. For instance, a startup with a promising business idea might have little capital prior to the offering, leaving limited amounts to be audited or certified. The issuer disclosures required for offerings made in reliance on Section 4(a)(6), therefore, might not always help investors with their investment decisions or may weigh against an issuer when a potential investor is deciding whether to make an investment.

The proposed rules would require all issuers to provide a complete set of their financial statements (a balance sheet, income statement, statement of cash flows and statement of changes

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934 *See* proposed Rule 201(s) of Regulation Crowdfunding. *See also* Section II.B.1.a.ii(a) above.

935 *See* proposed Rule 201(t) of Regulation Crowdfunding. *See also* Section II.B.1.a.ii(b) above.

in owners' equity) that are prepared in accordance with U.S. GAAP and cover the shorter of the two most recently completed fiscal years or the period since inception.[936] This proposed requirement may impose a cost on potential issuers, especially those smaller issuers that may have historically prepared their financial statements in accordance with other comprehensive bases of accounting, such as a cash basis of accounting or a tax basis of accounting, rather than U.S. GAAP. Investors, however, would benefit from the requirement that financial statements be prepared in accordance with U.S. GAAP, as U.S. GAAP is widely used and would allow for more comparability among issuers.

The proposed rules also specify that 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 the issuer's most recently completed fiscal year, the issuer was not otherwise required to update the financial statements and updated financial statements are not otherwise available.[937] This might impose a cost on potential investors to the extent that the investors would not have the most recent information about the issuer's financial condition. However, this concern is somewhat mitigated by the proposed requirement that issuers include a discussion of changes in their financial condition since the period covered by the financial statements, including changes in revenue or net income and other relevant financial measures.[938]

Requiring financial statements covering the two most recently completed fiscal years, as proposed, would benefit investors by providing a basis for comparison against the most recently

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936 *See* proposed Instruction 2 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

937 *See* proposed Instruction 8 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

938 *See* proposed Instruction 9 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

completed fiscal year and by allowing investors to identify changes in the development of the business. Compared to an alternative that we could have selected, that of requiring financial statements covering only the most recently completed fiscal year as one commenter suggested,[939] requiring a second year of financial statements might increase the cost for the issuer.[940] Also, to the extent that the issuer had no or little operations in the prior year, the benefit of comparability might not apply. In this regard, we recognize that many issuers 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.

For offerings of $100,000 or less, the statute and the proposed rules would require the issuer to provide its filed income tax returns for the most recently completed year (if any) and financial statements that are certified by the principal executive officer to be true and complete in all material respects.[941] While providing an income tax return is not expected to impose a significant cost on issuers, it is not clear to what extent the information presented in a tax return would be useful for an investor evaluating whether or not to purchase securities from the issuer. Although the information might be limited, it would not be uninformative. Under the proposed rules, issuers would be required to redact personal information from the required tax returns.[942] We believe that this would alleviate privacy concerns, while still satisfying the statutory requirement to provide tax return information.

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939 *See* CompTIA Letter.

940 *But see* note 174.

941 *See* Section 4A(b)(1)(D)(i). *See also* proposed Rule 201(t)(1) of Regulation Crowdfunding.

942 *See* proposed Instruction 3 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

Moreover, the proposed rules would specify that if an issuer is offering securities in reliance on Section 4(a)(6) before filing a tax return for the most recently completed fiscal year, the issuer could use the tax return filed for the prior year, on the condition that the issuer provides the tax return for the most recent fiscal year when it is filed, if it is filed during the offering period.[943] This accommodation should benefit issuers by enabling them to engage in transactions during the time period between the end of their fiscal year and when they file their tax return for that year. This might impose a cost on potential investors because they might not receive the most up-to-date information about the issuer's financial condition. However, this concern is somewhat mitigated by the proposed requirement that issuers provide disclosure about material changes in their financial condition since the prior year.[944] In addition, we are proposing a form of certification for the principal executive officer to provide in the issuer's offering statement, which we believe would help issuers comply with the certification required by the statute and the proposed rules.[945]

For offerings of more than $100,000, but not more than $500,000, the proposed rules specify that the required financial statements must be reviewed in accordance with SSARS issued by the AICPA.[946] Although one alternative we could have selected is to develop a new review standard for purposes of these rules, we believe that issuers would benefit from a rule that requires the use of the AICPA's widely-utilized review standard, particularly in light of the fact that there are no other widely-utilized review standards from which to choose. We believe that

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943 *Id.*

944 *See* proposed Instruction 9 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

945 *See* proposed Instruction 4 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

946 *See* proposed Rule 201(t)(2) of Regulation Crowdfunding.

many accountants reviewing financial statements of issuers raising capital in reliance on Section 4(a)(6) would be familiar with the AICPA's standards and procedures for review, which should help to lessen review costs.

For offerings of more than $500,000, the statute and the proposed rules would require that financial statements be audited.[947] The statute gives us discretion to change the threshold that would require audited financial statements, but we are not proposing to change it at this time. We believe 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. We also understand that requiring audited financial statements would increase the cost to issuers, and for issuers that are newly formed, with no or very limited operations, the benefit of the audit may not justify the cost of the audit. Compared to an alternative that we could have taken, that of a higher threshold (*e.g.*, offerings of more than $700,000) for providing audited financial statements, our approach in the proposed rules would likely result in more issuers having to provide audited financial statements, as well as higher compliance costs for those issuers. Based on a compilation of data submitted to us by reporting companies, the average cost of an audit for an issuer with less than $1 million in market capitalization and less than $1 million in revenues is approximately $28,700.[948] We expect that the cost of an audit for many issuers engaging in a crowdfunding transaction in reliance on Section 4(a)(6) might be less, because they likely would

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947 *See* Section 4A(b)(1)(D)(iii). *See also* proposed Rule 201(t)(3) of Regulation Crowdfunding.

948 *See* Audit Analytics, *Auditor-Fees*, *available at* http://www.auditanalytics.com/0002/audit-data-company.php. The auditor fee database contains fee data disclosed by Exchange Act reporting companies in electronic filings since January 1, 2001. For purposes of our calculation, we averaged the auditor fee data for companies with both market capitalization and revenues of less than $1 million (the smallest subgroup of companies for which data is compiled).

be at an earlier stage of development than issuers that file Exchange Act reports with us and, thus, would be less complex to audit.

For offerings of more than $500,000, the proposed rules also would require financial statements to be audited in accordance with the auditing standards issued by either the AICPA or the PCAOB.[949] We believe that letting issuers choose the auditing standards could provide a number of benefits. If an issuer currently has financial statements audited under one of the specified standards, the issuer would not need to obtain a new audit or engage a different auditor to conduct an audit to engage in a crowdfunding transaction in reliance on Section 4(a)(6) and the proposed rules. If an issuer chooses to have an audit conducted in accordance with PCAOB auditing standards, it would not need to obtain a new audit to file a registration statement with the Commission for a registered offering. By not taking an alternative approach, that of requiring the audits to be conducted by PCAOB-registered firms, the proposed rules should allow for the eligibility of a greater number of accountants to audit the issuers' financial statements, and thereby, could reduce costs for crowdfunding issuers.

As described above, the statute and the proposed rules require some financial statements to be reviewed or audited by a public accountant. The proposed rules would specify that a public accountant must be independent of the issuer, in accordance with the independence standards set forth in Rule 2-01 of Regulation S-X.[950] The proposed requirement to comply with our independence standards may impose costs to the extent that there are higher costs associated with engaging an accountant that satisfies the independence standards. Also, the independence

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949 *See* proposed Rule 201(t)(3) of Regulation Crowdfunding.

950 *See* proposed Instruction 7 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

standards set forth in Rule 2-01 of Regulation S-X may impose higher costs than other independence standards, such as the AICPA independence standards.[951]

In addition, the proposed rules would require an issuer to file a review report or audit report, whichever is applicable.[952] This could impose an additional cost on issuers to the extent that the accountant or auditor increases the fee associated with the review or audit to compensate for any additional liability that may result.

c. Issuer Filing Requirements

The statute does not specify a format that issuers must use to present the required disclosures and file the disclosures with the Commission. As noted above, we are proposing to require issuers to file the mandated disclosure on EDGAR using new Form C.[953] Issuers would incur the cost to comply with the disclosure requirements and file the information in the new proposed Form C: Offering Statement and Form C-U: Progress Update before the offering was funded, thus imposing a cost on issuers regardless of whether their offerings were successful. In addition, issuers would incur the cost to comply with the ongoing reporting requirements and file information in the new proposed Form C-AR: Annual Report.[954]

Form C would require certain disclosures to be submitted using an XML-based filing,[955] while allowing the issuer to customize the presentation of other required disclosures. This

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951 For example, under the independence standards set forth in Rule 2-01 of Regulation S-X, an auditor cannot provide bookkeeping services to an audit client, so an issuer would need to retain a different accountant to provide those services. *See* Rule 2-01(c)(4) of Regulation S-X [17 CFR 210.2-01(c)(4)].

952 *See* proposed Instructions 5 and 6 to paragraph (t) of proposed Rule 201 of Regulation Crowdfunding.

953 *See* proposed Rule 203(a) of Regulation Crowdfunding. *See also* Section II.B.3 above.

954 *See* proposed Rule 203(b) of Regulation Crowdfunding. *See also* Section II.B.3 above.

955 *See* proposed Instruction to paragraph (a)(1) of proposed Rule 203 of Regulation Crowdfunding. *See also* Section II.B.3 above.

proposed approach would provide issuers with the flexibility to present required disclosures in a cost-effective manner, while also requiring the disclosure of certain key offering information that would be collected in a standardized format, which we believe would benefit investors and help facilitate capital formation.

We expect that requiring certain disclosures to be submitted using XML-based filings would produce numerous benefits for issuers, investors and the Commission. For instance, using information filed pursuant to these proposed requirements, users of the information could readily track capital generated through crowdfunding offerings without requiring the manual inspection of each filing. The ability to efficiently collect information on all issuers also could provide an incentive for data aggregators or other market participants to offer services or analysis that investors could use to compare and choose among different offerings. For example, reporting key financial information using XML-based filings would allow investors, analysts and data aggregators to more easily compile, analyze and compare information regarding the capital structure and financial position of various issuers. XML-based filings also would provide the Commission with data about the use of the new exemption that would allow the Commission to evaluate whether the rules implementing the exemption include appropriate investor protections and whether the rules unduly restrict capital formation. In addition, requiring disclosure of the compensation paid to intermediaries would help inform the Commission, issuers and investors about the costs of raising capital in this market.

We expect that the cost of preparing and filing Form C could vary significantly among issuers. For example, issuers with little operating activity might have lower costs because they likely would have less to disclose than a more complex operation. Further, small issuers might choose to prepare and file Form C without seeking the assistance of outside counsel.[956] Thus, the Commission also expects that reporting costs for many small issuers may be insignificant.[957]

The proposed rules also would require that issuers file a Form C-U: Progress Update to describe the progress of the issuer in meeting the target offering amount.[958] The proposed rules would require the issuer to file two progress updates within five business days from the day when the issuer reaches one-half and 100 percent of the target offering amount, as well as a final progress update within five business days after the end of the offering period if the issuer will accept proceeds in excess of the target offering amount. The Commission expects the costs of preparing these updates to vary but to be relatively small, given how little information is required.[959] However, if the size of the security-based crowdfunding market developed to a level commensurate with the current non-security-based crowdfunding market, this could result in tens of thousands of filings with the Commission each year. To the extent that this same progress information also would be available on the registered intermediary's website, as is already occurring with existing non-security-based offering platforms, then there might be little marginal benefit to these filings. For these reasons, we are seeking comment on alternative frequencies and manner of progress updates.

As noted above, the statute also requires an issuer to file and provide to investors information about the issuer's financial condition on at least an annual basis, as determined by

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956 *See* Section IV.C.1. below.

957 We estimate, for purposes of the Paperwork Reduction Act, that 25 percent of the 60 hours anticipated to prepare and file Form C could be performed by outside counsel at a rate of $400 an hour. *See* Section IV.C.1.a below. We recognize that the costs of retaining outside professionals may vary depending on the nature of the professional service and that many small issuers are likely to face substantially lower costs.

958 *See* proposed Rule 203(a)(3) of Regulation Crowdfunding. *See also* Sections II.B.1.b and II.B.3 above.

959 *See* Section IV.C.1.a below.

the Commission.[960] To implement this statutory requirement, the proposed rules would require any issuer that sold securities in a crowdfunding transaction in reliance on Section 4(a)(6) to file annually with the Commission a new Form C-AR: Annual Report, no later than 120 days after the end of each fiscal year covered by the report.[961] We believe that annual reports would inform investors in their portfolio decisions and could enhance price efficiency. Moreover, as discussed above, under the statute and the proposed rules, the securities would be freely tradable after one year,[962] and therefore, this information also would benefit potential future holders of the issuer's securities by enabling them to update their assessments as new information was made available through the annual updates, potentially allowing for more efficient pricing. More generally, these proposed continued disclosures also might help facilitate the transfer of securities in secondary markets after the one-year restricted period ends, which could mitigate some of the potential liquidity issues that are unique to the securities-based crowdfunding market, discussed above.

Annual reporting requirements, however, would impose ongoing costs on issuers. The proposed rules would require that issuers continue to file Form C-AR: Annual Report until the earlier of the following: (1) the issuer becomes a reporting company required to file reports under Exchange Act Sections 13(a) or 15(d); (2) the issuer or another party repurchases all of the securities issued pursuant to Securities Act Section 4(a)(6), including any payment in full of debt securities or any complete redemption of redeemable securities; or (3) the issuer liquidates or

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960 *See* Section 4A(b)(4).

961 *See* proposed Rule 202 of Regulation Crowdfunding. *See also* Section II.B.2 above for a discussion of the disclosure requirements for Form C-AR.

962 *See* Section 4A(e). *See also* proposed Rule 501 of Regulation Crowdfunding.

dissolves its business in accordance with state law.[963] We estimate that the cost to prepare and file Form C-AR would be approximately two-thirds of the cost to prepare and file Form C: Offering Statement. Form C-AR requires similar disclosure as Form C. If an issuer undertakes multiple offerings, which individually require different levels of financial statements, the issuer would be required to provide financial statements that meet the highest standard previously provided. An issuer would not be required to provide the offering-specific information that was filed at the time of the offering, but the disclosure requirements would otherwise be the same as those required in connection with the offer and sale of the securities,[964] which should minimize the disclosure burden for issuers. Any issuer terminating its annual reporting obligations would be required to file a notice under cover of "Form C-TR: Termination of Reporting" to notify investors and the Commission that it would no longer file and provide annual reports pursuant to the requirements of Regulation Crowdfunding.[965] The Commission expects the costs of preparing these updates to vary significantly among issuers.[966]

d. Advertising – Notice of Offering

The statute and the proposed rules would prohibit an issuer from advertising the terms of the offering, except for notices that direct investors to an intermediary's platform.[967] The terms of the offering would include the amount offered, the nature of the securities, price of the

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963 *See* proposed Rule 202(b) of Regulation Crowdfunding.

964 *See* proposed Rule 202(a) of Regulation Crowdfunding.

965 *See* proposed Rule 203(b)(2) of Regulation Crowdfunding.

966 Issuers would spend, on average, approximately 1.5 hours to complete this task. Again, we do not have the information necessary to provide a reasonable estimate of the costs associated with this time burden because these costs would vary significantly among small issuers and would depend, in part, on the stage of the issuer's development. *See* Section IV.C.1.c below.

967 *See* Section 4A(b)(2). *See also* proposed Rule 204 of Regulation Crowdfunding.

securities and length of the offering period.[968] The proposed rules would allow an issuer to publish a notice about the terms of the offering made in reliance on Section 4(a)(6), subject to certain limitations on the content of the notice.[969] The notices would be similar to the "tombstone ads" permitted under Securities Act Rule 134,[970] except that the proposed rules would require the notices to direct potential investors to the intermediary's platform, through which the offering made in reliance on Section 4(a)(6) would be conducted.

We believe this approach would allow issuers to generate interest in offerings and to leverage the power of social media to attract potential investors. At the same time, we believe it also would protect potential investors by limiting the ability of issuers to provide certain advertising materials without also providing the disclosures, available on the intermediary's platform, that are required for an offering made in reliance on Section 4(a)(6). Moreover, this proposed requirement that limits the issuer's ability to advertise the terms of the offering, while directing investors to the intermediary's platform for more offering-specific information, would not impose costs to market participants.

e. Compensation of Persons Promoting the Offering

The statute and the proposed rules would prohibit an issuer from compensating, or committing to compensate, directly or indirectly, any person to promote the issuer's offering through communication channels provided by the intermediary unless the issuer takes reasonable

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968 *See* proposed Instruction to proposed Rule 204 of Regulation Crowdfunding.

969 *See* proposed Rule 204(b) of Regulation Crowdfunding. *See also* Section II.B.4 above.

970 17 CFR 230.134.

steps to ensure that such person clearly discloses the receipt of such compensation (both past and prospective) each time a promotional communication is made.[971]

We believe that such requirement would benefit the securities-based crowdfunding market because it would allow investors to make better informed investment decisions. A premise of crowdfunding is that investors would rely, at least in part, on the collective wisdom of the crowd to make better informed investment decisions. Accordingly, we propose to require intermediaries to provide communication channels for issuers and investors to exchange information about the issuer and its offering.[972] Although the requirement to take steps to ensure disclosure of compensation paid to persons promoting the offering would impose compliance costs for issuers, we believe that investors would benefit from knowing if the investment they are considering and discussing with other potential investors is being touted by a promoter who is compensated by the issuer.

f. Oversubscription and Offering Price

The proposed rules would permit an issuer to accept investments in excess of the target offering amount, subject to the $1 million limitation and certain conditions.[973] We believe that permitting oversubscriptions would provide flexibility to issuers so that they can raise the amount of capital they deem necessary to finance their businesses. For example, permitting oversubscriptions would allow an issuer to raise more funds, while lowering compliance costs, if the issuer discovers during the offering process that there is greater investor interest in the offering than initially anticipated or if the cost of capital is lower than initially anticipated.

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971 *See* Section 4A(b)(3). *See also* proposed Rule 205 of Regulation Crowdfunding.

972 *See* proposed Rule 303(c) of Regulation Crowdfunding.

973 *See* proposed Rule 201(h) of Regulation Crowdfunding. *See also* Section II.B.6.i above.

The proposed rules also would not require issuers to set a fixed price or prohibit dynamic pricing. We believe that allowing issuers flexibility in setting the offering price would allow them to extract investors' reservation price for a given offering or to incentivize investors to subscribe to an offering early, thus increasing the likelihood that the offering would be successful. Further, the proposed required disclosure of the pricing method used and the final prices for the securities before an offering closes,[974] coupled with the investor's ability to cancel his or her investment commitment,[975] could mitigate potential concerns that dynamic pricing could be used to provide preferential treatment to certain investors (*e.g.*, when an issuer offers better prices to relatives or insiders). We also believe that the proposed cancellation rights would address the concerns about time pressure on the investment decision because investors would have the opportunity to cancel their investment commitments if they decide to do so.

h. Restrictions on Resales

The statute and the proposed rules also include restrictions on transfers of securities for one year, subject to limited exceptions (*e.g.*, for transfers to the issuer of the securities, in a registered offering, to an accredited investor or to certain family members).[976] The proposed rules also would permit transfers to trusts controlled by, or held for the benefit of, covered family members.[977] We believe that including such proposed restrictions is important for investor protection. By restricting the transfer of securities for a one-year period, the proposed rules would give investors in a business a defined period to observe the performance of the business

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974 *See* proposed Rule 201(*l*) of Regulation Crowdfunding.

975 *See* proposed Rule 201(j) of Regulation Crowdfunding.

976 *See* Section 4A(e). *See also* proposed Rule 501 of Regulation Crowdfunding.

977 *See* proposed Rule 501(a)(4) of Regulation Crowdfunding.

and to potentially obtain more information about the potential success or failure of the business before trading occurs. The restrictions on resales, however, may impede price discovery.

The proposed one-year restriction on transfers of securities purchased in a transaction conducted in reliance on Section 4(a)(6) might reduce trading liquidity, raise capital costs to issuers and limit investor participation, particularly for investors who cannot risk locking up their investments for this period. The illiquidity cost would be mitigated, in part, by provisions that allow investors to transfer the securities within one year of issuance by reselling the securities to accredited investors, back to the issuer or in a registered offering or transferring them to certain family members or trusts of those family members. These provisions likely would improve the liquidity of these securities and, thus, could increase investor participation in securities-based crowdfunding offerings.

4. Intermediary Requirements

The statute and the proposed rules require that transactions be conducted through a registered broker or registered funding portal. The use of a registered intermediary to match issuers and investors would require that they incur certain transactions costs necessary to support the intermediation activity, but also would provide centralized venues for crowdfunding activities that should lower investor and issuer search costs. As discussed earlier, existing rewards-based and donations-based crowdfunding platforms already engage in a large number of transactions, estimated at over 500,000 successful campaigns in the aggregate,[978] demonstrating that the use of platforms for crowdfunding may be familiar to investors and issuers.

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978 *See* note 863.

We believe that existing crowdfunding platforms would initially be the primary, non-broker-dealer intermediaries in the securities-based crowdfunding market. Registered brokers, or broker-dealers that are currently unregistered, but are planning to register in the future, also might wish to enter the securities-based crowdfunding market, which would increase the competition among crowdfunding intermediaries and potentially lower the cost of intermediation to issuers. Both existing non-securities-based crowdfunding platforms and registered brokers might need to invest resources (including costs to comply with the proposed regime) to create the infrastructure for securities-based crowdfunding, with brokers likely investing to develop an Internet-based platform and non-securities-based crowdfunding platforms investing to register as funding portals and revise their existing sites to comply with the requirements of the statute and the proposed rules. Although the eventual extent of broker involvement in the securities-based crowdfunding market is difficult to anticipate, we believe that some brokers might acquire or form partnerships with funding portals to obtain access to a new and diverse investor base. In addition, some existing non-securities-based crowdfunding platforms might eventually either register as brokers or form partnerships with registered brokers to offer brokerage services as part of their service offerings. As discussed above, we believe that there could be incentives for funding portals to pursue such partnerships, because of brokers' expertise and access to investors, as well as because of the statutory and proposed rule restrictions on funding portal activities.

Although it is not possible to predict precisely the future number of persons (or entities) who would register as either brokers or funding portals to act as intermediaries in securities-based crowdfunding transactions,[979] we estimate that intermediaries would number approximately 110, including approximately 10 intermediaries that would register as brokers in order to engage in crowdfunding, approximately 50 intermediaries that would already be registered as brokers and approximately 50 intermediaries that would register as funding portals.[980] It is possible that the actual number of participants could deviate significantly from these estimates, and it is likely that there would be significant competition between existing crowdfunding venues and new entrants that could result in further changes in the number and types of intermediaries as the market develops and matures. It also is likely that there will be significant developments in the types and ranges of crowdfunding products and services offered to potential issuers and investors, particularly as competitors learn from their experiences. Moreover, the business models of the successful crowdfunding intermediaries are likely to change over time as they grow in size or market share or if they are forced to differentiate from other market participants in order to maintain a place in the market.

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979 There are significant challenges to establishing a statistically reliable estimate of the number of intermediaries that would participate in the securities-based crowdfunding market. For example, in a similar context, a 2005 report on private placement broker-dealers determined that there is no effective measuring device to estimate the number of intermediaries for small businesses currently in the marketplace. *See* Task Force on Private Placement Broker-Dealers, note 894. We also recognize that there are limitations on predicting the number of intermediaries that would participate in securities-based crowdfunding, based on existing practices in the donation-based and rewards-based crowdfunding markets or foreign securities-based crowdfunding. In particular, platforms currently involved in donation-based and rewards-based crowdfunding may be motivated by philanthropic interests and may not intend to expand their platforms to offer securities-based crowdfunding opportunities. In addition, foreign securities-based crowdfunding takes place in a different regulatory setting, and thus, the market may not develop the same way in the United States.

980 These estimates are based, in part, on current indications of interest, which may change as the market develops. According to FINRA, as of October 3, 2013, approximately 36 entities have submitted the voluntary Interim Form for Funding Portals to FINRA to indicate their intention to act as funding portals under the JOBS Act. *See* Press Release, Financial Industry Regulatory Authority, FINRA Issues Voluntary Interim Form for Crowdfunding Portals (Jan. 10, 2013), *available at* http://www.finra.org/Newsroom/NewsReleases/2013/P197636; Financial Industry Regulatory Authority, *Crowdfunding Portals*, *available at* http://www.finra.org/industry/issues/crowdfunding. Based on the current indication of interest, we expect that the number of funding portals that would ultimately register with the Commission will be approximately 50. This estimate may change as the market develops.

As a result of the uncertainty over how the market may develop, any estimates of the potential number of market participants, their services or fees charged are subject to significant estimation error. While we recognize that there are benefits as well as costs associated with the statutory requirements and the proposed rules pertaining to intermediaries, there are significant limitations to our ability to estimate the potential benefits and costs.

The statute requires that the offer or sale of securities in reliance on Securities Act Section 4(a)(6) be conducted through a broker or a funding portal that complies with the requirements of Securities Act Section 4A(a).[981] Among other things, the intermediary must register with the Commission as a broker or a funding portal, and it also must register with a registered national securities association.[982] The proposed rules would implement these statutory requirements, including by requiring an intermediary to be a member of FINRA or any other applicable registered national securities association.

We recognize that there are benefits and costs associated with the statutory requirements and the proposed rules pertaining to intermediaries. While the benefits and costs are described in further detail below, the following tables summarize the estimated direct costs to intermediaries, including brokers and funding portals. Some of the direct costs of the rules would be incurred by all intermediaries, while others are specific to whether the intermediary is a new entrant (either broker or funding portal) or is already registered as a broker.

Although we have attempted to estimate the direct costs on intermediaries, we recognize that some costs could vary significantly across intermediaries, and within categories of intermediaries. For example, some intermediaries may choose to leverage existing platforms or

981 Section 4(a)(6)(C).

982 Section 4A(a)(2).

systems and so may not need to incur significant additional expenses to develop a platform or comply with specific proposed requirements of Regulation Crowdfunding. In light of these uncertainties, we encourage commenters to provide data and analysis to help analyze and quantify further the potential benefits and costs of these rules.

We estimate that the cost for an entity to register as a broker and become a member of a national securities association in order to engage in crowdfunding pursuant to Section 4(a)(6) would be approximately $275,000, with an ongoing annual cost of approximately $50,000 to maintain that registration and membership.[983] In addition, we estimate that the cost to comply with the various requirements that apply to registered brokers engaging in transactions pursuant to Section 4(a)(6) would be approximately $245,000 initially, and $180,000 each year thereafter. In making this estimate, we assume that brokers acting as intermediaries in transactions pursuant to Section 4(a)(6) would provide a full range of brokerage services in connection with these transactions, including certain services such as providing investment advice and recommendations, soliciting investors, and managing and handling customer funds and securities, that funding portals cannot provide.[984]

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983 We recognize that the cost of registering and becoming a member of a national securities association varies significantly among brokers, depending on facts and circumstances. Among other things, the cost can vary depending on the number of associated persons of the broker entity and their licensing requirements, the scope of the proposed brokerage activities, and the means by which the broker administers the registration process (*e.g.*, it may choose to hire outside counsel to assist with the process). We also recognize that the time required for a broker to become a member of a national securities association varies and could take six months to one year. We estimate the range of this cost to be between $50,000 and $500,000, and so we have chosen the average amount of $275,000 for purposes of this discussion.

984 Among other things, a broker providing recommendations and investment advice would be required to comply with FINRA rules on suitability. *See* FINRA Rule 2111. A broker soliciting through advertisements would be required to comply with FINRA rules relating to communications with the public. *See* FINRA Rule 2210. Brokers handling customer funds and securities also would be required to maintain net capital, segregate customer funds and comply with Exchange Act Rule 15c2-4. *See* Exchange Act Rules 15c3-1, 15c3-3 and 15c2-4 [17 CFR 240.15c3-1, 15c3-3 and 15c2-4].

If instead an entity were to register as a funding portal and become a funding portal member of a national securities association, we estimate the initial cost would be approximately \$100,000, with an ongoing cost of approximately \$10,000 in each year thereafter to maintain this registration and membership.[985]

These estimated costs are exclusive of the cost of establishing and maintaining a platform and related functionality. We anticipate that a significant percentage of intermediaries (whether brokers or funding portals) will already have in place platforms and related systems that would only need to be tailored to comply with the requirements of Title III of the JOBS Act and Regulation Crowdfunding. We estimate that a cost of approximately \$100,000 in the first year, and approximately \$40,000 annually thereafter for an intermediary that already has in place a platform and related systems. However, for an intermediary (whether broker or funding portal) that would need to develop a platform from scratch, we estimate the cost to do so would be approximately \$400,000 in the initial year, and approximately \$40,000 annually to maintain thereafter.

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985 In making these estimates, we assume that the membership process would take approximately one month and that there would be no related licensing requirement for associated persons of the funding portal. We also only include domestic entities in these estimates, which would not need to comply with the proposed requirements in Regulation Crowdfunding that would apply to nonresident funding portals. Nonresident funding portals would be subject to an additional cost of approximately \$25,870 to comply with the costs of completing Schedule C to Form Funding Portal, hiring and maintaining an agent for service of process and providing the required opinion of counsel.

Estimated Costs of Intermediaries That Register As Brokers

	Estimated Costs	
	Initial Cost (Year 1)	**Ongoing Cost per Year**
Form BD Registration and National Securities Association Membership	$275,000	$50,000
Complying with Requirements to Act as an Intermediary in, and to Engage in Broker Activities Related to, Transactions pursuant to Section 4(a)(6)[986]	$245,000	$180,000
Platform Development	$250,000[987]	$40,000
Subtotal	*$770,000*	*$270,000*

Estimated Costs of Intermediaries That Register As Funding Portals

	Estimated Costs	
	Initial Cost (Year 1)	**Ongoing Cost per Year**
Form Funding Portal Registration and National Securities Association Membership[988]	$100,000	$10,000
Complying with Requirements to Act as an Intermediary[989]	$67,000	$40,000
Platform Development[990]	$250,000	$40,000
Subtotal	*$417,000*	*$90,000*

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986 As discussed above, these costs include, among others, the costs to the broker of having associated persons, who have licensing requirements, suitability requirements, requirements relating to advertisements, net capital and fidelity bond requirements, and compliance with Exchange Act Rule 15c2-4 (17 CFR 240.15c2-4), as well as the costs of complying with proposed Subpart C of Regulation Crowdfunding. *See* Section IV.C. 2 below for further detail on the costs associated with the requirements under proposed Subpart C.

987 As described above, the cost to develop a platform is expected to vary depending on the extent to which the entity already has a platform and related systems in place. For purposes of this chart, we use the average of the range provided above ($100,000 to $400,000 in the initial year).

988 As described above, this estimate reflects a streamlined process of becoming a member of a national securities association, which we assume would take approximately one month and not involve application or licensing of associated persons.

989 This includes the costs of complying with the requirements of proposed Subparts C and D of Regulation Crowdfunding. *See* Section IV.C.2 below for further detail on these costs.

990 As described above, the cost to develop a platform is expected to vary depending on the extent to which the entity already has a platform and related systems in place. For purposes of this chart, we use the average of the range provided above. *See* Section IV.C.2 below for further detail on costs associated with developing a platform.

Estimated Incremental Costs of Intermediaries Already Registered as Brokers

	Estimated Costs	
	Initial Cost (Year 1)	Ongoing Cost per Year
Complying with Requirements to Act as an Intermediary in Transactions pursuant to Section 4(a)(6)[991]	$45,000	$30,000
Platform Development[992]	$250,000	$40,000
Subtotal	*$295,000*	*$70,000*

We believe that, while the registration requirements would necessarily impose costs on intermediaries, they also would provide significant protections for the crowdfunding investor marketplace. Among other things, in addition to the Commission's oversight and rule-writing functions with regard to broker-dealers, FINRA currently is responsible for conducting most broker-dealer examinations, mandating certain disclosures by its members, writing rules governing the conduct of its members and associated persons, and informing and educating the investing public. Similarly, the regulatory framework that a registered national securities association – likely initially FINRA – would be required to create for funding portals would play an important role in the oversight of these entities.

The estimated costs in the table above reflect the direct, quantifiable costs that intermediaries would incur in connection with registering as a broker on Form BD or as a funding portal on Form Funding Portal, submitting amendments to registrations and withdrawing registrations. We estimate that approximately 50 intermediaries that would already be brokers

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991 This includes the incremental costs of complying with the requirements of proposed Subpart C of Regulation Crowdfunding, but it excludes any registration or membership requirements. *See* Section IV.C.2 below for further detail on these costs.

992 As described above, the cost to develop a platform is expected to vary depending on the extent to which the entity already has a platform and related systems in place. For purposes of this chart, we use the average of the range provided above. *See* Section IV.C.2 below for further detail on costs associated with developing a platform.

that have already registered with the Commission[993] and, as such, these brokers would not incur additional SEC registration costs associated with the proposed rules. Additionally, intermediaries that are not otherwise registered with FINRA or any other registered national securities association would need to register, and the estimated cost for such registration is included in the table above. We anticipate that the cost for a funding portal to become a member of a registered national securities association would be proportionately less than the cost for a broker to do so because of the more limited nature of a funding portal's permissible activities, and the streamlined set of rules that the association would impose on funding portals.[994] However, the exact cost of registration for funding portals would not be known until a registered national securities association adopts rules applicable to funding portals, and for purposes of this economic analysis, we have used a conservative estimate for this cost based on the current fee and costs applicable to brokers applying to become members of a national securities association.

The proposed rules would also require that an intermediary execute transactions exclusively through its online platform. This requirement should help to minimize the potential for "boiler room" and other similar abusive sales practices. Based on comments received and our discussions with industry participants,[995] we believe that the use of an online platform would enhance the ability of issuers and investors to transparently communicate as compared to the

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993 *See* Section IV.C.2 below.

994 *See* FINRA, *Jumpstart Our Business Startups Act: FINRA Requests Comment on Proposed Regulation of Crowdfunding Activities*, FINRA Regulatory Notice 12-34 (July 2012), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p131268.pdf ("In writing rules specifically for registered funding portals, FINRA would seek to ensure that the capital-raising objectives of the JOBS Act are advanced in a manner consistent with investor protection. Commenters are urged to identify the types of requirements that should apply to registered funding portals, taking into account the relatively limited scope of activities by a registered funding portal permitted under the JOBS Act.")

995 *See* note 888.

alternative of allowing transactions to occur offline. This requirement should help issuers gain exposure to a wide range of potential investors, who also may benefit from having numerous investment opportunities aggregated in one place, resulting in lower search costs or burdens related to identifying suitable investment opportunities.

We preliminarily estimate that the requirement to use an intermediary could result in transaction costs for issuers of 5% to 15% of the amount of the offering made in reliance on Section 4(a)(6),[996] depending on the intermediary used and the fees charged for services, including payment processing. Although crowdfunding intermediaries are not expected to provide issuers with underwriting services commensurate with registered offerings (and, in fact, funding portals would be prohibited from doing so), the fees charged in a crowdfunding offering could be significantly larger on a percentage basis relative to the underwriting fees for registered offerings, which range from as high as 7% for initial public offerings to less than 1% for certain bond issuances.[997] In general, to the extent that a significant component of the fees is fixed, the transaction costs for issuers would make smaller issues more expensive. Although crowdfunding offerings would likely vary in size, based on an offering size of $100,000, an issuer would incur an average of $5,000 to $15,000 in fees. As previously discussed, we believe that competition among potential crowdfunding venues and the potential development of new products and services could have a significant impact on these estimates over time.

a. Disclosure and Dissemination Requirements

The statute and proposed rules include disclosure and dissemination provisions designed to provide information to security-based crowdfunding investors. These provisions, together

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996 *See* note 918.

997 *See* note 817 and accompanying text.

with the issuer disclosure provisions discussed above, are expected to limit information asymmetries and promote the efficient allocation of capital amongst crowdfunding issues. Additionally, these disclosure and dissemination provisions would provide information intended to ensure that investors are aware of the risks associated with their investment, which would help protect investors in this new market. As discussed above, many of these costs and benefits are difficult to quantify or estimate with any degree of certainty, especially considering securities-based crowdfunding provides a new method for raising capital in the United States. To the extent possible, however, we have quantified the direct costs to intermediaries associated with these provisions in the table above. The proposed rules would prohibit any intermediary or its associated persons from accepting an investment commitment until the investor has opened an account with the intermediary and the intermediary has obtained the investor's consent to electronic delivery of materials. This requirement would help ensure that certain basic information about the investor is on file with the intermediary and that all investors are on notice of the primary method of delivery for communications from the intermediary. We estimate the direct cost of this requirement in the table above.

The statute requires intermediaries to provide disclosures related to risks and other investor education materials. The proposed rules would implement this statutory mandate by requiring intermediaries to deliver educational materials that explain how the offering process works and the risks associated with investing in crowdfunding securities.[998]

The proposed educational requirements would help make investors aware of the limits and risks associated with purchasing crowdfunding securities. Such knowledge would help

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998 *See* proposed Rule 302(b) of Regulation Crowdfunding.

investors understand the payoff structures that are specified by the offering contractual features and the circumstances under which they could expect to be compensated. It also would help ensure that offerings proceed more efficiently as investors would be more informed by the time they decide to make their investment commitments and receive required notices. We recognize that the effectiveness of the educational materials to enhance investor protection would vary depending upon the education and experience of retail investors.[999] In addition, a presentation that highlights the risks of securities-based crowdfunding could discourage investor participation.

Under the proposed rules, the educational materials could be in any electronic format, including video format, and the intermediary would have the flexibility to determine how best to communicate the contents of the educational material, thus the cost for intermediaries to develop educational materials is expected to vary widely. The table above includes our current estimates of the direct, quantifiable costs that would be incurred to comply with the proposed requirement, as well as additional costs to update or revise the materials from time to time.

The proposed rules also require that intermediaries obtain representations from investors regarding their review of the investor education materials and their understanding of the risks.[1000] The Commission believes these proposed rules would improve investors' understanding of crowdfunding generally, as well as aspects of certain types of securities and the implications for their investments in issuers that are raising capital through securities-based crowdfunding in reliance on Section 4(a)(6). We estimate that the direct costs of this requirement to an

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999 *See* Jennifer E. Bethel and Allen Ferrell, *Policy Issues Raised by Structured Products*, HARV. L. & ECON. Discussion Paper No. 560, 2007, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=941720.

1000 *See* proposed Rule 303(b)(2) of Regulation Crowdfunding.

intermediary would be incorporated into the costs of developing a platform and that the ongoing burden to comply would be minimal. This proposed requirement also might impose a further cost to the extent that the requirement deters investors from making investment commitments or otherwise participating in offerings made in reliance on Section 4(a)(6).

The proposed rules would also require an intermediary to clearly disclose the manner in which the intermediary is compensated in connection with offers and sales of securities in reliance on Section 4(a)(6).[1001] As explained above, we believe that investors would benefit by having information about how intermediaries are compensated, such as through compensation arrangements with affiliates. We believe that the costs of complying with this requirement also generally would be included in the overall cost for intermediaries to develop their platforms, as it would entail adding an item of disclosure that would be built into the functionality of their platforms. The costs are reflected in the table above, and we believe that this requirement would impose only nominal incremental costs on intermediaries on an ongoing basis. We also do not expect significant competitive costs from the disclosure of such compensation arrangements.

The statute and the proposed rules further would require that intermediaries make available certain issuer-provided information. As described above, intermediaries would have to implement and maintain systems to comply with the information disclosure requirements so that the information was publicly available and easily accessible on the intermediary's platform by interested persons.

The issuer disclosure requirements should benefit investors by enabling them to better evaluate the issuer and the offering. Requiring intermediaries to make the issuer information

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1001 *See* proposed Rule 302(d) of Regulation Crowdfunding.

publicly available and easily accessible on their platforms would reduce information asymmetries between issuers and investors and would enhance both transparency and efficiency of the market. We expect that intermediaries would incur costs to develop the functionality that would allow the uploading and downloading of issuer information. We believe that the direct costs of complying with this requirement would be included in the overall cost to intermediaries to develop their platforms and that this requirement would impose only nominal incremental costs on intermediaries on an ongoing basis, primarily because the functionality necessary to upload the required issuer disclosure information is a standard feature offered on many websites and would not require frequent updates.

The proposed rules would also require an intermediary to provide communication channels on its platform, meeting certain conditions, which would allow investors who have opened accounts with intermediaries and representatives of the issuer to interact and exchange comments about the issuer's offering on that intermediary's platform, and which would be publicly available for viewing (*i.e.,* by those who may not have opened accounts with the intermediary).[1002] While Congress contemplated the use of such communication channels, the statute does not explicitly require intermediaries to provide them.[1003] Compared with the alternative of not requiring intermediaries to provide communication channels, we believe that requiring the communications channel to be on the intermediary's platform would allow investors, particularly those who might be less familiar with online social media, to participate in online discussions regarding ongoing offerings without having to actively search for such discussions on external websites. We do recognize, however, that this requirement would not

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1002 *See* proposed Rule 303(c) of Regulation Crowdfunding.

1003 *See* Section 4A(b)(3).

preclude investors from initiating additional discussions on external websites. Furthermore, the requirements that the communication channels be viewable by the public and that promoters be clearly identified on these channels would enhance transparency about the issuer and its offering with appropriate disclosures, ultimately allowing investors to make more informed investment decisions. We estimate that the costs of this proposed requirement are incorporated into the costs of developing a platform and that once the platform has been set up the ongoing burden to comply would be minimal.

We are also proposing to require intermediaries to, upon receipt of an investment commitment from an investor, promptly provide or send to the investor a notification of that investment commitment.[1004] While this notice is not statutorily required, we believe that this requirement is appropriate as it would provide investors with key information about their investment commitments, including notice of the opportunity, as relevant, to cancel their investment commitments. Investors would benefit from these requirements because they would be provided with the necessary information to evaluate their investment commitments, their securities transactions and the intermediaries that are effecting those transactions. We estimate that the costs of these requirements are incorporated into the costs of developing a platform and that the ongoing burden to comply would be minimal.

We also propose to implement the statutory requirement for intermediaries to allow investors to cancel their commitments to invest, by requiring investors to have until 48 hours prior to the deadline identified in the issuer's offering materials to cancel their investment

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1004 *See* proposed Rule 303(d) of Regulation Crowdfunding.

commitments.[1005] If an issuer reaches its target offering amount prior to the target offering deadline, the proposed rules would permit early closing of the offering, provided that the intermediary sends notices to investors informing them of the closing and the deadline for the opportunity to cancel.[1006] The proposed rules also would set forth notice requirements and requirements related to the intermediary directing payments in the event of cancellations and material changes to offerings.[1007] The proposed rules would impose specific obligations on intermediaries related to informing investors about their right to cancel, depending on particular circumstances relating to timing of the offering, such as in the event of early closings, cancellations and material changes that trigger reconfirmations of investment commitments.

We believe that investors would benefit from receiving these notices because the notifications and accompanying information would keep investors informed about the status of the offering and help them make informed investment decisions. We further believe that investors would reasonably expect to be informed of changes impacting the timing of offerings and other material changes. This approach also would benefit investors by providing investors with sufficient time to review and assess information and communications about the issuer.

We recognize that allowing investors to cancel their investment commitments up to 48 hours prior to the deadline identified in the issuer's offering materials may impose a cost on issuers who, because of investors cancelling commitments late in the offering period, may fall below the target offering amount and so decide to cancel the offering or to extend the offering period. Accordingly, we recognize that this requirement may have an effect on capital

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[1005] *See* proposed Rule 304(a) of Regulation Crowdfunding.

[1006] *See* proposed Rule 304(b) of Regulation Crowdfunding.

[1007] *See* proposed Rules 304(c) and (d) of Regulation Crowdfunding.

formation. Intermediaries also may incur direct costs in developing and maintaining such systems, for instance to send the relevant notices to investors, as part of the cost of developing a platform reflected in the table above.

b. Measures to Reduce the Risk of Fraud and Limitations

The statute and proposed rules require intermediaries to take certain steps to reduce the risk of fraud, including steps related to checking whether issuers are eligible to rely on Section 4(a)(6) and whether investors comply with investment limits in order to participate in an offering pursuant to Section 4(a)(6). We believe that intermediaries will be in the best position to take these steps and that these requirements will increase investor protections. Additionally, the statute and proposed rules place certain limitations on intermediaries. These limitations are further meant to increase investor protection in the securities-based crowdfunding market. As noted above, the costs and benefits of these provisions are difficult to quantify or estimate with any degree of certainty. To the extent possible, however, we have quantified estimates of the direct costs associated with these provisions and the proposed rules in the table above.

The proposed rules would require that an intermediary 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 Securities Act and the related requirements in Regulation Crowdfunding. In satisfying this requirement, an intermediary may rely on the representations of the issuer concerning compliance with these requirements unless the intermediary has reason to question the reliability of those representations. The proposed rules would also require that an intermediary have a reasonable basis for believing that an issuer seeking to offer and sell securities on the intermediary's platform complies with all issuer requirements and has established means to keep accurate records of holders of the securities. The proposed rules would permit an intermediary to rely on an issuer's representations concerning compliance with these requirements unless the intermediary has reason to question the reliability of the representations. The proposed rules also would require an intermediary to deny access to an issuer if it has a reasonable basis for believing that the issuer or any of its officers, directors (or any person occupying a similar status or performing a similar function) or 20 Percent Beneficial Owners was subject to a disqualification under the proposed rules. As required by the statute, the proposed rules would require the intermediary to conduct a background and securities enforcement check on each of these persons. Furthermore, the proposed rules would require an intermediary to deny access to its platform if the intermediary believes that the issuer or the offering presents the potential for fraud or otherwise raises concerns regarding investor protection.[1008] Each of these proposed requirements is intended to help reduce the risk of fraud in securities-based crowdfunding.

We believe that if intermediaries take the measures we propose to require, investors would be more willing to participate in securities-based crowdfunding offerings. Investors would rely on the efforts of the intermediary that conducted a background and securities enforcement regulatory history check, solving a collective action problem that would be prohibitively costly if left to individual investors. To the extent these checks lessened the likelihood of inappropriate or nefarious activity, they could increase investor willingness to purchase crowdfunding securities, thereby potentially resulting in issuers having greater access to capital. We anticipate that most intermediaries would employ third parties to perform background checks.

1008 *See* proposed Rule 301 of Regulation Crowdfunding.

We also recognize that permitting an intermediary to rely on an issuer's representations unless the intermediary has reason to question the reliability of the representations could potentially lessen the incentive for an intermediary to thoroughly investigate the issuers and securities to be offered on its platform. Such an outcome could result in a higher levels of fraud compared to a requirement that intermediaries perform a thorough investigation to ensure that the issuer complied with all the requirements. A higher level of fraud would negatively affect both investors in crowdfunding offerings and non-fraudulent issuers. Based on comments and conversations with industry participants,[1009] however, we believe it is likely that investors and interested participants would provide relevant adverse information about an issuer or an offering through postings on chat sites, message boards, and other communication channels, including, but not limited to, the communication channels to be provided by the intermediary. These media would provide a potential source of information for intermediaries who may be subject to liability as "issuers."

The proposed rules also would require an intermediary to have a reasonable basis for believing that an investor has not exceeded the investment limits discussed above before accepting an investment commitment from that investor.[1010] Under the proposed rules, an intermediary may rely on an investor's representations concerning compliance with the investment limits unless the intermediary has reason to question the reliability of the representations. We believe that this requirement would help to ensure that the investor protection benefits associated with the investment limits are realized. This ability to rely on investor representations should help mitigate the potential cost that intermediaries could incur in

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1009 *See* note 888.

1010 *See* proposed Rule 303(b)(1) of Regulation Crowdfunding.

relation to this requirement. At the same time, we realize that investors might make inaccurate representations, whether intentionally or not. Although some of these concerns could be addressed by the use of a central data repository, for example, the statute does not mandate the use of such a central data repository and we are not proposing to require one because, as we consider this alternative to the proposed standard, we believe that the benefits of establishing such a repository would not at this time justify the potentially significant costs. Accordingly, we believe that the standard proposed represents a reasonable approach to implement the statutory requirement, achieving an appropriate balance between competing concerns.

We expect that because system functionality to obtain user acknowledgments is standard on many online trading and electronic commerce websites, the market to build such system functionality is highly commoditized and the average cost to both develop and maintain systems that allow an investor to represent that he or she has not exceeded allowable investment limits would not be unduly high. As noted in the table above, we estimate that the cost to comply with this requirement would be incorporated into the costs to develop a platform and that the ongoing burden to comply would be minimal.

As noted above, the statute and the proposed rules would also prohibit an issuer from compensating, or committing to compensate, directly or indirectly, any person to promote the issuer's offering through communication channels provided by the intermediary unless the issuer takes reasonable steps to ensure that such person clearly discloses the receipt (both past and prospective) of such compensation each time a promotional communication is made. We also are proposing to require that an intermediary take certain steps to ensure that investors are made aware of such compensation, and that such compensation is disclosed in the communication channels, so that investors can gauge the promoter's communications appropriately.[1011] We believe that intermediaries would be in an appropriate position to take such steps. As part of the account opening, the intermediary would be required disclose to persons opening accounts that any person who receives compensation to promote an issuer's offering, or who is a founder or an employee of an issuer that engages in promotional activities on behalf of the issuer on the intermediary's platform, must clearly disclose on the platform the receipt of the compensation and that he or she is engaging in promotional activities on behalf of the issuer. In addition, under the proposed rules, the intermediary must require that any person posting a comment in the communication channels clearly disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or is otherwise compensated, whether in the past or prospectively, to promote the issuer's offering.

Under the proposed rules, intermediaries might incur direct costs in complying with the requirements to disclose compensation to promoters, and certain additional costs from time to time to ensure continued compliance, as outlined in the table above. In addition, if this proposed requirement discourages the use of promoters by issuers, it could limit the investor pool for a securities-based offering made in reliance on Section 4(a)(6), thus limiting the ability of an issuer to raise capital.

Additionally, the statute prohibits the directors, officers or partners of an intermediary, or any person occupying a similar status or performing a similar function, from having any financial interest in an issuer that uses the services of the intermediary. The proposed rules would implement this statutory requirement but extend the prohibition to the intermediary as

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1011 *See* proposed Rules 302(c) and 303(c)(4) of Regulation Crowdfunding.

well.[1012] Such a prohibition would be beneficial to investors and issuers because if an intermediary were to have a financial interest in one or more issuers that plan to use its services, the intermediary could have an incentive not based solely on merit to promote that issuer's offering, potentially to the detriment of investors and other issuers. The prohibition would, however, impose a cost on an issuer who might otherwise seek to compensate an intermediary with an interest in the issuer, rather than cash, for its services. It is thus possible that the prohibition could make securities-based crowdfunding unavailable to an issuer that does not have the ability to otherwise compensate an intermediary.

The statute requires that intermediaries ensure that all offering proceeds are provided to the issuer only when the aggregate capital raised from all investors is equal to or greater than a target offering amount. The proposed rules would implement this requirement by requiring intermediaries that are registered as brokers to comply with the existing requirements of Exchange Act Rule 15c2-4.[1013] Intermediaries registered as funding portals would be required to direct investors to transmit the funds or other consideration directly to a qualified third party, which is a bank, that has agreed in writing to hold the funds or maintain a bank account (or accounts) for the exclusive benefit of, and to promptly transmit the funds to, the issuer or the investors, depending on circumstances such as whether the offering was completed or was cancelled, and whether the investment commitment was cancelled. The proposed rules also would require a funding portal to direct the qualified third party to transmit funds to the issuer once the target offering amount is reached and the cancellation period has elapsed; to return

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1012 *See* proposed Rule 300(b) of Regulation Crowdfunding.

1013 *See* proposed Rule 303(e) of Regulation Crowdfunding.

funds to an investor when an investment commitment has been cancelled; and to return funds to investors when the offering has not been completed.

These requirements would benefit investors and issuers by helping to ensure that funds are appropriately refunded or transmitted in accordance with the terms of the offering. In particular, the requirement that the account in which funds are deposited be exclusively for the benefit of investors and the issuer would help prevent the intermediary or other parties from claiming or otherwise unlawfully taking funds from that account.

Under the statute, intermediaries also may not compensate promoters, finders or lead generators for providing brokers or funding portals with the personally identifiable information of any potential investor. We propose to implement this statutory requirement by prohibiting an intermediary from compensating any person for providing the personally identifiable information of any crowdfunding investor or potential investor to intermediaries.[1014] We anticipate that intermediaries would have some need for referrals to the intermediary's platform and, therefore, we are proposing to permit an intermediary to compensate a person for directing issuers or potential investors to the intermediary's platform in certain situations.[1015] These requirements would benefit intermediaries by providing them with a means to attract more investors to their crowdfunding portals, without allowing the sharing of personally identifiable information. Investors would meanwhile benefit from the additional privacy protection. Intermediaries might incur a cost because the proposed requirement would not allow them to use personally identifiable information to target and seek out specific investors, thus reducing the potential investor pool for certain offerings.

1014 *See* proposed Rule 305(a) of Regulation Crowdfunding.

1015 *See* proposed Rule 305(b) of Regulation Crowdfunding.

5. Additional Funding Portal Requirements

Under the proposed rules, a funding portal would register with the Commission by filing a complete Form Funding Portal with information concerning the funding portal's operation.[1016] In the table above, we estimate the costs that intermediaries would incur related to registering as a funding portal on Form Funding Portal.

The proposed rules would include the statutory requirement that a funding portal be a member of a registered national securities association. As explained above, we believe that the statute effectively mandates that an intermediary be a FINRA member or any other registered national securities association (as applicable). The proposed requirement that funding portals register with the Commission and a registered national securities association benefits investors by providing oversight to reduce the risk for fraud. Although we estimate that there are costs associated with this requirement, we believe that the reduction in fraud risk deriving from this requirement might benefit portals by helping to create a marketplace in which investors are more willing to participate and issuers are more comfortable using this method of capital formation.

The proposed rules also would require that funding portals use proposed Form Funding Portal to provide updates whenever information on file becomes inaccurate for any reason, to register successor funding portals and to withdraw from funding portal registration. Although funding portals would incur time and compliance costs to update Form Funding Portal, we expect funding portals would have navigated the filing process for Form Funding Portal when they register and would be familiar with the process by the time they update the form.

1016 *See* proposed Rule 400(a) of Regulation Crowdfunding.

We propose to allow nonresident funding portals to register with us, provided that certain conditions are met. One condition is that an information sharing agreement is in place between the Commission and a competent regulatory authority in the relevant jurisdiction. The proposed rules would also require a nonresident funding portal to appoint an agent for service of process in the United States, and to certify and provide opinion of counsel that as a matter of law, the funding portal can provide the Commission and any national securities association of which it is a member with prompt access to its books and records and can, as a matter of law, submit to onsite inspection and examination by the Commission and the national securities association.

Compared to an alternative that we could have selected, *i.e.*, that of not allowing nonresident entities to operate as funding portals in the U.S. crowdfunding market, the proposed rules would increase competition among crowdfunding intermediaries, which in turn is likely to reduce the fees that intermediaries charge issuers. The lack of data does not allow us to estimate the magnitude of this potential fee reduction. Lower costs of raising capital could also attract more potential issuers to use the crowdfunding exemption, thus enhancing capital formation. Conditioning the nonresident funding portal registration on the presence of an information sharing agreement as mentioned above would provide regulators and market participants with more information about the nonresident funding portals, thus reducing the likelihood of fraud.

Although the requirements we propose with respect to appointment of an agent for service of process, and a certification and legal opinion would impose costs on nonresident funding portals, these requirements are consistent with regulations we have proposed to impose on other nonresident entities subject to our regulation. The proposed regulations would enhance investor protection by requiring steps to ensure that funding portals that were not based in the United States, or that were subject to laws other than those of the United States, would nevertheless be accessible to the Commission and other relevant regulators for purposes of conducting examinations of, and enforcing

U.S. laws and regulations against these entities. While the JOBS Act does not distinguish between resident and nonresident funding portals, it clearly contemplates Commission oversight of registered funding portals and the tailoring of such requirements to varied circumstances.

The statute also provides an exemption from broker-dealer registration for funding portals. The proposed rules would implement the statutory requirement by stating that a registered funding portal is exempt from the broker registration requirements of Exchange Act Section 15(a)(1) in connection with its activities as a funding portal.[1017] This proposed rule would benefit funding portals because it would specify the scope of the limited exemption in the statute, thus providing clarity to the funding portals regarding their activities. We believe this approach of exempting funding portals from broker registration and its accompanying regulations would benefit the market and its participants. The activities of funding portals would be more limited than those of brokers. Thus, the proposed rules would require funding portals to comply with a registration requirement and set of regulations more appropriate for their activities, rather than the more extensive and higher cost requirements that accompany broker-dealer registration. Lower registration costs of funding portals could translate into lower fees they charge issuers that use these portals, thus benefiting issuers of crowdfunding securities and potentially increasing capital formation. We are unable to quantify these potential benefits. We do not expect any significant benefits to registered broker-dealers from this limited exemption for funding portals. Registered broker-dealers could be put at a competitive disadvantage because of the higher registration cost. They, however, will be allowed a wider variety of

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[1017] *See* proposed Rule 401(a) of Regulation Crowdfunding. *See also* Section IV.C.2.j below.

activities compared to funding portals, the benefits of which could more than compensate for the higher registration costs.

The proposed rules would also require a funding portal to obtain a fidelity bond, and maintain fidelity bond coverage for the duration of its registration as a funding portal.[1018] This requirement would benefit investors by protecting them to some extent from potential losses caused by fraud. Investors and issuers that used funding portals for their offerings would likewise benefit from the added stability that the fidelity bond protection would provide.

We estimated the costs of maintaining fidelity bond coverage based on conversations with insurance service companies for FINRA-registered firms and note that the actual cost of coverage for funding portals would vary depending on particular circumstances, such as the size of the firm. For instance, according to these sources, funding portals with fewer employees (*e.g.*, up to 30 employees) might incur lower fidelity bond costs than funding portals with more employees.

a. Safe Harbor for Certain Activities

Exchange Act Section 3(a)(80) prohibits funding portals from (1) offering investment advice or recommendations, (2) soliciting purchases, sales or offers to buy securities offered or displayed on the funding portal's platform, (3) compensating employees, agents or other such persons for solicitation or based on the sale of securities displayed or referenced on the funding portal's platform, or (4) holding, managing, possessing or otherwise handling investor funds or securities. The proposed rules would give funding portals, their associated persons, affiliates and business associates, a measure of clarity regarding activities that would be permissible without

1018 *See* proposed Rule 400(f) of Regulation Crowdfunding.

violating these statutory prohibitions, while also helping to protect investors from activities that would create potential conflicts of interest.[1019] Thus, compared with the alternative that we could have chosen, that of not providing the safe harbor, the proposed rules will likely reduce funding portals' regulatory burden (*e.g.*, it will be easier for funding portals to advertise their activities and attract issuers and investors, thus potentially increasing their revenue). The legal certainty provided by the safe harbors, for example proposed Rule 402(b)(4) which permits a funding portal to provide on its platform communication channels, would help ensure that the benefits of the substantive rule provisions are realized. Such measures have the potential to attract greater numbers of investors to crowdfunding through funding portals than would otherwise participate, thereby encouraging capital formation.

The proposed rules would permit a funding portal to apply objective criteria to limit the crowdfunding securities offered on its platform.[1020] Investors would benefit by being able to search, sort or categorize offerings on a funding portal's platform in an organized manner, which would allow them to find investment opportunities meeting specific criteria. This functionality would more efficiently match investors with investment opportunities. These proposed rules would benefit funding portals by providing them with the flexibility to limit the use of their platform to certain types of issuers and to highlight certain offerings on their platforms which investors may find of interest.

Under the proposed rules, funding portals would be permitted to provide advice to an issuer on the structure and content of its offerings, including assistance to the issuer in preparing

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[1019] *See* proposed Rule 402 of Regulation Crowdfunding.

[1020] *See* proposed Rule 402(b)(1) of Regulation Crowdfunding.

documentation.[1021] This proposed rule would allow issuers to obtain guidance that may not typically be available to them and lower funding costs. Many potential issuers seeking to offer and sell crowdfunding securities are unlikely to be familiar with how to best structure offerings so as to raise capital in the most cost effective manner, and they might not have the capital, knowledge or resources to hire outside advisors. Given that an issuer would be required to effect offerings through an intermediary, we believe that permitting funding portals to provide these services to issuers would lower overall transaction costs for issuers, as they would not need to engage another party to provide these services. This effect would in turn help to enhance market efficiency.

The proposed rules would also permit a funding portal to compensate a third party for referring a person to the funding portal in certain circumstances.[1022] As discussed above, this proposed safe harbor would benefit funding portals by providing them with a means to attract more investors to their crowdfunding platforms, while protecting investors' personally identifiable information. Investors also would benefit from the prohibition on transaction-based compensation (other than to registered broker-dealers), which would help to reduce the incentive for abusive practices.

The proposed rules would permit a funding portal to pay or offer to pay compensation to a registered broker or dealer for services provided in connection with the offer or sale of securities in reliance on Section 4(a)(6), subject to certain conditions set forth in the rule.[1023] Similarly, a funding portal could, subject to certain conditions, receive compensation from a

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1021 *See* proposed Rule 402(b)(5) of Regulation Crowdfunding.

1022 *See* proposed Rule 402(b)(6) of Regulation Crowdfunding.

1023 *See* proposed Rule 402(b)(7) of Regulation Crowdfunding.

registered broker or dealer for services provided by the funding portal.[1024] Under these proposed rules, funding portals would benefit from being able to enter into these types of arrangements with registered broker-dealers who could provide services that the funding portals otherwise would be prohibited from providing. Brokers also would benefit from the additional business that funding portals might be able to attract through their platforms and online presence generally, as well as from services, such as those related to technology, which funding portals could provide. Issuers and investors might benefit from such arrangements by having more readily-available services provided to them by entities subject to the applicable regulatory oversight.

The proposed rules would permit a funding portal to advertise its existence, subject to certain conditions.[1025] These requirements would benefit funding portals by allowing them to advertise publicly to attract more investors to their crowdfunding platforms; however, they might bear costs associated with ensuring compliance with the rule's conditions. The proposed rule also would enhance market efficiency as investors become more aware of available offerings through advertisements by funding portals and are thus able to better match their investments with projects that are most suitable for their risk preferences.

The statute requires intermediaries to take measures to reduce the risk of fraud, and we propose to implement this requirement by requiring a funding portal to deny access to its platform to an issuer that the funding portal believes presents the potential for fraud or otherwise raises concerns regarding investor protection.[1026] The requirement would further enhance

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1024 *See* proposed Rule 402(b)(8) of Regulation Crowdfunding.

1025 *See* proposed Rule 402(b)(9) of Regulation Crowdfunding.

1026 *See* proposed Rules 301(c) and 402(b)(10) of Regulation Crowdfunding.

investor protection by giving funding portals the flexibility to deny access to potential bad actors. Funding portals also would benefit from the ability to deny access to certain issuers to protect the integrity of the offering process and the market reputation of the crowdfunding platforms without fear of violating the prohibition on providing investment advice.

The proposed rules would clarify that a funding portal would not be in violation of the statutory prohibitions on holding, managing, possessing or otherwise handling investor funds or securities by accepting investment commitments from potential investors.[1027] Under the proposed rules funding portals could direct investors where to transmit funds or remit payment in connection with the purchase of securities offered and sold in reliance on Section 4(a)(6).[1028] Similarly, a funding portal could direct a qualified third party to release proceeds of a successful offering to the issuer upon completion of the offering or to return investor proceeds when an investment commitment or offering is cancelled.[1029] These proposed rules would give both funding portals and entities with which they do business a measure of legal certainty that funding portals providing direction for funds to and from qualified third parties in compliance with the proposed rules would not constitute activity in violation of the statutory prohibitions on holding, managing, possessing or otherwise handling investor funds or securities.

b. Compliance Requirements

We are proposing to require that a funding portal implement written policies and procedures, reasonably designed to achieve compliance with proposed Regulation Crowdfunding

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1027 *See* proposed Rule 402(b)(11) of Regulation Crowdfunding.

1028 *See* proposed Rule 402(b)(12) of Regulation Crowdfunding.

1029 *See* proposed Rule 402(b)(13) of Regulation Crowdfunding.

and the rules and regulations thereunder, relating to its business as a funding portal.[1030] This requirement would provide a benefit to investors and funding portals alike, as written policies and procedures would aid, enhance and help to ensure consistent compliance with the proposed rules. Funding portals would incur costs associated with the requirement to develop their own procedures and implement written policies and procedures, as well as to update and enforce them, as set forth in the table above.

We are also proposing to require registered funding portals to comply with the requirements of the Bank Secrecy Act (BSA), including the reporting, recordkeeping and record retention requirements that apply to brokers.[1031] We recognize that the proposed rules would impose costs on funding portals to implement anti-money laundering (AML) procedures, as set forth in the table above; however, we believe that the proposed requirements provide important benefits. As discussed above,[1032] low-priced and privately-placed securities pose a money laundering risk because they are susceptible to market manipulation and fraud.[1033] Requiring funding portals to follow these AML procedures, in particular the requirement to file SARs, would help identify to law enforcement and regulators potentially fraudulent activity. These AML requirements would help therefore to protect market participants from illegal activity that could potentially infiltrate new online investment opportunities. Requiring the implementation of AML procedures would, in turn, provide potential investors with some degree of confidence

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1030 *See* proposed Rule 403(a) of Regulation Crowdfunding.

1031 *See* proposed Rules 401(b), 403(b) and 404(f) of Regulation Crowdfunding. *See also* Section II.D.4 above.

1032 *See* Section II.D.4.b above.

1033 *See* FATF Typology, note 641.

that adequate protections against illegal activity exist for this new fundraising approach and would encourage more investors to participate, thus facilitating capital formation.

Additionally, the statute requires that intermediaries take such steps to protect the privacy of information collected from investors as we determine appropriate. We are proposing to implement this statutory provision by requiring a funding portal to comply with Regulation S-P, S-ID and Regulation S-AM, which are applicable to brokers.[1034] We believe that requiring a funding portal to comply with privacy obligations would help protect the personally identifiable information of investors and potential investors, consistent with how it is protected by other financial intermediaries. Compared with an alternative that we could have selected, that of developing a new privacy regime applicable only to funding portals, the proposed rules would introduce consistency between funding portals and broker-dealers with respect to privacy obligations. That will benefit investors by lowering their information search costs and reducing investor confusion. We recognize that the requirement would impose costs on funding portals to comply with the privacy requirements, as set forth in the table above; however, these additional privacy protections could give potential investors the confidence to participate in offerings made in reliance on Section 4(a)(6), which would facilitate capital formation and benefit the markets generally.

As a condition to exempting funding portals from the requirement to register as broker-dealers under Exchange Act Section 15(a)(1), Exchange Act Section 3(h)(1)(A) requires that registered funding portals remain subject to, among other things, the Commission's examination authority. Under the proposed rules, a funding portal would be required to permit the

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1034 *See* proposed Rule 403(c) of Regulation Crowdfunding.

examination and inspection of all its business and business operations relating to its activities as a funding portal, including its premises, systems, platforms and records by Commission representatives and by representatives of the registered national securities association of which it is a member.[1035] Although funding portals would face time and compliance costs in submitting to Commission and registered national securities association examinations, inspections or investigations, and potentially responding to any issues identified, funding portals, investors and issuers would benefit from the enhanced compliance with regulations due to the oversight, as well as the sanctions or other disciplinary actions that may follow upon findings of violations through such inspections, examinations or investigations.

We are proposing to require a registered funding portal to maintain and preserve certain records relating to its business.[1036] The proposed rules would require, among other things, that the funding portal maintain and preserve certain books and records for a period of not less than five years and in an easily-accessible place for the first two years. Recordkeeping requirements help registrants with their compliance. They are a familiar and important element of the approach to broker-dealer regulation, as well as the regulation of investment advisers and others, and are designed to maintain the effectiveness of our inspection program for regulated entities, facilitating our review of their compliance with statutory mandates and with our rules. The proposed rule would assist us in evaluating a funding portal's compliance with the Securities Act Sections 4(a)(6) and 4A and the rules issued thereunder. Regulators would benefit from

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1035 *See* proposed Rule 403(d) of Regulation Crowdfunding.

1036 *See* proposed Rule 404 of Regulation Crowdfunding. We note that registered brokers already are expected to comply with the books and records requirements in Exchange Act Rules 17a-3, 17a-4 and 17a-5 (17 CFR 240.17a-3, 17a-4 and 17a-5). Thus, all intermediaries, whether registered as brokers or as funding portals, would be required to make and preserve books and records.

standardized recordkeeping practices for intermediaries because they would be able to perform more efficient, targeted inspections and examinations, and have an increased likelihood of identifying improper conduct at earlier stages of the inspection or examination.

Funding portals may incur one-time costs in establishing the systems necessary to comply with the proposed books and records requirements. We note, however, that the records required to be made and preserved under the proposed rules are those that would ordinarily be made and preserved in the ordinary course of business by a regulated broker engaging in these activities. We recognize that there may be a slight competitive advantage for funding portals over brokers to the extent that the proposed recordkeeping rule for funding portals is less burdensome for than the requirements applicable to brokers. At the same time, we believe that the proposed recordkeeping rule for funding portals is consistent with the narrow range of their activities. Our estimates of the costs associated with this requirement are set forth in the table above.

6. Insignificant Deviations

We are proposing to provide a safe harbor for issuers for certain insignificant deviations from a term, condition or requirement of Regulation Crowdfunding.[1037] The proposed safe harbor would provide that insignificant deviations from a term, condition or requirement of Regulation Crowdfunding would not result in a loss of the exemption, so long as the issuer relying on the exemption can show that: (1) the failure to comply was insignificant with respect to the offering as a whole; (2) the issuer made a good faith and reasonable attempt to comply with all applicable terms, conditions and requirements of Regulation Crowdfunding; and (3) the issuer did not know of the failure to comply, where the failure to comply with a term, condition

1037 *See* proposed Rule 502(a) of Regulation Crowdfunding.

or requirement was the result of the failure of the intermediary to comply with the requirements of Section 4A(a) and the related rules, or such failure by the intermediary occurred solely in offerings other than the issuer's offering.

Providing a safe harbor could impose costs on investors, issuers, funding portals and regulators, compared with the alternative of not providing a safe harbor, to the extent that issuers lessen the vigor with which they develop and implement systems and controls to achieve compliance with the requirements of Regulation Crowdfunding. We believe that limiting the proposed safe harbor to insignificant instances of non-compliance and requiring a good faith and reasonable attempt to comply with the requirements would mitigate these potential costs and would benefit issuers and funding portals by providing greater certainty regarding their reliance on the exemption. In the absence of a safe harbor, issuers may extend significantly more effort and more resources to satisfy the requirements of Regulation Crowdfunding or they may face greater uncertainty regarding their reliance on the exemption, which could discourage participation in this market, impacting efficiency and capital formation.

7. Relationship with State Law

Section 305 of the JOBS Act amended Securities Act Section 18(b)(4)[1038] to preempt the ability of states to regulate certain aspects of crowdfunding conducted pursuant to Section 4(a)(6). This statutory amendment would benefit issuers by making transactions made in reliance on Section 4(a)(6) less costly, because an issuer would not be required to register transactions with each state where it offers and sells securities in reliance on Section 4(a)(6). It also could benefit investors because these cost savings ultimately may be passed on to investors.

1038 15 U.S.C. 77r(b)(4).

Absent preemption of the states' registration requirements, an offering made through the Internet in reliance on Section 4(a)(6) and the proposed rules could result in an issuer potentially violating state securities laws. Recent evidence in donation-based and reward-based crowdfunding campaigns suggests that contributions are not exclusively local.[1039] The statutory preemption of state registration laws would reduce issuer uncertainty regarding the necessity of state registration, and it would eliminate the costs that would be associated with state registration. On the other hand, state registration laws may provide an additional layer of investor protection, and their preemption will remove a potential layer of review and may lead to increased levels of fraud. This potential negative effect of state law preemption, however, could be offset by some of the statutory requirements and the proposed rules that are designed to deter fraud, such as public disclosure, investment limits and the use of a registered intermediary.

8. Exemption from Section 12(g)

Proposed Rule 12g-6 provides that securities issued pursuant to an offering made under Section 4(a)(6) would be permanently exempted from the record holder count under Section 12(g). This proposal delays the more extensive Exchange Act reporting requirements until the issuer either sells securities in a registered transaction or registers a class of securities under the Exchange Act to reach a trading market. This allows an issuer to time the decision to become a reporting company without forcing it to become a reporting company through actions outside of its control (*e.g.*, secondary market trading). By conditioning the more burdensome reporting requirements on the decision to raise new capital or to actively seek a liquid trading market, the

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1039 For example, in crowdfunding campaigns for early stage musical projects, the average distance between artist-entrepreneurs and contributors was 3,000 miles. *See* Ajay Agrawal, Christian Catalini and Avi Goldfarb, *The Geography of Crowdfunding*, NET Institute Working Paper No. 10-08 (Oct. 29, 2010), *available at* http://ssrn.com/abstract=1692661.

benefits of increased disclosure would scale with the scope of investment in the issuer, thus improving efficiency.

This proposal could, however, result in an unintended and potentially costly outcome. It is possible that an issuer that sells securities in reliance on Section 4(a)(6) could become an Exchange Act reporting company, but then deregister and go dark with potentially thousands of investors. For example, in an attempt to provide additional liquidity to its shareholders, an issuer could voluntarily register a class of securities under Exchange Act Section 12(g) so that the securities could be quoted in the over-the-counter market. The issuer would become subject to Exchange Act reporting requirements and would no longer be subject to the ongoing reporting requirements of Regulation Crowdfunding. If the issuer does not sell securities in a registered offering or trigger the asset and holder of record thresholds for mandatory Exchange Act registration in Section 12(g), the issuer could deregister its securities and stop all ongoing reporting obligations even if all the securities sold in reliance on Section 4(a)(6) remain outstanding.[1040] Given that securities-based crowdfunding could attract thousands of potential issuers, this is a possible outcome for some of these issuers. Under such an outcome, a significant number of investors in an issuer might be unable to obtain important information about that issuer, which could affect the liquidity and pricing of the securities these investors hold.

1040 Although less likely, the same could happen if an issuer sells securities in reliance on Section 4(a)(6) and subsequently registers a class of securities under Exchange Act Section 12(b) in order to list its securities on a national securities exchange.

9. Disqualification

The statute and the proposed rules impose disqualification provisions under which an issuer would not be eligible to offer securities pursuant to Section 4(a)(6) and an intermediary would not be eligible to effect or participate in transactions pursuant to Section 4(a)(6).[1041] The proposed disqualification provisions for issuers are substantially similar to those imposed under Rules 262 of Regulation A and 506 of Regulation D,[1042] while the proposed disqualification provisions for intermediaries under Section 3(a)(39) are substantially similar to, while somewhat broader than, the provisions of Rule 262.

a. Issuers

The proposed rules should induce issuers to implement measures to restrict bad actor participation in offerings made in reliance on Section 4(a)(6). This should help reduce the potential for fraud in the market for such offerings, which should help reduce the cost of raising capital to issuers that rely on Section 4(a)(6), to the extent that disqualification standards lower the risk premium associated with the presence of bad actors in securities offerings. In addition, the requirement that issuers determine whether any covered persons are subject to disqualification might obviate the need for investors to do their own investigations and eliminate redundancies that might exist in otherwise separate investigations. This should help reduce information-gathering costs to investors, to the extent that issuers are at an advantage in accessing much of the relevant information and to the extent that issuers could do so at a lower cost than investors.

1041 *See* Section 302(d) of the JOBS Act; proposed Rule 503 of Regulation Crowdfunding. *See also* discussion in Section II.E.6 above.

1042 *See Disqualification Adopting Release*, note 101.

The proposed rules still would, however, impose costs on issuers, other covered persons and investors. If issuers are disqualified from relying on Section 4(a)(6) to make their offerings, they might experience increased costs in raising capital through alternative methods that do not require bad actor disqualification, if available, or alternative methods might be altogether unavailable. This could hinder potential investment opportunities for such issuers, with possible negative effects on capital formation. In addition, issuers and other covered persons may incur costs in connection with internal personnel changes that issuers may make to avoid the participation of those covered persons who are subject to disqualifying events. Issuers also might incur costs associated with restructuring share ownership positions to avoid having 20 Percent Beneficial Owners who are subject to disqualifying events. Finally, issuers might incur costs in connection with seeking waivers of disqualification from the Commission or determinations by other authorities that existing orders should not give rise to disqualification.

We anticipate that the reasonable care exception[1043] also would impose costs and benefits. In this regard, a reasonable care exception might encourage capital formation by eliminating any hesitation issuers might otherwise experience under a strict liability standard. However, such an exception also might encourage issuers to take fewer steps to inquire about offering participants than they would if a strict liability standard applied, increasing the potential for fraud in the market for offerings made in reliance on Section 4(a)(6). Nevertheless, some issuers, with regard to the exercise of reasonable care, might incur costs associated with conducting and documenting their factual inquiry into possible disqualifications. The lack of specificity in the rule, while providing flexibility to the issuer to tailor its factual inquiry as

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[1043] *See* proposed Rule 503(b)(4) of Regulation Crowdfunding. *See also* Section II.E.6.a.iii above.

appropriate to a particular offering, might increase these costs because uncertainty could drive issuers to do more than necessary under the rule. Alternatively, it might reduce these costs because uncertainty might drive issuers to exert minimum effort in conducting and documenting a factual inquiry.

The requirement that issuers disclose matters that would have triggered disqualification, had they occurred after the effective date of proposed Regulation Crowdfunding,[1044] also would impose costs and benefits. The disclosure requirement would reduce costs associated with covered persons who would be disqualified under the proposed rules but for the fact that the disqualifying event occurred prior to the effective date of the rules. However, this approach would allow the participation of past bad actors, whose disqualifying events occurred prior to the effective date of the proposed rules, which could expose investors to the risks that arise when bad actors are associated with an offering. Nevertheless, investors would benefit by having access to such information that could inform their investment decisions. Issuers also may incur costs associated with the factual inquiry, preparing the required disclosure and making any internal or share ownership changes they may decide to make to avoid the participation of covered persons that trigger the disclosure requirement. Disclosure of triggering events also may make it more difficult for issuers to attract investors, and issuers may experience some or all of the impact of disqualification as a result.

We believe the inclusion of Commission cease-and-desist orders in the list of disqualifying events would not impose a significant, incremental cost on issuers and other covered persons because many of these groups might already be subject to disqualifying orders

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[1044] *See* proposed Rule 201(u) of Regulation Crowdfunding. *See also* Section II.E.6.a.v above.

issued by the states, federal banking regulators and the National Credit Union Administration.[1045] The inclusion of such orders in the list of disqualifying events might change how settlement negotiations are conducted between respondents and the Commission, and the Commission could grant an appropriate waiver from disqualification.

Under the proposed rules, orders issued by the CFTC would trigger disqualification to the same extent as orders of the regulators enumerated in Section 302(d)(2)(B)(i) of the JOBS Act (*e.g.*, state securities, insurance and banking regulators, federal banking agencies and the National Credit Union Administration). We believe that including orders of the CFTC would result in the similar treatment, for disqualification purposes, of comparable sanctions. In this regard, we note that the conduct that would typically give rise to CFTC sanctions is similar to the type of conduct that would result in disqualification if it were the subject of sanctions by another financial services industry regulator. This should enable the disqualification rules to more effectively screen out bad actors.

As discussed above, the baseline for our economic analysis of proposed Regulation Crowdfunding, including the baseline for our consideration of the effects of the proposed rules on efficiency, competition and capital formation, is the situation in existence today, in which startups and small businesses seeking to raise capital through securities offerings must register the offer and sale of securities under the Securities Act unless they can comply with an existing exemption from registration under the federal securities laws. Relative to the current baseline, we believe that the disqualification provisions may not impose significant incremental costs on

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1045 *See Disqualification Adopting Release*, note 101.

issuers and other covered persons because the proposed rules are substantially similar to the disqualification provisions under existing exemptions.

b. Intermediaries

In implementing the statute, we are proposing to apply to intermediaries the disqualification provisions under Section 3(a)(39), rather than Rule 262 or the disqualification rules we are proposing for issuers. We believe that the standard of Section 3(a)(39) is already an established one among broker-dealers and their regulators and that, despite the differences, Section 3(a)(39) and Rule 262 are substantially similar in particular with regard to the persons and events they cover, their scope and their purpose.[1046] We believe that imposing any new or different standard, including Rule 262, only for those intermediaries that engage in crowdfunding transactions would likely create confusion and unnecessary burdens, as currently-registered broker-dealers and their associated persons would become subject to two distinct standards for disqualification. Consistent standards for all brokers and funding portals also would assist a registered national securities association in monitoring compliance and enforcing its rules.

The proposed rules would implement the statutory requirement for intermediaries by providing that a person subject to a statutory disqualification, as defined in Exchange Act Section 3(a)(39), may not act as, or be an associated person of, an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) unless so permitted by Commission rule or order. While this requirement would potentially reduce the number of intermediaries, we expect that it would strengthen investor protection by preventing bad actors

[1046] *See* discussion in Section II.E.6.b above.

from entering the securities-based crowdfunding market and by reducing the potential for fraud and other abuse.

As discussed above, the baseline for our economic analysis of proposed Regulation Crowdfunding, including the baseline for our consideration of the effects of the proposed rules on efficiency, competition and capital formation, is the situation in existence today, in which intermediaries intending to facilitate securities transactions are required to register with the Commission as broker-dealers under Exchange Act Section 15(a). Relative to the current baseline, we believe that the disqualification provisions might not impose significant incremental costs to brokers because the proposed rules are the same as the disqualification provisions that are already imposed on broker-dealers.

C. Request for Comment

Throughout this release, we have discussed the anticipated costs and benefits of the proposed rules and their potential impact on efficiency, competition and capital formation. We request and encourage any interested person to submit comments regarding the proposed rules, our analysis of the potential effects of the rules and other matters that may have an effect on the proposed rules. We request comment from the point of view of issuers, investors and other market participants. With regard to any comments, we note that such comments are of particular assistance to us if accompanied by supporting data and analysis of the issues addressed in those comments. We also are interested in comments on the qualitative benefits and costs we have identified and any benefits and costs we may have overlooked. We urge commenters to be as specific as possible.

Comments on the following questions are of particular interest.

285. How similar or different is a securities-based crowdfunding offering from a non-securities-based crowdfunding offering? To what extent should we base the anticipated effects of the proposed rules on the experience of current crowdfunding platforms and their participants, including those based on rewards and donations? Should we expect the same incidence of success, failure, fraud and other outcomes when crowdfunding involves participants providing financing with an expectation of a monetary return on their investments? Would securities-based crowdfunding attract similar projects, ventures and capital seekers as other forms of crowdfunding? If not, why not, and what differences in the types of ventures, participants and outcomes might be expected?

286. How would securities issued in reliance on Section 4(a)(6) be valued? Would issuers and/or investors have sufficient financial sophistication or methods available to accurately assess the intrinsic risks associated with the issuance? If so, what mechanisms would help assure accurate pricing? If not, what specific challenges or issues would prevent issuers and/or investors from arriving at a price that reflects the intrinsic value of the offering?

287. How would investors who purchase securities in an offering in reliance on Section 4(a)(6) exit their investment? Once the securities are issued, investors would have to wait, except in certain circumstances, for one year before selling a security sold in a Section 4(a)(6) offering. At that time, how would existing security holders liquidate their positions? What is the likelihood that there would be a ready market for mature securities issued in reliance on Section 4(a)(6)? What entities or investors are likely to supply the liquidity, and what

discounts, if any, are investors likely to face when exiting their investments? To what extent would, or should, liquidity provisions be built into the design of the security issues (*e.g.*, call provisions or self-liquidation features)?

288. How, and to what extent, would the collective knowledge of crowdfunding investors (*i.e.*, the "wisdom of the crowd") provide investor protections and mitigate potential fraud or unspecified offering risks at the time of issuance? Would "the wisdom of the crowd" provide ongoing investor protections to the community of securities-based crowdfunding investors? If so, how and to what extent?

289. Do the proposed rules require sufficient disclosure and educational requirements to help ensure that investors have a reasonable understanding of the risks and costs of investing in crowdfunding securities? Are the proposed disclosure and educational requirements sufficient for investors to understand: (1) the methods used for valuing securities issued in reliance on Section 4(a)(6), (2) potential complexity in the security design, or (3) risks of subsequent dilution of their investment? If not, what additional requirements would further mitigate the associated risks?

290. Should intermediaries be required to systematically collect and report information – to the Commission and/or publicly – about the progress, success and failures of issuers that relied on Section 4(a)(6) to offer and sell securities subsequent to initial financing? Would collecting and reporting such statistics help investors better understand the risks associated with securities-based crowdfunding investments with the passage of time? If so, what information

should be reported, and to whom and in what manner should it be reported? Would a requirement to collect and maintain information about issuers that relied on Section 4(a)(6) after the completion of the offering be too burdensome for intermediaries?

291. Other than averting potential losses, what are the potential economic effects of limiting the investment size for any single investor to a maximum aggregate amount of $100,000? Would this reduce the incentive for some investors to participate in offerings in reliance on Section 4(a)(6), and if so, would this impede potential capital formation or the efficiency with which offerings can be made? Would this limit the ability of investors to appropriately diversify their securities-based crowdfunding investments? Please explain.

292. Would the permanent exemption of securities-based crowdfunding securities from the record holder count under Section 12(g) of the Exchange Act pose any significant risks to investors of successful ventures? For example, is it likely or possible that an issuers that offers and sells securities in reliance on Section 4(a)(6) could became subject to Exchange Act reporting, but then subsequently delist and go dark without regard to the number of record holders?

293. We estimated the costs for a broker to act as an intermediary in transactions conducted pursuant to Section 4(a)(6), and to engage in related broker activities, to be approximately $770,000 in the first year and approximately $270,000 each year thereafter. In making these estimates, we assumed that brokers would engage in particular activities in connection with these transactions, namely providing investment advice and recommendations, soliciting investors, and

managing and handling customer funds and securities. Are our assumptions correct? If not, please explain. Are our estimates of the cost of doing business as a broker, in general, accurate? If not, please explain and provide relevant data.

294. We estimated the costs for a funding portal to act as an intermediary in transactions pursuant to Section 4(a)(6) to be approximately $417,000 in the first year, and approximately $90,000 each year thereafter. Are our estimates of the costs of doing business as a funding portal, and the assumptions behind these estimates, in general, accurate? If not, please explain and provide relevant data.

295. The Commission is interested in receiving comments, views, estimates and data concerning the following:

- Expected size of the securities-based crowdfunding market (*e.g.*, number of offerings, number of issuers, number for funding portals, size of offerings, number of investors, etc., as well as information comparing these estimates to the current baseline);
- Overall economic impact of the proposed rules;
- Competitive effects on brokers of the development of funding portals; and
- Any other aspect of the economic analysis.

IV. Paperwork Reduction Act

A. Background

Certain provisions of the proposed rules contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[1047] We are submitting the proposal to the Office of Management and Budget ("OMB") for review in accordance with the PRA.[1048] The titles for the collections of information are:

(1) "Form ID" (OMB Control Number 3235-0328);

(2) "Form C" (a proposed new collection of information);

(3) "Form BD" (OMB Control Number 3235-0012); and

(4) "Regulation Crowdfunding – Intermediaries and Funding Portals" (a proposed new collection of information).

In addition, the collections of information included under OMB Control Numbers 1506-0034 and 1506-0019, regarding the CIP and SAR requirements of the Department of Treasury, would be amended to reflect related burdens under proposed Rule 403(b) of Regulation Crowdfunding. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. We are applying for OMB control numbers for the proposed new collections of information in accordance with 44 U.S.C. 3507(j) and 5 CFR 1320.13, and OMB has not yet assigned a control number to each new collection. Responses to these new collections of information would be mandatory.

1047 44 U.S.C. 3501 *et seq.*

1048 44 U.S.C. 3507(d); 5 CFR 1320.11.

B. Estimate of Issuers and Intermediaries

1. Issuers

The number, type and size of the issuers that would participate in securities-based crowdfunding transactions are uncertain, but data regarding current market practices may help identify the number and characteristics of potential issuers that may offer and sell securities in reliance on Section 4(a)(6).[1049] While it is not possible to predict the number of future offerings made in reliance on Section 4(a)(6), particularly because rules governing the process are not yet in place, for purposes of this analysis, we estimate that the number would be 2,300 offerings per year. We base this estimate on the number of issuers that conducted a Regulation D offering that had no revenues or less than $1 million in revenues.[1050] We believe those issuers would be similar in size to the potential issuers that may participate in securities-based crowdfunding, and we assume that each issuer would conduct one offering per year, raising an average of $100,000 per offering.

2. Intermediaries that are Registered Brokers

We estimate that the proposed collections of information would apply to approximately 10 intermediaries per year that are not currently registered with the Commission and would choose to register as brokers to act as intermediaries for transactions made in reliance on Section 4(a)(6). However, we believe that, given the high cost that an unregistered entity would incur to register as a broker with us, compared with the lower cost of becoming a funding portal, unregistered entities generally would have less incentive to register as brokers than as funding portals.

1049 *See* Section III.A.4.a above for a discussion of the data regarding current market practices.

1050 *See id.*

We further estimate that approximately 50 intermediaries per year that are already registered as brokers with the Commission would choose to add to their current service offerings by also becoming crowdfunding intermediaries. These entities would not have to register anew with us, and if doing business with the public, would already be members of FINRA (the applicable national securities association registered under Exchange Act Section 15A). Because we do not have any data indicating the number of currently-registered brokers that would be interested in becoming crowdfunding intermediaries, we cannot estimate how many would choose to enter the crowdfunding market.[1051]

3. Funding Portals

We estimate that approximately 50 intermediaries per year would choose to register as funding portals during the first three years following effectiveness of the proposed rules. This estimate assumes that, upon effectiveness of the proposed rules, about 15% of the approximately 200 U.S.-based crowdfunding portals[1052] currently in existence would participate in securities-based crowdfunding and that the number of crowdfunding portals would grow at 60% per year over the next three years.[1053] Therefore, we estimate that an average of approximately 50

1051 Similarly, we cannot estimate with any degree of certainty how many unregistered "finders" would potentially choose to enter the securities-based crowdfunding market. *See, e.g.*, Task Force on Private Placement Broker-Dealers, note 894 (stating that quantifying the number of "finders" that help small businesses to obtain sources of capital "is an impossibility, since there is no effective measuring device.").

1052 This estimate is based in part on an industry estimate that, as of April 2012, there were approximately 200 non-securities-based crowdfunding portals operating in the United States. *See* Massolution, note 861 at 16.

1053 A worldwide survey of crowdfunding portals indicated that, in 2011, approximately 14.8% of the surveyed crowdfunding portals (mostly based in Europe) participated in "equity-based" crowdfunding. *Id.* Also, the total number of crowdfunding portals worldwide grew by an estimated 60% from 2011 to 2012. *Id.* at 13.

respondents would register as funding portals annually.[1054] Of those 50 funding portals, we estimate that two would be nonresident funding portals. These estimates are based in part on current indications of interest expressed in responses to FINRA's voluntary interim form for funding portals.[1055]

C. Estimate of Burdens

1. Issuers

a. Form C: Offering Statement and Progress Update

Under the proposed rules, an issuer conducting a transaction in reliance on Section 4(a)(6) would file with us specified disclosures on a Form C: Offering Statement.[1056] An issuer also would file with us amendments to Form C to disclose any material change in the offer terms or disclosure previously provided to investors.[1057] Form C is similar to the Form 1-A offering statement under Regulation A, but it would require fewer disclosure items (*e.g.*, it would not require disclosure about the plan of distribution, the compensation of officers and directors, litigation or a discussion of federal tax aspects). We note that offerings made in reliance on Regulation A allow issuers to offer up to $5 million, involve review by the staff and require filings at the state level. In light of these factors, we expect that issuers seeking to raise capital pursuant to a Regulation A offering generally would be at a more advanced stage of development

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1054 200 U.S.-based crowdfunding portals x 15% (estimated percentage of crowdfunding portals that would participate in securities-based crowdfunding) = 30 funding portals that would participate in securities-based crowdfunding. Assuming 60% growth over three years, the number of registered funding portals would be 30 during the first year, 48 during the second year and 77 during the third year. The average number of registered funding portals over three years is (30 + 48 + 77) / 3 = 52 funding portals (or approximately 50 funding portals per year).

1055 *See* note 980.

1056 *See* proposed Rule 203(a)(1) of Regulation Crowdfunding.

1057 *See* proposed Rule 203(a)(2) of Regulation Crowdfunding.

than issuers likely to raise capital pursuant to Section 4(a)(6), so the complexity of the required disclosure and, in turn, the burden of compliance with the requirements of proposed Form C would be significantly less than for Form 1-A.[1058] We estimate that the total burden to prepare and file the Form C, including any amendment to disclose any material change, would be approximately 60.00 hours, which is approximately 10 percent of the burden to prepare a Form 1-A for a Regulation A offering. We estimate that 75 percent of the burden of preparation would be carried by the issuer internally and that 25 percent would be carried by outside professionals[1059] retained by the issuer at an average cost of $400 per hour.[1060]

Under the proposed rules, the issuer also would be required to file with us regular updates regarding the progress of the issuer in meeting the target offering amount.[1061] The issuer would make the filing under cover of a Form C-U: Progress Update. The issuer would be required to disclose its progress in meeting the target offering amount. Form C-U is similar to a Form D Notice of Exempt Offering of Securities under Regulation D[1062] and a Form 2-A Report of Sales and Uses of Proceeds Pursuant to Rule 257 of Regulation A.[1063] Form C-U would require significantly less disclosure than the Form D and the Form 2-A, however, as it would only require disclosure of the issuer's progress in meeting the target offering amount, rather than

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1058 We estimate the burden per response for preparing a Form 1-A to be 608.00 hours. *See* Form 1-A at 1.

1059 For example, an issuer could retain an outside professional to assist in the preparation of the financial statements, but could decide to address the remaining disclosure requirements internally.

1060 We recognize that the costs of retaining outside professionals may vary depending on the nature of the professional services, but for purposes of this PRA analysis, we estimate that such costs would be an average of $400 per hour. This is the rate we typically estimate for outside legal services used in connection with public company reporting.

1061 *See* proposed Rule 203(a)(3) of Regulation Crowdfunding.

1062 We estimate the burden per response for preparing a Form D to be 4.00 hours. *See* Form D at 1.

1063 We estimate the burden per response for preparing a Form 2-A to be 12.00 hours. *See* Form 2-A at 1.

compensation and use of proceeds disclosures or other information about the issuer and the offering. Thus, the complexity of the required disclosure and the burden to prepare and file Form C-U would be significantly less than for either Form D or Form 2-A. We estimate that the burden to prepare and file each progress update, which only has one disclosure requirement, would be 0.50 hours. We further estimate that an issuer would be required to file an average of two progress updates during each offering.[1064] Therefore, we estimate that an issuer's compliance with proposed Form C-U would result in an aggregate burden of 1.00 hours per issuer.[1065]

We estimate that compliance with the requirements of a Form C submitted in connection with transactions made in reliance on Section 4(a)(6) would require 138,000 burden hours (2,300 offering statements x 60.00 hours/offering statement) in aggregate each year, which corresponds to 103,500 hours carried by the issuer internally (2,300 offering statements x 60.00 hours/offering statement x 0.75) and costs of $13,800,000 (2,300 offering statements x 60.00 hours/offering statement x 0.25 x $400) for the services of outside professionals. We also estimate that compliance with the requirements of Form C-U submitted during an offering would require 2,300 burden hours (2,300 offering statements x 2 progress updates per offering x 0.50 hours per progress update) in aggregate each year. These estimates include the time and cost of collecting the information, preparing and reviewing disclosure, filing documents and retaining records. We derived the above estimates by estimating the average number of hours it would take an issuer to prepare and review the proposed disclosure requirements. In deriving our

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1064 *See* proposed Rule 203(a)(3) of Regulation Crowdfunding. The proposed rules would require an issuer to file a progress update after reaching one-half and 100 percent of the target offering amount.

1065 We estimate that the burden of preparing Form C-U would be approximately 1/8 of the burden for Form D. Therefore, the aggregate burden per issuer would be 100 hour (2 progress updates x 0.50 hours/update).

estimates, we recognize that the burdens likely would vary among individual issuers based on a number of factors, including the stage of development of the business and the number of years since inception of the business. We believe that some issuers would experience costs in excess of this average and some issuers may experience less than these average costs.

b. Form C-AR: Annual Report

Under the proposed rules, any issuer that sells securities in a transaction made pursuant to Section 4(a)(6) would be required to file annually with us an annual report on Form C-AR: Annual Report.[1066] Form C-AR would require disclosure substantially similar to the disclosure provided in the Form C: Offering Statement, except that offering-specific disclosure would not be required. Therefore, we estimate that the burden to prepare and file Form C-AR would be less than that required to prepare and file Form C. We estimate that compliance with proposed Form C-AR would result in a burden of 40.00 hours per response.[1067] We further estimate that 75 percent of the burden of preparation would be carried by the issuer internally and that 25 percent would be carried by outside professionals[1068] retained by the issuer at an average cost of $400 per hour.[1069]

We estimate that compliance with the requirements of Form C-AR after issuers sell securities pursuant to Section 4(a)(6) would require 92,000 burden hours (2,300 issuers x 40.00 hours/issuer) in the aggregate each year, which corresponds to 69,000 hours carried by the issuer

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1066 *See* proposed Rule 202 of Regulation Crowdfunding.

1067 We estimate that the burden of preparing the information required by Form C-AR would be approximately 2/3 of the burden for the Form C: Offering Statement in light of the fact that offering-specific disclosure would not be required and that the issuer may be able to update disclosure previously provided in the Form C: Offering Statement.

1068 *See* note 1059.

1069 *See* note 1060.

internally (2,300 issuers x 40.00 hours/issuer x 0.75) and costs of $9,200,000 (2,300 issuers x 40.00 hours/issuer x 0.25 x $400) for the services of outside professionals.

c. Form C-TR: Termination of Reporting

Under the proposed rules, any issuer terminating its annual reporting obligations would be required to file a notice under cover of Form C-TR: Termination of Reporting to notify investors and the Commission that it no longer will file and provide annual reports pursuant to the requirements of Regulation Crowdfunding.[1070] We estimate that eight percent of the issuers that sell securities pursuant to Section 4(a)(6) would file a notice under cover of Form C-TR during the first year.[1071] The Form C-TR would be similar to the Form 15 that issuers file to provide notice of termination of the registration of a class of securities under Exchange Act Section 12(g) or to provide notice of the suspension of the duty to file reports required by Exchange Act Sections 13(a) or 15(d).[1072] Therefore, we estimate that compliance with the proposed Form C-TR would result in a similar burden as compliance with Form 15, a burden of 1.50 hours per response. We estimate that compliance with proposed Form C-TR would result in a burden of 276 hours (2,300 issuers x 0.08 issuers filing Form C-TR x 1.50 hours/issuer) in the aggregate during the first year for issuers terminating their reporting obligations.

d. Form ID Filings

1070 *See* proposed Rule 203(b)(2) of Regulation Crowdfunding.

1071 For purposes of the PRA, we estimate that eight percent of issuers will not survive past their first year, based on a recent study that found that of a random sample of 4,022 new high-technology businesses started in 2004, 92.3% survived past their first year. *See* Kauffman Firm Survey, note 869 at 13.

1072 We currently estimate the burden per response for preparing a Form 15 to be 1.50 hours. *See* Form 15 at 1.

Under the proposed rules, an issuer would be required to file specified disclosures with us on EDGAR.[1073] We anticipate that the majority of first-time issuers seeking to offer and sell securities in reliance on Section 4(a)(6) would not previously have filed an electronic submission with us and so would need to file a Form ID. Form ID is the application form for access codes to permit filing on EDGAR. The proposed rules would not change the form itself, but we anticipate that the number of Form ID filings would increase due to new issuers seeking to offer and sell securities in reliance on Section 4(a)(6). For purposes of this PRA discussion, we estimate that all of the issuers who would seek to offer and sell securities in reliance on Section 4(a)(6) would not have filed an electronic submission with us previously and would, therefore, be required to file a Form ID. As noted above, we estimate that approximately 2,300 issuers per year would seek to offer and sell securities in reliance on Section 4(a)(6), which would correspond to 2,300 additional Form ID filings. As a result, we estimate the additional annual burden would be approximately 345 hours (2,300 filings x 0.15 hours/filing).[1074]

2. Brokers and Funding Portals

a. Registration Requirements

i. Time Burden

The proposed rules would require intermediaries to register with us as either a broker or funding portal. We believe that some entities that may engage in crowdfunding pursuant to Section 4(a)(6) and the proposed regulation would already be registered as brokers. Therefore, this registration requirement would impose no new requirement on these entities and no additional burden for purposes of this PRA discussion. Entities that are not already registered as

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1073 *See* proposed Rules 201-203 of Regulation Crowdfunding.

1074 We currently estimate the burden associated with Form ID is 0.15 hours per response. *See* Form ID at 1.

brokers may decide to register as brokers or as funding portals and to become members of a registered national securities association, pursuant to the proposed rules. We estimate that each year, approximately 10 entities may decide to register as brokers, and on average, approximately 50 entities may decide to register as funding portals by filing Form Funding Portal. In addition, we estimate that of those 50 entities that register as funding portals, two would be nonresident funding portals and subject to the additional requirements of completing Schedule C, hiring an agent for service of process in the United States and providing an opinion of counsel.

We estimate the burden for registering as a broker with us based upon the existing burdens for completing and filing Form BD.[1075] Consequently, we estimate that total annual burden hours required for all intermediaries, including brokers and funding portals, to register with us under the proposed rules would be approximately 165 hours (2.75 hours/respondent x (10 brokers + 50 funding portals)). In addition, those entities that register as nonresident funding portals would face an additional burden of half an hour to complete Schedule C, half an hour to hire an agent for the service of process, and one hour to provide an opinion of counsel. Consequently, we estimate that of the 50 registered funding portals, two would face the burden of an additional two hours to register.

We take into consideration that brokers that register to engage in crowdfunding transactions conducted in reliance on Section 4(a)(6) may eventually decide to withdraw their

[1075] While it is likely that the time necessary to complete Form BD varies depending on the nature and complexity of the entity's business, we previously estimated that the average time necessary for a broker-dealer to complete and file an application for broker-dealer registration on Form BD would be approximately 2.75 hours. We also estimate that the time burden to register as a funding portal on Form Funding Portal would be, for purposes of this PRA discussion, the same, based upon the time required to complete and file Form BD because the information required for that form is similar.

registration. Withdrawal requires the entity to complete and file with us a Form BDW.[1076] We further estimate that approximately 500 broker-dealers withdraw from Commission registration annually[1077] and, therefore, file a Form BDW. Of them, we estimate that approximately one broker who had registered in order to facilitate crowdfunding transactions made in reliance on Section 4(a)(6) may decide to withdraw in each year following adoption of the rules.[1078] Therefore, the one broker-dealer that withdraws from registration by filing Form BDW would incur an aggregate annual reporting burden of approximately one hour (one hour/respondent x one broker). Similarly, we estimate that approximately six funding portals may choose to withdraw from registration each year[1079] and that each withdrawal, as with Form BDW, would take one hour. This would result in an aggregate annual reporting burden of approximately six hours (one hour/respondent x 6 funding portals).

1076 The time necessary to complete Form BDW varies depending on the nature and complexity of the applicant's securities business. We previously estimated that it would take a broker-dealer approximately one hour to complete and file a Form BDW to withdraw from Commission registration, as required by Exchange Act Rule 15b6-1 (17 CFR 240.15b6-1).

1077 This estimate is based on Form BDW data collected over the past five years and may be skewed as a result of the impact of the financial crisis on broker-dealers. For the past five fiscal years (from 10/1 through 9/30), the number of broker-dealers that withdrew from registration were as follows: 503 in 2008, 533 in 2009, 510 in 2010, 524 in 2011 and 428 in 2012. (503 + 533 + 510 + 524 + 428) / 5 = 500.

1078 As of September 30, 2012, there were 4,653 broker-dealers registered with the Commission. An average of 500 broker-dealers per year withdraw from registration, or 11% of the number of registered broker-dealers (500 withdrawing broker-dealers / 4,653 registered broker-dealers). We are assuming that the same percentage of broker-dealers that withdraw from registration would apply to the population of registered broker-dealers participating in offerings in reliance on Section 4(a)(6). Of our estimate of 10 registered broker-dealers per year registering to participate in crowdfunding transactions in reliance on Section 4(a)(6), we estimate that approximately one broker-dealer per year (10 registered broker-dealers x 11%) would withdraw from registration.

1079 We estimate that the percentage of registered funding portals participating in crowdfunding transactions in reliance on Section 4(a)(6) that would withdraw from registration annually would be the same as the percentage of broker dealers that withdraw from registration annually because of the similarity of the businesses. Of our estimate of 50 registered funding portals participating in crowdfunding transactions in reliance on Section 4(a)(6), we estimate that approximately six funding portals per year (50 registered funding portals x 11%) would withdraw from registration. For funding portals, a decision to withdraw registration would be required to be reported to us in the same way an amendment would; however, for brokers, withdrawal requires the fling of Form BDW.

Newly-registered intermediaries would be required to also become members of FINRA or any other registered national securities association. Based on discussions with industry participants, we estimate that the burden associated with this requirement would be approximately 220 hours per intermediary that registers as a broker-dealer. We also assume that approximately one-half of that amount or 110 hours would be required of an intermediary registering as a funding portal. Consequently, we estimate that total annual burden hours required for all intermediaries, including brokers and funding portals, to register with FINRA or any other registered national securities association would be approximately 6,600 hours (220 hours/broker-dealer respondent x 10 brokers + 110 hours/funding portal respondent x 50 funding portals). For intermediaries who choose to hire a third party to assist in the membership process, we assume that the hours would be further reduced by at least one-half for a total of 3,300 hours.

Once registered, a broker must promptly file an amended Form BD when information it originally reported on Form BD changes or becomes inaccurate. Similarly, a registered funding portal must report to us amendments relating to its Form Funding Portal filing.[1080] Based on the number of amended Forms BD that we received from October 1, 2007 through September 30, 2012, we estimate that the total number of amendments that we would receive on Form BD from the 10 brokers that register under this proposed system would be approximately 34.[1081]

1080 We previously estimated that the average time necessary to complete an amended Form BD would be approximately 20 minutes. We estimate that an amendment to Form Funding Portal would take the same amount of time as an amendment to Form BD because the forms are similar.

1081 We received 16,365, 17,247, 15,638, 15,491 and 13,271 amended Forms BD during the fiscal years ending 2008, 2009, 2010, 2011 and 2012, respectively, reflecting an average of 15,602 amendment filings per year (16,365 + 17,247 + 15,638 + 15,491 + 13,271) / 5 years). As of September 30, 2012, there were 4,653 broker-dealers registered with the Commission. Therefore, we estimate that there are approximately 3.4 amendments (15,602 amended Forms BD / 4,653 broker-dealers) per registered broker-dealer per year. We estimate that the 10 broker-dealers who register under this proposed regulation would submit, on aggregate, approximately 34 amendments per year.

Therefore, we estimate that the total additional annual burden hours necessary for broker-dealers to complete and file amended Forms BD would be approximately 11.2 hours (34 amended Forms BD per year x 0.33 hours, *i.e.*, 20 minutes, per amendment). Similarly, we estimate that the total annual burden hours for funding portals to complete and file amended Forms Funding Portal would be approximately 56.1 hours (50 funding portals x 3.4 amendments per year x 0.33 hours per amendment).

ii. Cost

We estimate that the initial registration cost for an intermediary to register with a national securities association would be approximately $10,000. This estimate is based on FINRA's current member application fee structure, which assesses fees depending on the size of the new member applicant. The current member application fee for broker-dealers with 1 to 10 associated registered persons is $7,500, and the fee for broker-dealers with 11 to 100 associated registered persons is $12,500.[1082] We expect that the size of funding portals that would register with FINRA would be similar, and therefore, our preliminary estimate of FINRA's application fee for funding portals is based on the above fees. The average of the two fees is ($7,500 + $12,500)/2 = $10,000. The total cost across all intermediaries would be approximately ($10,000/intermediary x (10 brokers + 50 funding portals) = $600,000. In addition, two intermediaries would face an additional cost of $25,130 to complete Schedule C, retain an agent for the service of process and provide an opinion of counsel to register as a nonresident funding portal.

1082 *See* FINRA, *Revised Fees: Changes to Advertising, Corporate Financing, New Membership and Continuing Membership Application, Central Registration Depository and Branch Office Annual Registration Fees*, FINRA Regulatory Notice 12-32 (June 2012), *available at* http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p127238.pdf.

In addition to the initial registration cost, we estimate that costs associated with completing a membership process with FINRA or any other registered national securities association would be approximately $3,450,000 across all intermediaries. Discussions with industry participants have indicated that most broker-dealers currently hire a third party consultant or attorney to assist in the membership process. Assuming that 90% of intermediaries (9 brokers and 45 funding portals) would employ an outside party, we estimate total costs charged by the outside party to be $1,575,000 ($50,000/third party assisting broker-dealers x 9 brokers + $25,0000/third party assisting funding portals x 45 funding portals).[1083] As indicated above, we assume that the intermediary's Chief Compliance Officer or person in a similar position would spend approximately 110 hours assisting in broker-dealer registration and 55 hours assisting in funding portal registration for a total approximate cost of $1,530,000 (110 hours/broker-dealer respondent x 9 brokers + 55 hours/funding portal respondent x 45 funding portals) x $441/hour.[1084] For the remaining 10% of intermediaries (1 broker and 5 funding portals) that would not employ an outside party to assist in the process, we estimate the total cost to be $340,000 ((220 hours/broker-dealer respondent x 1 broker + 110 hours/funding portal respondent x 45 funding portals) x $441/hour).

Intermediaries would face an ongoing cost to remain registered with a national securities association. We expect these costs would vary based on the size and profitability of the intermediary. The current FINRA annual assessment fee for members that are brokers having

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1083 Discussions with industry participants indicated that third parties charge between $25,000 and $75,000, for an average of $50,000, to assist applicants seeking to register as broker-dealers. We assume that charges for intermediaries registering as funding portals would be approximately one-half of these costs, for an average of $25,000.

1084 The hourly rate estimate for a Chief Compliance Officer is taken from SIFMA Management Data.

annual revenue of up to $1,000,000 is $1,200. In addition, FINRA members currently pay $150.00 for each principal and each representative of the member entity, up to five principals and representatives, and also pay $175 for the first 250 branch offices registered by the member. For purposes of the PRA, we assume that brokers acting as intermediaries as well as funding portals would have on average a total of five principals or representatives (or their equivalent), would maintain fewer than 250 branch offices, and would have annual revenues less than $1,000,000. Also for purpose of these estimates, we assume that the fees the national securities association would set for funding portals would be the same as those FINRA currently has set for members that are brokers. We do recognize, however, that the national securities association fees for funding portals may be lower than those currently in place for brokers, proportionate to funding portals' more limited scope of activity compared to brokers.[1085] Thus, we estimate that on average intermediaries would pay ongoing annual fees to a national securities association of $2,130, after the year they become members ((5x$150.00) + $175 + $1,200 = $2,125). Nonresident funding portals, would also be subject to an annual cost of $130 to maintain an agent for service of process in the United States

b. Development of Intermediary Platform

i. Time Burden

The proposed rules are based on an intermediary developing an electronic platform to offer securities in reliance on Section 4(a)(6) to the public. A broker or funding portal that creates its initial platform in-house would incur an initial time burden associated with setting up systems functionality to comply with our proposed rules, and developing other platform

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[1085] *See* note 994.

capabilities and operations. Based on our discussions with potential intermediaries, we initially estimate that intermediaries would typically hire a team of approximately 4 to 6 developers that would work on all aspects of platform development, including, but not limited to, front-end programming, data management, systems analysis, communication channels, document delivery, and Internet security. To develop a platform, we estimate, based on our discussions with potential intermediaries, that intermediaries would spend an average of 1,500 hours for planning, programming and implementation.

As discussed above, we anticipate that 10 intermediaries would newly register as brokers, 50 intermediaries would be brokers that are already registered and 50 intermediaries would register as funding portals. It is difficult to estimate the number of intermediaries that would develop their platforms in-house, but if we assume that half of the 110 newly-registered intermediaries were to do so, then the total initial time burden would be 82,500 hours (55 intermediaries x 1,500 hours = 82,500 hours).

We estimate that annually updating the features and functionality of an intermediary's platform would require approximately 20% of the hours required to initially develop the platform, for an average burden of 300 hours per year. If we assume that half of the 110 newly-registered intermediaries updated their systems accordingly, the total ongoing time burden would be 16,500 hours per year (55 intermediaries x 300 hours = 16,500 hours).

ii. Cost

There would be a cost to developing a platform. Based on our discussions with potential intermediaries, we initially estimate that it would cost an intermediary approximately $250,000 to $600,000 to build an Internet-based crowdfunding portal and all of its basic functionality. Assuming that half of the 110 newly-registered intermediaries were to hire outside developers to build their platforms, the total initial cost would be $13,750,000 to $33,000,000 (55 intermediaries x $250,000 = $13,750,000; 55 intermediaries x $600,000 = $33,000,000). For purposes of the PRA, we are estimating the cost at $23,375,000.

We estimate that it would typically cost an intermediary approximately one-fifth of the initial development cost per year to use a third-party developer to update an Internet-based crowdfunding portal and all of its basic functionality, or $85,000 per year on average.[1086] If we assume that half of the 110 newly-registered intermediaries updated their systems accordingly, the total ongoing cost would be $4,675,000 per year (55 intermediaries x $85,000 = $4,675,000).

c. Measures to Reduce the Risk of Fraud

i. Time Burden

The proposed rules would require intermediaries to 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) and the related requirements in Regulation Crowdfunding.[1087] The proposed rules would require intermediaries to have a reasonable basis for believing that an issuer has established means to keep accurate records of the holders of the securities it would offer and sell through the intermediary's platform. For both requirements, an intermediary may reasonably rely on the representations of the issuer. For the purposes of the PRA, we expect that 100% of intermediaries would rely on the representations of issuers. This would impose an estimated time burden in the first year of five hours per intermediary to establish standard representations it would request from issuers,

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[1086] Our estimate of the average initial external cost per intermediary to develop a crowdfunding platform is the average of the cited range of $250,000 to $600,000, or (($250,000 + $600,000)/)/) / 2) = $425,000. One-fifth of the cost of $425,000 is ($425,000/ / 5) = $85,000.

[1087] *See* proposed Rule 301(a) of Regulation Crowdfunding.

and 6 minutes per intermediary per issuer to obtain the issuer representation, which is consistent with estimates we have used for other regulated entities to obtain similar documentation, such as consents, from customers. Based on our estimate that there would be approximately 2,300 offerings per year, that each issuer would conduct one offering per year, and that there would be 110 intermediaries, we calculate that each intermediary would facilitate approximately 20 offerings per year (2,300 offerings /(10 newly registered broker-dealers + 50 previously registered broker-dealers + 50 funding portals) = 20.9). Therefore, we estimate that the total initial burden hours would be approximately 770 hours ((5 hours/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals) + (6 minutes/issuer x 20 issuers/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)).

We believe that the ongoing time burdens for this requirement would be approximately one hour per intermediary per year to review and check that the standard representations it requests from issuers remain appropriate, and 6 minutes per intermediary per issuer to obtain the representation. Therefore, we estimate that the ongoing total burden hours necessary for intermediaries to rely on the representations of the issuers would be approximately 330 hours per year ((1 hour/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)) + (6 minutes/issuer x 20 issuers/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals))).

ii. Cost

The proposed rules would require intermediaries to conduct a background and securities enforcement regulatory history check on each issuer and each officer, director or 20 Percent Beneficial Owner to determine whether the issuer or such person is subject to a disqualification.

We anticipate that most intermediaries would employ third-parties that perform background checks, and for the purposes of this PRA discussion, we assume that 100% of intermediaries would use these third-party services rather than develop the capability to conduct background and securities enforcement regulatory history checks in-house. The cost to perform a background check is estimated to be between $200 and $500, depending on the nature and extent of the information provided.[1088] We recognize that some issuers would require more than one background check (*e.g.*, for officers or directors of the issuer), and we estimate that intermediaries would perform four background checks per issuer, on average. We base this number on that assumption that most crowdfunding issuers will be startups and small businesses with small management teams and few owners. Assuming that there is an average of approximately 2,300 offerings made in reliance on Section 4(a)(6) per year,[1089] the total estimated initial cost for all intermediaries to fulfill the required background and securities enforcement regulatory history checks would range from approximately $1,840,000 to $4,600,000 per year,[1090] or approximately $16,700 to $41,800 per intermediary per year.[1091] For purposes of the PRA, we will average the cost to $29,250 per intermediary per year.

1088 *See, e.g.*, A Matter of Fact, *Background Check FAQ: Frequently Asked Questions*, *available at* http://www.amof.info/faq.htm (Matter of Fact is a background check provider accredited by the National Association of Professional Background Screeners and the Background Screening Credentialing Council and states that the cost for a comprehensive background check is $200 to $500).

1089 Because crowdfunding transactions in reliance on Section 4(a)(6) are a new approach to capital formation, it is difficult for us to accurately estimate an average number of offerings per year. As stated above, we assume that there would be approximately 2,300 offerings made in reliance on Section 4(a)(6) per year.

1090 2,300 securities-based offerings made in reliance on Section 4(a)(6) per year x ($200 to $500 per background and securities enforcement regulatory history check) x 4 checks per offering = $1,840,000 to $4,600,000 per year.

1091 $1,840,000/110 intermediaries = approx. $16,700 per intermediary; $4,600,000/110 intermediaries = approx. $41,800 per intermediary.

We believe that, on an ongoing basis, intermediaries would continue to use third-party services to conduct background and securities enforcement regulatory history checks. We also believe that the total estimated ongoing cost for all intermediaries to fulfill the required background and securities enforcement regulatory history checks would be the same as the estimated initial cost, ranging from approximately $1,840,000 to $4,600,000 per year, or approximately $16,700 to $41,800 per intermediary per year. For purposes of the PRA, we will average the cost to $29,250 per intermediary per year.

d. Account Opening: Accounts and Electronic Delivery

i. Time Burden

The proposed rules would provide that no intermediary or associated person of an intermediary could accept an investment commitment in a transaction involving the offer or sale of securities made in reliance on Section 4(a)(6) until the investor has opened an account with the intermediary and consented to electronic delivery of materials.[1092] For the purposes of the PRA, we expect that the functionality required to require an investor to open an account with an intermediary and obtain consents would result in an initial time burden of approximately 10 hours per intermediary in the first year. Therefore, we estimate that the total initial burden hours necessary for this functionality would be approximately 1,100 hours (10 hours/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)).

We believe that the ongoing time burdens for this requirement would be significantly less than the initial time burden, and thus we are estimating approximately two hours per

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1092 *See* proposed Rule 302(a) of Regulation Crowdfunding.

intermediary per year, to review and check the related processes. Therefore, we estimate that the ongoing total burden hours necessary for this functionality would be approximately 220 hours per year (2 hours/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)).

ii. Cost

To the extent an intermediary uses a third party to establish account opening functionality, the initial costs relevant to this requirement would be incorporated into the cost of hiring a third party to develop the platform, discussed below in Section IV.C.2.f.

We do not believe that there are any ongoing costs relevant to this requirement.

e. Account Opening: Educational Materials

i. Time Burden

The proposed rules would require intermediaries to provide educational materials to investors,[1093] to help ensure that investors have a baseline understanding of the risks and costs of investing in securities offered and sold in reliance on Section 4(a)(6). Given that the intermediary would determine what electronic format is effective in communicating the requisite contents of the educational material, the expected cost for intermediaries to develop the educational material is expected to vary widely and are difficult to estimate. For the purposes of the PRA, we are assuming that half of the intermediaries would develop their educational materials in-house, which would include online presentations and written documents, and that the other half would employ third-parties to produce professional-quality online video presentations. We estimate that, to develop their non-video educational materials in-house, each

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[1093] *See* proposed Rule 302(b) of Regulation Crowdfunding.

intermediary would incur an initial time burden of approximately 20 hours. Therefore, the total initial burden would be approximately 2,200 hours (110 intermediaries x 20 hours/intermediary).

Assuming that half of the intermediaries would develop their educational materials in-house, we expect that these intermediaries also would update their educational materials in-house, as needed. We estimate that to update their educational materials in-house, each intermediary would incur an ongoing time burden of approximately 10 hours per year. Therefore, the total ongoing burden would be approximately 1,100 hours per year (110 intermediaries x 10 hours/intermediary).

ii. Cost

As stated above, for the purposes of this PRA discussion, we assume that half of the intermediaries would employ third-party companies to produce professional-quality video materials instead of developing materials in-house. Public sources indicate that the typical cost to produce a professional corporate training video ranges from approximately $1,000 to $3,000 per production minute.[1094] Based on discussions with industry participants, we assume that, on average, each intermediary would produce a series of short educational videos that would cover all of the requirements of the proposed rules, and the video material would be 10 minutes long in total. Based on this assumption, we estimate that the average initial cost for an intermediary to develop and produce educational materials would range from approximately $10,000 to $30,000. The total initial cost across all 110 intermediaries per year would be $1,100,000 to $3,300,000. For purposes of the PRA, we will average the cost to $20,000 per intermediary per year. We

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1094 *See, e.g.*, Lee W. Frederiksen, *What Is the Cost of Video Production for the Web?*, Hinge Marketing, *available at* http://www.hingemarketing.com/library/article/what-is-the-cost-of-video-production-for-the-web.

note that the estimated initial cost may be significantly lower, because not all intermediaries that outsource the development of educational materials may choose to produce educational videos, while others may produce videos of shorter length.

We estimate that, on an ongoing basis, when using a third-party company to update their video educational materials, each intermediary would spend approximately half of the initial average cost. We estimate, therefore, that the average ongoing annual cost for an issuer to update its video educational materials would range from approximately $5,000 to $15,000 and that the total ongoing annual cost across all intermediaries would range from approximately $550,000 to $1,650,000 per year. For purposes of the PRA, we will average the cost to $10,000 per intermediary per year.

f. Account Opening: Promoters

i. Time Burden

The proposed rules would require an intermediary, at the account opening stage, to disclose to investors that any person who receives compensation to promote an issuer's offering, or who is a founder or employee of an issuer engaging in promotional activities on behalf of the issuer, must clearly disclose the receipt of compensation and his or her engagement in promotional activities on the platform.[1095] For purposes of the PRA, we expect that this requirement would result in an estimated time burden of five hours per intermediary in the first year, to prepare this particular disclosure and incorporate it into the account opening process. Therefore, we estimate that the total initial burden hours necessary for intermediaries to comply

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[1095] *See* proposed Rule 302(c) of Regulation Crowdfunding.

with this requirement would be approximately 550 hours (5 hours/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)).

We believe that the ongoing time burdens for this requirement would be approximately one hour per intermediary per year to review and check that the disclosures remain appropriate. Therefore, we estimate that the ongoing total burden hours necessary for intermediaries to comply with this requirement would be approximately 110 hours per year (1 hour/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)).

ii. Cost

To the extent an intermediary uses a third party to develop the functionality for this requirement, the initial costs relevant to this requirement would be incorporated into the cost of hiring a third party to develop the platform, discussed below in subsection IV.C.2.f.

We do not believe that there are any ongoing costs relevant to this requirement.

g. Issuer Disclosures to be Made Available

i. Time Burden

The proposed rules would require an intermediary to make publicly available on its platform the information that an issuer of crowdfunding securities is required to provide to potential investors, in a manner that reasonably permits a person accessing the platform to save, download or otherwise store the information, until the offer and sale of securities is completed or cancelled.[1096]

[1096] *See* proposed Rule 303(a) of Regulation Crowdfunding.

For purposes of the PRA, our estimate of the hourly burdens related to the public availability of the issuer information is included as part of our estimate of the hourly burdens associated with overall platform development, as discussed above in Section IV.C.2.b. The platform functionality would include not only the ability to display, upload and download issuer information as required under the proposed rules, but also the ability to provide users with required online disclosures, as discussed below.

We recognize that, over time, intermediaries may need to update their systems that allow issuer information to be uploaded to their platforms. We do not expect a significant ongoing burden for providing issuer disclosures, primarily because the functionality required for required issuer disclosure information to be uploaded is a standard feature offered on many websites and would not require frequent or significant updates.

ii. Cost

We do not expect a significant ongoing cost for providing issuer disclosures, primarily because the functionality required to upload required issuer disclosure information is a standard feature offered on many websites and would not require frequent updates. Because we are including the burdens that are associated with providing issuer disclosures as part of our estimates for overall platform development, we discuss our cost estimates for ongoing platform development and updates there.

h. Other Disclosures to Investors and Potential Investors

i. Time Burden

Intermediaries would be required to implement and maintain systems to comply with the information disclosure, communication channels, and investor notification requirements, including providing disclosure about compensation at account opening, obtaining investor acknowledgements to confirm investor qualifications and review of educational materials, providing investor questionnaires, providing communication channels with third parties and among investors, notifying investors of investment commitments, confirming completed transactions and confirming or reconfirming offering cancellations. Based on our discussions with industry participants, these functionalities would generally be part of the overall platform development process and costs. We discuss platform development costs above, which would include developing the functionality that would allow intermediaries to comply with disclosure and notification requirements.[1097]

We do not expect a significant ongoing burden for providing disclosures, as required by the proposed rules, because the functionality required to provide information and communication channels would likely not require frequent updates. We incorporate the total burden to update the required functionality for processing issuer disclosure and investor acknowledgment information in the total burden estimates discussed above relating to platform development.[1098]

ii. Cost

We recognize that some intermediaries may add the required functionality for processing issuer disclosure and investor acknowledgments by using a third-party developer. We also do not expect there to be a significant ongoing cost for developing the functionality to process these disclosures and acknowledgments, primarily because this functionality would likely not require frequent updates by third-party developers. The total cost to add the required functionality for processing issuer disclosure and investor acknowledgments, as well as to update the required

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1097 *See* Section IV.C.2.b.i above.

1098 *See* Section IV.C.2.b.i above.

functionality for processing issuer disclosure and investor acknowledgments, is incorporated into the total cost estimates discussed above relating to platform development.[1099]

i. Maintenance and Transmission of Funds

i. Time Burden

Intermediaries would be required to comply with the requirements related to the maintenance and transmission of funds. A registered broker would be required to comply with the requirements of Rule 15c2-4 of the Exchange Act (Transmission or Maintenance of Payments Received in Connection with Underwritings).[1100] A registered funding portal would be required to enter into a written agreement with a qualified third party to hold its client funds, or to open a bank account for the exclusive benefit of the investors and issuer, and it also would be required to send directions to the qualified third party depending on whether an investing target is met or an investment commitment or offering is cancelled. For purposes of the PRA, we are providing an estimate for the time that a funding portal would need to enter into on an initial basis, and review and update on an ongoing basis, a written agreement with the qualified third party. We expect that the burden associated with the website functionality required to send directions to third parties would be included as part of the platform development discussed above. Based on discussion with industry participants, we estimate that funding portals would incur an initial burden of approximately 20 hours each to comply with these requirements, or 1,000 hours total (20 hours per funding portal x 50 funding portals = 1,000 hours).

1099 *See* Section IV.C.2.b above.

1100 17 CFR 240.15c2-4. For purposes of this PRA discussion, the burdens associated with this rule, as well as for any other rule to which brokers are subject regardless of whether they engage in transactions pursuant to Section 4(a)(6), are not addressed here; rather, they are included in any OMB approvals for the relevant rule. Rule 15c2-4, however, does not include any information collection requests for purposes of the PRA, and so there is no relevant approval or control number from OMB for this rule.

We expect that, on an ongoing basis, a registered funding portal would have to periodically review and update its written agreement with a bank or other third party to hold its client funds. A registered funding portal also would be required to send directions on an ongoing basis to a third party depending on whether an investing target is met or an investment commitment or offering is cancelled. Based on discussion with industry participants, we estimate that funding portals would incur an ongoing annual burden of approximately 5 hours each to comply with these requirements, or 250 hours total (5 hours per funding portal x 50 funding portals = 2,500 hours).

ii. Cost

For purposes of the PRA, we are not providing any cost estimate for this requirement, because we expect that the cost associated with developing the functionality required to send instructions to third parties would be included as part of the platform development discussed above.[1101]

j. Fidelity Bond

i. Time Burden

Funding portals would be required to comply with the requirements in proposed Rule 400(f) related to obtaining and maintaining fidelity bond coverage. A registered funding portal would be required to enter into a written agreement with a fidelity bond provider to obtain the required coverage. Based on discussion with industry participants, we estimate that funding portals would incur an initial burden of approximately 15 hours each to comply with these requirements, or 750 hours total (15 hours per funding portal x 50 funding portals = 750 hours).

[1101] *See* Section IV.C.2.f above.

We expect that, on an ongoing basis, a registered funding portal would have to periodically review and update its fidelity bond coverage. We estimate that funding portals would incur an ongoing burden of approximately 5 hours each to comply with these requirements, or 250 hours total (5 hours per funding portal x 50 funding portals = 2,500 hours).

ii. Cost

We estimate the initial costs for the fidelity bond to be $825. We estimate that on an ongoing basis, the costs would be $825.

k. Compliance: Policies and Procedures

i. Time Burden

Based on discussion with industry participants, we estimate that a funding portal would spend approximately 40 hours to establish written policies and procedures to achieve compliance with the JOBS Act and the rules and regulations thereunder, as required under the proposed rules. This would result in an aggregate initial recordkeeping burden of 2,000 hours (40 hours x 50 funding portals).

We estimate that, on an ongoing basis, funding portals would spend approximately 5 hours per year updating, as necessary, the policies and procedures required by the proposed rules. This would result in an aggregate ongoing recordkeeping burden of 250 hours (5 hours x 50 funding portals).

ii. Cost

As we anticipate that funding portals would comply with this requirement by using internal personnel and internal information technology resources integrated into their platforms, we estimate that there would be no costs related to this requirement. To the extent a funding portal employs a consultant or attorney to establish written policies and procedures, these costs would be incorporated into the cost of hiring a third party to assist in the membership process.

l. Compliance: Anti-Money Laundering

While the proposed CIP and the SAR Requirements, and other BSA requirements, impose burdens on relevant entities, the proposed rules do not impose any burden on funding portals in addition to that already imposed on broker-dealers by those requirements. The burden on funding portals, would be the same as broker-dealers, and would be included within those estimates provided by Treasury,[1102] so we do not discuss those burdens here, and we would not be requesting any separate approval from OMB to impose the burdens associated with the information collection requirements to comply with the CIP and SAR Requirements.

m. Compliance: Privacy

i. Time Burden

We estimate that the initial time burden of the requirement related to the proposed Privacy Rules, including Regulation S-P, S-AM and S-ID, would be negligible in light of the limited activities of funding portals, so we discuss it below only in relation to ongoing time burdens.

Regulation S-P would require a funding portal to provide notice to investors about its privacy policies and practices; describes the conditions under which a broker may disclose nonpublic personal information about investors to nonaffiliated third parties; and provides a method for investors to prevent a funding portal from disclosing that information to most nonaffiliated third parties by "opting out" of that disclosure, subject to certain exceptions. For

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[1102] *See* OMB File No. 1506-0034 for the CIP requirement and OMB File No. 1506-0019 for the SAR requirement.

funding portals, we expect that the privacy and opt-out notices would be delivered electronically, which reduces the delivery burden compared to paper delivery.

Based on the proposed requirements, we estimate that all 50 funding portals would be subject to the requirements of Regulation S-P under the proposed regulation. In developing an estimate we have considered: (1) the minimal recordkeeping burden imposed by Regulation S-P (Regulation S-P has no recordkeeping requirement, and records relating to customer communications already must be made and retained pursuant to other Commission rules); (2) the summary fashion in which information must be provided to investors in the privacy and opt-out notices required by Regulation S-P (the model privacy form adopted by the Commission and the other agencies in 2009, designed to serve as both a privacy notice and an opt-out notice, is only two pages); and (3) the availability of the model privacy form and online model privacy form builder. Given these consideration and with the aid of our institutional knowledge, we estimate that each funding portal would spend, on an ongoing basis, an average of approximately 12 hours per year complying with the information collection requirement of Regulation S-P, for a total of approximately 600 annual burden-hours (12 hours/respondent x 50 funding portals).

Regulation S-AM would require funding portals to provide a notice to each affected individual informing the individual of his or her right to prohibit such marketing before a receiving affiliate may make marketing solicitations based on the communication of certain consumer financial information from the broker. Based on the discussion with industry participants, we estimate that approximately 20 funding portals would have affiliations that would subject them to the requirements of Regulation S-AM under the proposed regulation, and that they would require an average one-time burden of 1 hour to review affiliate marketing practices, for a total of 20 hours (1 hour/respondent x 20 funding portals). We also estimate that these 20 funding portals would be required to provide notice and opt-out opportunities to consumers pursuant to the requirements of Regulation S-AM and that they would incur an average first-year burden of 18 hours in doing so, for a total estimated first-year burden of 360 hours (18 hours/respondent x 20 funding portals). We estimate that funding portals would incur a continuing ongoing burden related to the requirements of Regulation S-AM to provide notice and opt-out opportunities of approximately 4 hours per respondent per year to create and deliver notices to new investors and record any opt-outs that are received on an ongoing basis, for a total of approximately 80 annual burden-hours (4 hours/respondent x 20 funding portals).[1103]

Under our proposed rules, Regulation S-ID generally would require funding portals to develop and implement a written identity theft prevention program that is designed to detect, prevent and mitigate identity theft in connection with certain existing accounts or the opening of new accounts. Based on our institutional knowledge, we estimate that the initial burden for funding portals to comply with the applicable portions of proposed Regulation S-ID would be (1) 25 hours to develop and obtain board approval of a program; (2) 4 hours to train staff; and (3) 2 hours to conduct an initial assessment of relevant accounts, for a total of 31 hours. We estimate that all 50 funding portals would incur these initial time burdens, resulting in an aggregate time burden of 1,550 hours ((25 + 4 + 2 hours / respondent) x 50 funding portals).

With respect to the requirements of Regulation S-ID, we estimate that the ongoing burden per year would include: (1) 2 hours to periodically review and update the program, review and preserve contracts with service providers and review and preserve any documentation received from service providers; (2) 4 hours to prepare and present an annual report to a compliance

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1103 The average (blended) annual time burden per respondent for Regulation S-AM requirements would be 10 hours ((18 hours in the first year / 3 years) + 4 hours/year continuing burden = 10 hours per year).

director; and (3) 2 hours to conduct periodic assessments to determine if the entity offers or maintains covered accounts, for a total of 8 hours, of which we estimate 7 hours would be spent by internal counsel and 1 hour would be spent by a compliance director. We estimate that 50 funding portals would incur these ongoing time burdens, making the total ongoing burden 400 hours (8 hours/respondent x 50 funding portals).

ii. Cost

We estimate that, for PRA purposes, there is no cost associated with the requirements of Regulation S-P, Regulation S-AM or Regulation S-ID.

n. Records to be Made and Kept by Funding Portals

i. Time Burden

All funding portals would be required to make and keep records related to their activities to facilitate transactions in reliance on Section 4(a)(6) and the related rules. These proposed books and records requirements are based generally on Exchange Act Rules 17a-3 and 17a-4, which apply to broker-dealers. To estimate the initial burden for funding portals, we examined the current annual burdens of Rules 17a-3 and 17a-4.[1104]

The most recently approved annual recordkeeping burden for broker-dealer compliance with Rule 17a-3 is currently estimated at 394.16 hours per respondent, and the most recently approved annual recordkeeping burden for broker-dealer compliance with Rule 17a-4 is currently estimated at 254 hours per respondent.

[1104] *See* Collections of Information for Exchange Act Rules 17a-3 and 17a-4 (OMB Control Nos. 3235-0033 and 3235-0279), Office of Information and Regulatory Affairs, Office of Management and Budget, *available at* http://www.reginfo.gov/public/do/PRAMain.

Given the more limited scope of a funding portal's business as compared to that of a broker, the more limited scope of the proposed books and records rules, and the fact that funding portals would make, deliver and store records electronically (as required), we expect the burden of the proposed rules may be less than that of Rules 17a-3 and 17a-4. For the purposes of the PRA, we assume that the recordkeeping burden, on average, for a funding portal to comply with the proposed rules would be 50% of the burdens of a broker-dealer to comply with Rules 17a-3 and 17a-4 (although 50% may turn out to be a high estimate). We expect the ongoing recordkeeping burden for funding portals would be the same as the initial burden because maintaining such records would be consistent each year. Therefore, we estimate the initial burden to be approximately 325 hours per respondent,[1105] or 16,250 hours total (325 hours/respondent x 50 respondents = 16,250 hours). We estimate that the ongoing recordkeeping burden for funding portals would be approximately 325 hours per respondent, or 16,250 hours total (325 hours/ respondent x 50 funding portals).

ii. Cost

For purposes of the PRA, we assume that a funding portal's initial recordkeeping cost associated with making and keeping records by a funding portal would not be significantly different from the ongoing recordkeeping cost because maintaining such records would be consistent each year. The most recently approved annual recordkeeping cost for broker-dealer compliance with Rule 17a-3 is currently estimated at $5,706.67 per respondent. These ongoing recordkeeping costs reflect the costs of systems and equipment development. The most recently

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1105 394.16 hours (recordkeeping burden for Rule 17a-3) + 254 hours (recordkeeping burden for Rule 17a-4) = 648.16 hours. 648.16 hours/2 = 324.08 hours.

approved annual recordkeeping cost for broker-dealer compliance with Rule 17a-4 is currently estimated at $5,000 per respondent.

Given the more limited scope of a funding portal's business as compared to that of a broker, the more limited scope of the proposed books and records rules, and the fact that funding portals would make, deliver (as required) and store records electronically, we expect the annual recordkeeping cost of the proposed rule requirements may be less than that of Rules 17a-3 and 17a-4. For purposes of the PRA, we assume that the annual recordkeeping cost on average for a funding portal to comply with the proposed requirements that records be made and kept would be about 50% less than burdens of a broker-dealer to comply with Rules 17a-3 and 17a-4. We expect the initial recordkeeping cost for funding portals, therefore, to be approximately $5,350 per respondent,[1106] or $267,500 total ($5,350 per respondent x 50 respondents = $267,500).

We also estimate that the ongoing recordkeeping cost for funding portals would be approximately $5,350 per respondent, or $267,500 total ($5,350 per respondent x 50 respondents = $267,500).

D. Collections of Information are Mandatory

The collections of information required under proposed Rules 201 through 203 would be mandatory for all issuers. The collections of information required under proposed Rules 300 through 304 would be mandatory for all intermediaries. The collections of information required under proposed Rules 400 through 404 would be mandatory for all funding portals.

1106 $5,706.673 (recordkeeping cost for Rule 17a-3) + $5,000 (recordkeeping cost for Rule 17a-4) = $10,706.673 multiplied by 50%.

E. Confidentiality

Responses on Form C, Form C-A, Form C-U, Form C-AR and Form C-TR would not be confidential. Responses on Form ID would be kept confidential by the Commission, subject to a request under the Freedom of Information Act.[1107] Responses on Form Funding Portal would not be confidential.

F. Retention Period of Recordkeeping Requirements

Issuers are not subject to recordkeeping requirements under proposed Regulation Crowdfunding. Intermediaries that are brokers would be required to retain records and information relating to proposed Regulation Crowdfunding for the required retention periods specified in Exchange Act Rule 17a-4.[1108] Intermediaries that are funding portals would be required to retain records and information under proposed Regulation Crowdfunding for the required retention periods specified in proposed Rule 404.[1109]

G. Request for Comment

The Commission invites comment on all of the above estimates. In particular, the Commission requests comment on the assumptions and estimates described above with respect to how issuers and intermediaries, especially funding portals, would comply with the proposed information collection requests. Pursuant to 44 U.S.C. 3506(c)(2)(A), the Commission requests comment in order to: (1) evaluate whether the proposed collections of information are necessary for the proper performance of our functions, including whether the information would have practical utility; (2) evaluate the accuracy of our estimate of the burden of the proposed

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1107 5 U.S.C. 552. The Commission's regulations that implement the Freedom of Information Act are at 17 CFR 200.80 *et seq*.

1108 17 CFR 240.17a-4.

1109 *See* proposed Rule 404 of Regulation Crowdfunding.

collections of information; (3) determine whether there are ways to enhance the quality, utility and clarity of the information to be collected; and (4) evaluate whether there are ways to minimize the burden of the proposed collections of information on those who respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the proposed collection of information requirements should direct their comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-09-13. Requests for materials submitted to OMB by the Commission, with regard to these collections of information, should be in writing, with reference to File No. S7-09-13, and they should be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street, NE, Washington, DC 20549-2736. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

V. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),[1110] the Commission must advise the OMB as to whether the proposed rules constitute a "major" rule. Under SBREFA, a rule is considered "major" when, if adopted, it

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1110 Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various Sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

results or is likely to result in: (1) an annual effect on the economy of $100 million or more (either in the form of an increase or a decrease); (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effect on competition, investment or innovation. If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review.

The Commission requests comment on the potential impact of the proposed rules on the economy on an annual basis, any potential increase in costs or prices for consumers or individual industries and any potential effect on competition, investment or innovation. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

VI. Initial Regulatory Flexibility Act Analysis

The Commission has prepared the following Initial Regulatory Flexibility Analysis ("IRFA"), in accordance with the provisions of the Regulatory Flexibility Act,[1111] regarding proposed Regulation Crowdfunding.

A. Reasons for the Proposed Actions

The proposed regulation is designed to implement the requirements of Title III. Title III added Securities Act Section 4(a)(6), which provides a new exemption from the registration requirements of Securities Act Section 5 for crowdfunding transactions, provided the transactions are conducted in the manner set forth in new Securities Act Section 4A. Section 4A includes requirements for issuers that offer or sell securities in reliance on the crowdfunding exemption, as well as for persons acting as intermediaries in those transactions. The proposed rules prescribe requirements governing the offer and sale of securities in reliance on Section

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1111 5 U.S.C. 603.

4(a)(6), and provide a framework for the regulation of registered funding portals and brokers that act as intermediaries in the offer and sale of securities in reliance on Section 4(a)(6).

B. Objectives

As discussed above, the crowdfunding provisions of the JOBS Act, which we would implement through this proposed regulation, were designed to help alleviate the funding gap and accompanying regulatory concerns faced by small businesses by making relatively low dollar offerings of securities less costly and by providing crowdfunding platforms a means by which to facilitate the offer and sale of securities without registering as brokers, with a framework for regulatory oversight to protect investors.

C. Small Entities Subject to the Proposed Rules

For purposes of the Regulatory Flexibility Act, under our rules, an issuer (other than an investment company) is a "small business" or "small organization" if it has total assets of $5 million or less as of the end of its most recent fiscal year and is engaged or proposing to engage in an offering of securities which does not exceed $5 million.[1112] We believe that many issuers seeking to offer and sell securities in reliance on Section 4(a)(6) would be at a very early stage of their business development and would likely have total assets of $5 million or less. Also, to qualify for the exemption under Section 4(a)(6), the amount raised by an issuer must not exceed $1 million in a 12-month period. Therefore, we estimate that all issuers who offer or sell securities in reliance on the exemption would be classified as a "small business" or "small organization."

[1112] 17 CFR 230.157.

Paragraph (a) of Rule 0-10 under the Exchange Act provides that, for purposes of the Regulatory Flexibility Act, "[w]hen used with reference to a broker or dealer, the Commission has defined the term "small entity" to mean a broker or dealer ("small broker-dealer" that: (1) had total capital (net worth plus subordinated liabilities of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) or, if not required to file such statements, a broker or dealer that had total capital (net worth plus subordinated debt) of less than $500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business if shorter); and (2) is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined in this release."[1113] Currently, based on FOCUS Report[1114] data, there are 871 broker-dealers that are classified as "small" entities for purposes of the Regulatory Flexibility Act.[1115] We apply comparable criteria to funding portals that would register under the proposed regulation. Based on discussions with industry participants, we estimate that, of the anticipated 50 funding portals we expect to register under the proposed regulation, 30 would be classified as "small" entities for purposes of the Regulatory Flexibility Act.

D. Projected Reporting, Recordkeeping and other Compliance Requirements

As discussed above, the proposed regulation includes reporting, recordkeeping and other compliance requirements. In particular, the proposed regulation would impose certain disclosure requirements on issuers offering and selling securities in a transaction relying on the exemption

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1113 17 CFR 240.0-10(c).

1114 FOCUS Reports, or "Financial and Operational Combined Uniform Single" Reports, are monthly, quarterly, and annual reports that broker-dealers generally are required to file with the Commission and/or self-regulatory organizations pursuant to Exchange Act Rule 17a-5 (17 CFR 240.17a-5).

1115 *See* 17 CFR 240.0-10(a).

provided by Section 4(a)(6). The proposed rules would require that issuers relying on the exemption provided by Section 4(a)(6) file with the Commission certain specified information about the issuer and the offering, including information about the issuer's contact information; directors, officers and certain beneficial owners; business and business plan; current number of employees; financial condition; target offering amount and the deadline to reach the target offering amount; use of proceeds from the offering and price or method for calculating the price of the securities being offered; ownership and capital structure; material factors that make an investment in the issuer speculative or risky; indebtedness; description of other offerings of securities; and transactions with related parties. Issuers also would be required to file updates with the Commission to describe the progress of the issuer in meeting the target offering amount. Any issuer that sold securities in reliance on Section 4(a)(6) also would be required to file annually with the Commission an annual report to update the previously provided disclosure about the issuer's contact information; directors, officers and certain beneficial owners; business and business plan; current number of employees; financial condition; ownership and capital structure; material factors that make an investment in the issuer speculative or risky; indebtedness; description of other offerings of securities; and transactions with related parties.

Intermediaries would be required to register with the Commission as either brokers or as funding portals pursuant to the proposed rules. Intermediaries also would be required to provide quarterly reports to the Commission. Funding portals would be required to make and keep certain records in accordance with the proposed rules. In addition, the proposed rules would impose specific compliance requirements on intermediaries.

In proposing this regulation, the Commission took into account that the regulation, as mandated in the JOBS Act, aimed to address difficulties encountered by issuers that are small entities. Accordingly, the Commission designed the proposed rules for intermediaries, to the extent possible, for small entities. We believe that the potential impact of the proposed regulation on larger brokers and funding portals would be less than on small brokers and small intermediaries. We believe that the reporting, recordkeeping and other compliance requirements of the proposed regulation applicable to intermediaries would impact, in particular, small entities that decide to register as funding portals. We believe that most of these requirements would be performed by internal compliance personnel of the broker or funding portal, but we estimate that at least one-third of funding portals may decide to hire outside counsel and third-party service providers to assist in meeting the compliance requirements. For example, a funding portal may decide to hire a third party to maintain records required by the proposed rules.

E. Duplicative, Overlapping or Conflicting Federal Rules

The Commission believes that there are no federal rules that duplicate, overlap or conflict with the proposed regulation or the proposed amendment to Rule 30-1 of our Rules of Organization and Program Management.

F. Significant Alternatives

Pursuant to Section 3(a) of the Regulatory Flexibility Act,[1116] the Commission must consider certain types of alternatives, including: (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation or simplification of compliance and reporting requirements under the rule for small entities; (3) the use of performance rather than design

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[1116] 5 U.S.C. 603(c).

standards; and (4) an exemption from coverage of the rule, or any part of the rule, for small entities.

1. Issuers

The Commission considered whether it is necessary or appropriate to establish different compliance or reporting requirements or timetables or to clarify, consolidate or simplify compliance and reporting requirements under the proposed rules for small issuers. With respect to using performance rather than design standards, the Commission used performance standards to the extent appropriate under the statute. For example, issuers have the flexibility to customize the presentation of certain disclosures in their offering statements.[1117] The Commission also considered whether there should be an exemption from coverage of the rule, or any part of the rule, for small issuers. However, because the proposed rules have been designed in the context of crowdfunding, which focuses on the needs of issuers that are small entities, the Commission believes that small issuers should be covered by the proposed rules. The Commission does not believe it would be necessary to establish different compliance requirements for small issuers. Having inconsistent requirements could undermine the objectives of the proposed rules.

2. Intermediaries

The Commission also considered whether, for small brokers or small funding portals, it is appropriate to establish different compliance, reporting or timing requirements, or whether to clarify, consolidate or simplify those requirements in our proposed rules. While the proposed rules are based in large part on existing compliance requirements applicable to registered brokers, the Commission believes that it would not be necessary to establish different

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1117 *See* Section II.B.3 above.

requirements for small entities (whether brokers or funding portals) that engage in crowdfunding. The proposed rules have been tailored to the limited role intermediaries would play in offerings made pursuant to Section 4(a)(6) (as compared to the wide range of services that a traditional broker-dealer may provide). Therefore, we believe that the proposed rules are appropriate, and properly cover all brokers and funding portals. The Commission believes that having separate requirements for small entities (whether brokers or funding portals) could undermine the objectives of the proposed requirements, and could lead to less regulatory clarity.

G. Request for Comment

The Commission encourages written comments on matters discussed in this IRFA. In particular, the Commission seeks comment on the number of small entities that would be affected by the proposed rules and whether the effect on small entities would be economically significant. Commenters are asked to describe the nature of any effect and to provide empirical data to support their views.

VII. STATUTORY AUTHORITY AND TEXT OF PROPOSED REGULATION

We are proposing the rules and forms contained in this document under the authority set forth in the Securities Act, particularly, Sections 4(a)(6), 4A and 19 thereof, 15 U.S.C. 77a *et seq.*, the Exchange Act, particularly, Sections 3(b), 3(h), 10(b), 15, 17, 23(a) and 36 thereof, 15 U.S.C. 78a *et seq.*, and Pub. L. No. 112-106, §301-305, 126 Stat. 306 (2012).

List of Subjects

17 CFR Part 200

Administrative practice and procedure, Authority delegations (Government agencies), Organization and functions (Government agencies).

Reporting and recordkeeping requirements.

17 CFR Part 227

Crowdfunding, Funding Portals, Intermediaries, Reporting and recordkeeping requirements, Securities.

17 CFR Parts 232 and 239

Reporting and recordkeeping requirements, Securities.

17 CFR Part 240

Brokers, Confidential business information, Fraud, Reporting and recordkeeping requirements, Securities.

17 CFR Part 249

Brokers, Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, we propose to amend Title 17, Chapter II of the Code of Federal Regulations as follows:

PART 200 – ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

Subpart A – Organization and Program Management

1. The authority citation for Part 200, Subpart A, continues to read, in part as follows: Authority: 15 U.S.C. 77o, 77s, 77sss, 78d, 78d-1, 78d-2, 78w, 78ll(d), 78mm, 80a-37, 80b-11, 7202, and 7211 et seq., unless otherwise noted.

* * * * *

2. Amend § 200.30-1 by:

a. Redesignating paragraphs (d), (e), (f), (g), (h), (i), (j) and (k) as paragraphs (e), (f), (g), (h), (i), (j), (k) and (*l*), respectively; and

b. Adding new paragraph (d).

The addition reads as follows:

§ 200.30-1 Delegation of authority to Director of Division of Corporation Finance.

* * * * *

(d) With respect to the Securities Act of 1933 (15 U.S.C. 77a *et seq.*) and Regulation Crowdfunding thereunder (§§ 227.100 through 227.503 of this chapter), to authorize the granting of applications under § 227.503(b)(2) of this chapter upon the showing of good cause that it is not necessary under the circumstances that the exemption under Regulation Crowdfunding be denied.

* * * * *

3. Part 227 is added to read as follows:

PART 227—REGULATION CROWDFUNDING, GENERAL RULES AND REGULATIONS

227.302 Account opening.

227.303 Requirements with respect to transactions.

227.304 Completion of offerings, cancellations and reconfirmations.

227.305 Payments to third parties.

Subpart D Funding Portal Regulation

227.400 Registration of funding portals.

227.401 Exemption.

227.402 Conditional safe harbor.

227.403 Compliance.

227.404 Records to be made and kept by funding portals.

Subpart E Miscellaneous Provisions

227.501 Restrictions on resales.

227.502 Insignificant deviations from a term, condition or requirement of Regulation Crowdfunding.

227.503 Disqualification.

Authority: 15 U.S.C. 77d, 77d-1, 77s, 78c, 78o, 78q, 78w, 78mm, and Pub. L. No. 112-106, §301-305, 126 Stat. 306 (2012), unless otherwise noted.

REGULATION CROWDFUNDING

SUBPART A – General

§ 227.100. Crowdfunding exemption and requirements.

(a) *Exemption*. An issuer may offer and sell securities in reliance on Section 4(a)(6) of the Securities Act of 1933 (the "Securities Act") (15 U.S.C. 77d(a)(6)), provided that:

(1) The aggregate amount of securities sold to all investors by the issuer in reliance on

Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) during the 12-month period preceding the date of such offer or sale, including the securities offered in such transaction, shall not exceed $1,000,000;

(2) The aggregate amount of securities sold to any investor by any issuer in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) during the 12-month period preceding the date of such transaction, including the securities sold to such investor in such transaction, shall not exceed the greater of:

(i) $2,000 or 5 percent of annual income or net worth of the investor, whichever is greater, if both the annual income and net worth are less than $100,000; and

(ii) 10 percent of annual income or net worth of the investor, whichever is greater, not to exceed an amount sold of $100,000, if either the annual income or net worth of the investor is equal to or more than $100,000;

Instruction 1 to paragraph (a)(2). To determine the investment limit for a natural person, the person's annual income and net worth shall be calculated as those values are calculated for purposes of determining accredited investor status in accordance with 17 CFR 230.501.

Instruction 2 to paragraph (a)(2). The person's annual income and net worth may be calculated jointly with the annual income and net worth of the person's spouse.

Instruction 3 to paragraph (a)(2). An issuer offering and selling securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) may rely on the efforts an intermediary is required to undertake pursuant to § 227.303(b) to ensure that the aggregate amount of securities purchased by an investor in offerings pursuant to Section 4(a)(6) of the Securities Act will not cause the investor to exceed the limit set forth in Section 4(a)(6) of the Securities Act and § 227.100(a)(2), provided that the issuer does not know that the investor had exceeded the investor limits or would exceed the investor limits as a result of purchasing securities in the issuer's offering.

(3) The transaction is conducted through an intermediary that complies with the requirements in Section 4A(a) of the Securities Act (15 U.S.C. 77d-1(a)) and the related requirements in Regulation Crowdfunding (§§ 227.100 *et seq.*), and the transaction is conducted exclusively through the intermediary's platform; and

Instruction 1 to paragraph (a)(3). An issuer shall not conduct an offering or concurrent offerings in reliance on Section 4(a)(6) of the Securities Act of 1933 (15 U.S.C. 77d(a)(6)) using more than one intermediary.

Instruction 2 to paragraph (a)(3). An intermediary through which a crowdfunding transaction is conducted may engage in back office or other administrative functions other than on the intermediary's platform.

(4) The issuer complies with the requirements in Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)) and the related requirements in Regulation Crowdfunding (§§ 227.100 *et seq.*).

(b) *Applicability.* The crowdfunding exemption shall not apply to transactions involving the offer or sale of securities by any issuer that:

(1) Is not organized under, and subject to, the laws of a State or territory of the United States or the District of Columbia;

(2) Is subject to the requirement to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act") (15 U.S.C. 78m or 78o(d));

(3) Is an investment company, as defined in Section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), or is excluded from the definition of investment company by Section 3(b) or Section 3(c) of that Act (15 U.S.C. 80a-3(b) or 80a-3(c));

(4) Is not eligible to offer or sell securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) as a result of a disqualification as specified in § 227.503(a);

(5) Has sold securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) and has not filed with the Commission and provided to investors, to the extent required, the ongoing annual reports required by Regulation Crowdfunding (§§ 227.100 *et seq.*) during the two years immediately preceding the filing of the required offering statement; or

(6) Has no specific business plan or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies.

(c) *Issuer*. For purposes of this Regulation Crowdfunding (§§ 227.100 *et seq.*), *issuer* includes all entities controlled by or under common control with the issuer. It also includes any predecessor of the issuer.

Instruction to paragraph (c). An entity is controlled by or under common control with the issuer if the issuer possesses, directly or indirectly, the power to direct or cause the direction of the management and policies of the entity, whether through the ownership of voting securities, by contract or otherwise.

(d) *Platform*. For purposes of this Regulation Crowdfunding (§§ 227.100 *et seq.*), *platform* means an Internet website or other similar electronic medium through which a registered broker or a registered funding portal acts as 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)).

SUBPART B – Requirements for Issuers

§ 227.201. Disclosure requirements.

An issuer offering or selling securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) and in accordance with Section 4A of the Securities Act (15 U.S.C. 77d-1) and Regulation Crowdfunding (§§ 227.100 *et seq.*) must file with the Commission on the Electronic Data Gathering, Analysis, and Retrieval system (EDGAR), provide to investors and the relevant intermediary, and make available to potential investors the following information:

(a) The name, legal status (including its form of organization, jurisdiction in which it is organized and date of organization), physical address and website of the issuer;

(b) The names of the directors and officers (and any persons occupying a similar status or performing a similar function) of the issuer, all positions and offices with the issuer held by such persons, the period of time in which such persons served in the position or office and their business experience during the past three years, including:

(1) Each person's principal occupation and employment, including whether any officer is employed by another employer; and

(2) The name and principal business of any corporation or other organization in which such occupation and employment took place.

Instruction to paragraph (b). For purposes of this paragraph (b), the term *officer* means a president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization, whether incorporated or unincorporated.

(c) The name of each person, as of the most recent practicable date, who is a beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power;

(d) A description of the business of the issuer and the anticipated business plan of the issuer;

(e) The current number of employees of the issuer;

(f) A discussion of the material factors that make an investment in the issuer speculative or risky;

(g) The target offering amount and the deadline to reach the target offering amount, including a statement that if the sum of the investment commitments does not equal or exceed the target offering amount at the offering deadline, no securities will be sold in the offering, investment commitments will be cancelled and committed funds will be returned;

(h) Whether the issuer will accept investments in excess of the target offering amount and, if so, the maximum amount that the issuer will accept and whether oversubscriptions will be allocated on a pro-rata, first come-first served, or other basis;

(i) A description of the purpose and intended use of the offering proceeds;

Instruction to paragraph (i). An issuer must identify any intended use of proceeds and provide a reasonably detailed description of such intended use, such that investors are provided with an adequate amount of information to understand how the offering proceeds will be used. If an issuer has identified a range of possible uses, the issuer should identify and describe each probable use and the factors impacting the selection of each particular use. If the issuer will accept proceeds in excess of the target offering amount, the issuer must describe the stated purpose and intended use of the excess proceeds with similar specificity.

(j) A description of the process to complete the transaction or cancel an investment commitment, including a statement that:

(1) Investors may cancel an investment commitment until 48 hours prior to the deadline identified in the issuer's offering materials;

(2) The intermediary will notify investors when the target offering amount has been met;

(3) If an issuer reaches the target offering amount prior to the deadline identified in its offering materials, it may close the offering early if it provides notice about the new offering deadline at least five business days prior to such new offering deadline (absent a material change that would require an extension of the offering and reconfirmation of the investment commitment); and

(4) If an investor does not cancel an investment commitment before the 48-hour period prior to the offering deadline, the funds will be released to the issuer upon closing of the offering and the investor will receive securities in exchange for his or her investment;

(k) A statement that if an investor does not reconfirm his or her investment commitment after a material change is made to the offering, the investor's investment commitment will be cancelled and the committed funds will be returned;

(l) The price to the public of the securities or the method for determining the price, provided that, prior to any sale of securities, each investor shall be provided in writing the final price and all required disclosures;

(m) A description of the ownership and capital structure of the issuer, including:

(1) The terms of the securities being offered and each other class of security of the issuer, including the number of securities being offered and/or outstanding, whether or not such securities have voting rights, any limitations on such voting rights, how the terms of the securities being offered may be modified and a summary of the differences between such securities and each other class of security of the issuer, and how the rights of the securities being

offered may be materially limited, diluted or qualified by the rights of any other class of security of the issuer;

(2) A description of how the exercise of the rights held by the principal shareholders of the issuer could affect the purchasers of the securities being offered;

(3) The name and ownership level of each person, as of the most recent practicable date, who is the beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power;

(4) How the securities being offered are being valued, and examples of methods for how such securities may be valued by the issuer in the future, including during subsequent corporate actions;

(5) The risks to purchasers of the securities relating to minority ownership in the issuer and the risks associated with corporate actions including additional issuances of securities, issuer repurchases of securities, a sale of the issuer or of assets of the issuer or transactions with related parties; and

(6) A description of the restrictions on transfer of the securities, as set forth in § 227.501;

(n) The name, Commission file number and Central Registration Depository (CRD) number (as applicable) of the intermediary through which the offering is being conducted;

(o) The amount of compensation paid to the intermediary for conducting the offering, including the amount of referral and any other fees associated with the offering;

(p) A description of the material terms of any indebtedness of the issuer, including the amount, interest rate, maturity date and any other material terms;

(q) A description of exempt offerings conducted within the past three years;

Instruction to paragraph (q). In providing a description of any prior exempt offerings, disclose:

(1) The date of the offering;

(2) The offering exemption relied upon;

(3) The type of securities offered; and

(4) The amount of securities sold and the use of proceeds.

(r) A description of any transaction since the beginning of the issuer's last full fiscal year, or any currently proposed transaction, to which the issuer or any entities controlled by or under common control with the issuer was or is to be a party and the amount involved exceeds five percent of the aggregate amount of capital raised by the issuer in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) during the preceding 12-month period, inclusive of the amount the issuer seeks to raise in the current offering under Section 4(a)(6) of the Securities Act, in which any of the following persons had or is to have a direct or indirect material interest:

(1) Any director or officer of the issuer;

(2) Any person who is, as of the most recent practicable date, the beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power;

(3) If the issuer was incorporated or organized within the past three years, any promoter of the issuer;

(4) Any immediate family member of any of the foregoing persons, which means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of the person, and any persons (other than a tenant or employee) sharing the household of the person;

Instruction to paragraph (r). For each transaction identified, disclose the name of the specified person and state his or her relationship to the issuer, the nature of his or her interest in the transaction and, where practicable, the approximate amount of the interest of such specified person. The amount of such interest shall be computed without regard to the amount of the profit or loss involved in the transaction. Where it is not practicable to state the approximate amount of the interest, the approximate amount involved in the transaction shall be disclosed.

(s) A description of the financial condition of the issuer;

Instruction to paragraph (s). In providing a description of the issuer's financial condition, provide a discussion, to the extent material, of the issuer's historical results of operations, liquidity and capital resources. For issuers with no prior operating history, the description should include a discussion of financial milestones and operational, liquidity and other challenges. For issuers with an operating history, the discussion should address whether historical earnings and cash flows are representative of what investors should expect in the future. Issuers should take into account the proceeds of the offering and any other known or pending sources of capital. Issuers should also discuss how the proceeds from the offering will impact the issuer's liquidity and the necessity of receiving these funds and any other additional funds to the viability of the business. In addition, issuers should describe the other available sources of capital to the business, such as lines of credit or required contributions by shareholders.

(t) For offerings that, together with all other offerings of the issuer under Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) within the preceding 12-month period, have, in the aggregate, target offering amounts of:

(1) $100,000 or less, the income tax returns filed by the issuer for the most recently completed year (if any) and financial statements of the issuer, which shall be certified by the principal executive officer of the issuer to be true and complete in all material respects;

(2) More than $100,000, but not more than $500,000, financial statements reviewed by a public accountant who is independent of the issuer, using the Statements on Standards for Accounting and Review Services issued by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants; and

(3) More than $500,000, financial statements audited by a public accountant who is independent of the issuer, using auditing standards issued by either the American Institute of Certified Public Accountants or the Public Company Accounting Oversight Board;

Instruction 1 to paragraph (t). To determine the financial statements that would be required under paragraph (t), an issuer would aggregate amounts offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) within the preceding 12-month period and the offering amount in the offering for which disclosure is being provided. If the issuer will accept proceeds in excess of the target offering amount, the issuer must include in the calculation to determine the financial statements that would be required under paragraph (t) the maximum offering amount that the issuer will accept.

Instruction 2 to paragraph (t). The financial statements required by paragraphs (t)(1), (t)(2) and (t)(3) of this section would include a balance sheet, income statement, statement of cash flows and statement of changes in owners' equity and notes to the financial statements prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP). The required financial statements must cover the shorter of the two most recently completed fiscal years or the period since inception.

Instruction 3 to paragraph (t). An issuer shall redact personally identifiable information from any tax returns required to be provided under paragraph (t)(1) of this section. Issuers offering securities in a transaction in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) before filing a tax return with the U.S. Internal Revenue Service for the most recently completed fiscal year may use the tax return filed with the U.S. Internal Revenue Service for the prior year (if any), provided that the issuer uses the tax return for the most recent fiscal year when it is filed, if filed during the offering period.

Instruction 4 to paragraph (t). With respect to the financial statements required by paragraph (t)(1) of this section, an issuer's principal executive officer must provide the following certification in the Form C – Offering Statement (§ 239.900 of this chapter):

> I, [identify the certifying individual], certify that the financial statements of [identify the issuer] included in this Form are true and complete in all material respects. [Signature and title].

Instruction 5 to paragraph (t). A copy of the public accountant's review report must accompany the financial statements required by paragraph (t)(2) of this section.

Instruction 6 to paragraph (t). A copy of the audit report must accompany financial statements required by paragraph (t)(3) of this section. An issuer will be in compliance with the requirement to provide audited financial statements if the issuer received an unqualified or a qualified opinion, but it will not be in compliance with the requirement if it received an adverse opinion or a disclaimer of opinion.

Instruction 7 to paragraph (t). To qualify as an independent public accountant for purposes of paragraphs (t)(2) and (t)(3) of this section, the accountant must satisfy the independence requirements in Rule 2-01 of Regulation S-X (17 CFR 210.2-01).

Instruction 8 to paragraph (t). An issuer may conduct an offering in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) using financial statements for the fiscal year prior to the issuer's most recently completed fiscal year, provided that the issuer was not otherwise already required to update the financial statements pursuant to § 227.202 and updated financial statements are not otherwise available. If more than 120 days have passed since the end of the issuer's most recently completed fiscal year, the issuer must use financial statements for its most recently completed fiscal year.

Instruction 9 to paragraph (t). An issuer must include a discussion of any material changes in the financial condition of the issuer during any time period subsequent to the period for which financial statements are provided, including changes in reported revenue or net income.

Instruction 10 to paragraph (t). An issuer may voluntarily provide financial statements that meet the requirements for a higher aggregate target offering amount, even if the aggregate amounts sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) within the preceding 12-month period do not require it.

(u) Any matters that would have triggered disqualification under § 227.503(a) had they occurred on or after [effective date of final rule]. The failure to furnish such disclosure timely shall not prevent an issuer from continuing to rely on the exemption provided by Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) if the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known of the existence of the undisclosed matter or matters; and

Instruction to paragraph (u). An issuer will not be able to establish that it has exercised reasonable care unless it has made factual inquiry into whether any disqualifications exist. The nature and scope of the factual inquiry will vary based on the facts and circumstances concerning, among other things, the issuer and the other offering participants.

(v) Updates regarding the progress of the issuer in meeting the target offering amount, to be provided in accordance with § 227.203.

§ 227.202. Ongoing reporting requirements.

(a) An issuer that has offered and sold securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) and in accordance with Section 4A of the Securities Act (15 U.S.C. 77d-1) and Regulation Crowdfunding (§§ 227.100 *et seq.*) must file with the Commission on EDGAR and post on the issuer's website an annual report of its results of operations as described in § 227.201(s) and financial statements of the issuer for the highest aggregate target offering amount previously provided under § 227.201(t). The report also must include the disclosure required by paragraphs (a), (b), (c), (d), (e), (f), (m), (p), (q), and (r) of § 227.201. The report must be filed in accordance with the requirements of § 227.203 and Form C (§ 239.900 of this chapter) and no later than 120 days after the end of the fiscal year covered by the report.

(b) An issuer must continue to comply with the ongoing reporting requirements until:

(1) The issuer becomes a reporting company required to file reports under Section 13(a) or Section 15(d) of the Exchange Act (15 U.S.C. 78m(a) or 78o(d));

(2) The issuer or another party repurchases all of the securities issued in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), including any payment in full of debt securities or any complete redemption of redeemable securities; or

(3) The issuer liquidates or dissolves its business in accordance with state law.

§ 227.203. Filing requirements and form.

(a) Form C – Offering Statement and Amendments (§ 239.900 of this chapter).

(1) *Offering Statement.* An issuer offering or selling securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) and in accordance with Section 4A of the Securities Act (15 U.S.C. 77d-1) and Regulation Crowdfunding (§§ 227.100 *et seq.*) must file with the Commission on EDGAR, provide to investors and the relevant intermediary, and make available to potential investors a Form C: Offering Statement (Form C) (§ 239.900 of this chapter) prior to the commencement of the offering of securities. The Form C must include the information required by § 227.201 of Regulation Crowdfunding

Instruction to paragraph (a)(1). An issuer shall input the following information in the XML-based portion of Form C (§ 239.900 of this chapter): name, legal status and contact information of the issuer; name, Commission file number and CRD number (as applicable) of the intermediary through which the offering will be conducted; amount of compensation paid to the intermediary, including the amount of referral and other fees associated with the offering; type of security offered; number of securities offered; offering price; target offering amount and maximum offering amount (if different from the target offering amount); whether oversubscriptions will be accepted and, if so, how they will be allocated; deadline to reach the target offering amount; current number of employees; and selected financial data for the prior two fiscal years (including total assets, cash and cash equivalents, accounts receivable, short-term debt, long-term debt, revenues/sales, cost of goods sold, taxes paid and net income).

(2) *Amendments to Offering Statement.* An issuer must file with the Commission on EDGAR, provide to investors and the relevant intermediary, and make available to potential investors an amendment to the offering statement filed on Form C (§ 239.900 of this chapter) to disclose any material changes, additions or updates to information that it provides to investors

through the intermediary's platform, only if the offering has not yet been completed or terminated. The amendment must be filed on Form C: Amendment (Form C-A) (§ 239.900 of this chapter), and if the amendment reflects material changes, additions or updates, the issuer shall check the box indicating that investors must reconfirm an investment commitment within five business days or the investor's commitment will be considered withdrawn.

Instruction to paragraph (a)(2). An issuer may file an amendment on Form C-A (§ 239.900 of this chapter) to reflect changes, additions or updates that it considers not material, and in such circumstance, an issuer should not check the box indicating that investors must reconfirm the investment commitment within five business days.

(3) *Progress Updates.* An issuer must file with the Commission on EDGAR, provide to investors and the relevant intermediary, and make available to potential investors a Form C: Progress Update (Form C-U) (§ 239.900 of this chapter) to disclose its progress in meeting the target offering amount no later than five business days after the issuer reaches one-half and 100 percent of the target offering amount. If the issuer will accept proceeds in excess of the target offering amount, the issuer must file with the Commission on EDGAR, provide to investors and the relevant intermediary, and make available to potential investors, no later than five business days after the offering deadline, a final Form C-U to disclose the total amount of securities sold in the offering.

Instruction 1 to paragraph (a)(3). An issuer shall input the progress update in the XML-based portion of Form C-U (§ 239.900 of this chapter).

Instruction 2 to paragraph (a)(3). If multiple Forms C-U (§ 239.900 of this chapter) are triggered within the same five business day period, the issuer may consolidate such progress updates into one Form C-U, so long as the Form C-U discloses the most recent threshold that was met and the Form C-U is filed with the Commission on EDGAR, provided to investors and the relevant intermediary, and made available to potential investors by the day on which the first progress update is due.

Instruction 1 to paragraph (a). An issuer would satisfy the requirement to provide to the relevant intermediary the information required by § 227.203(a) if the issuer provides to the relevant intermediary a copy of the disclosures filed with the Commission on EDGAR.

Instruction 2 to paragraph (a). An issuer would satisfy the requirement to provide to investors and to make available to potential investors the information required by § 227.203(a) if the issuer refers investors to the information on the intermediary's platform by means of a posting on the issuer's website or by e-mail.

(b) *Form C: Annual Report* (§ 239.900 of this chapter). (1) An issuer that sold securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) and in accordance with Section 4A of the Securities Act (15 U.S.C. 77d-1) and Regulation Crowdfunding (§§ 227.100 *et seq.*) must file an annual report on Form C: Annual Report (Form C-AR) (§ 239.900 of this chapter) with the Commission no later than 120 days after the end of the fiscal year covered by the report. The annual report shall include the information required by § 227.202(a).

Instruction to paragraph (b)(1). An issuer shall input the following information in the XML-based portion of Form C-AR (§ 239.900 of this chapter): name, legal status and contact information of the issuer; current number of employees; and selected financial data for the prior two fiscal years (including total assets, cash and cash equivalents, accounts receivable, short-term debt, long-term debt, revenues/sales, cost of goods sold, taxes paid and net income).

(2) An issuer eligible to terminate its obligation to file annual reports with the Commission pursuant to § 227.202(b) must file, within five business days from the date on

which the issuer becomes eligible to terminate is reporting obligation, Form C: Termination of Reporting (Form C-TR) (§ 239.900 of this chapter) with the Commission to advise investors that the issuer will cease reporting pursuant to Regulation Crowdfunding (§§ 227.100 *et seq.*).

§ 227.204. Advertising.

(a) An issuer may not advertise directly or indirectly the terms of an offering made in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), except for notices that direct investors to the intermediary's platform.

(b) A notice regarding the terms of an issuer's offering in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) that directs investors to the intermediary's platform may include no more than the following:

(1) A statement that the issuer is conducting an offering pursuant to Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), the name of the intermediary through which the offering is being conducted and a link directing the potential investor to the intermediary's platform;

(2) The terms of the offering; and

(3) Factual information about the legal identity and business location of the issuer, limited to the name of the issuer of the security, the address, phone number and website of the issuer, the e-mail address of a representative of the issuer and a brief description of the business of the issuer.

(c) Notwithstanding the prohibition on advertising the terms of the offering, an issuer may communicate with investors and potential investors about the terms of the offering through communication channels provided by the intermediary on the intermediary's platform, provided that an issuer identifies itself as the issuer in all communications.

Instruction to § 227.204. For purposes of this section, *terms of the offering* means the amount of securities offered, the nature of the securities, the price of the securities and the closing date of the offering period.

§ 227.205. Promoter compensation.

(a) An issuer shall be permitted to compensate or commit to compensate, directly or indirectly, any person to promote its offerings in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through communication channels provided by an intermediary on the intermediary's platform, but only if the issuer takes reasonable steps to ensure that such person clearly discloses the receipt, past or prospective, of such compensation with any such communication. A founder or an employee of the issuer that engages in promotional activities on behalf of the issuer through the communication channels provided by the intermediary must disclose, with each posting, that he or she is engaging in those activities on behalf of the issuer.

(b) Other than as set forth in paragraph (a) of this section, an issuer shall not compensate or commit to compensate, directly or indirectly, any person to promote its offerings in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), unless such promotion is limited to notices permitted by, and in compliance with, § 227.204.

SUBPART C – Requirements for Intermediaries

§ 227.300. Intermediaries.

(a) *Requirements*. A person acting as 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:

(1) Be registered with the Commission as a broker under Section 15(b) of the Exchange Act (15 U.S.C. 78*o*(b)) or as a funding portal in accordance with the requirements of § 227.400; and

(2) Be a member of the Financial Industry Regulatory Authority or any other applicable national securities association registered under Section 15A of the Exchange Act (15 U.S.C. 78*o*-3).

(b) *Prohibitions*. An intermediary and any director, officer or partner, or any person occupying a similar status or performing a similar function may not have a financial interest in an issuer that is offering or selling securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through the intermediary's platform, or receive a financial interest in an issuer as compensation for the services provided to or for the benefit of the issuer in connection with the offer or sale of such securities. For purposes of this paragraph, a *financial interest in an issuer* means a direct or indirect ownership of, or economic interest in, any class of the issuer's securities.

(c) *Definitions*. For purposes of Regulation Crowdfunding (§§ 227.100 *et seq.*):

(1) *Associated person of a funding portal* or *person associated with a funding portal* means any partner, officer, director or manager of a funding portal (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling or controlled by such funding portal, or any employee of a funding portal, except that any person associated with a funding portal whose functions are solely clerical or ministerial shall not be included in the meaning of such term for purposes of Section 15(b) of the Exchange Act (15 U.S.C. 78*o*(b)) (other than paragraphs (4) and (6) thereof).

(2) *Funding portal* means a broker acting as 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)), that does not:

(i) Offer investment advice or recommendations;

(ii) Solicit purchases, sales or offers to buy the securities displayed on its platform;

(iii) Compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its platform; or

(iv) Hold, manage, possess, or otherwise handle investor funds or securities.

(3) *Intermediary* means a broker registered under Section 15(b) of the Exchange Act (15 U.S.C. 78*o*(b)) or a funding portal registered under § 227.400 and includes, where relevant, an associated person of the registered broker or registered funding portal.

(4) *Investor* refers to any investor or any potential investor, as the context requires.

(5) *Self-regulatory organization* or *SRO* has the meaning as defined in Section 3(a)(26) of the Exchange Act (15 U.S.C. 78c(a)(26)), and includes the Financial Industry Regulatory Authority (FINRA) and any other national securities association registered with the Commission.

§ 227.301. Measures to reduce risk of fraud.

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) of the Securities Act (15 U.S.C. 77d(a)(6)) through the intermediary's platform complies with the requirements in Section 4A(b) of the Act (15 U.S.C. 77d-1(b)) and the related requirements in Regulation Crowdfunding (§§ 227.100 *et seq.*). In satisfying this requirement, an intermediary may rely on the representations of the issuer concerning compliance with these 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.

(c) Deny access to its platform to an issuer if the intermediary:

(1) Has a reasonable basis for believing that the issuer or any of its officers, directors (or any person occupying a similar status or performing a similar function) or beneficial owners of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power, is subject to a disqualification under § 227.503. In satisfying this requirement, an intermediary must, at a minimum, conduct a background and securities enforcement regulatory history check on each issuer whose securities are to be offered by the intermediary and on each officer, director or beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power.

(2) Believes that the issuer or the offering presents the potential for fraud or otherwise raises concerns regarding investor protection. In satisfying this requirement, an intermediary must deny access if it believes that it is unable to adequately or effectively assess the risk of fraud of the issuer or its potential offering. In addition, if an intermediary becomes aware of information after it has granted access that causes it to believe that the issuer or the offering presents the potential for fraud or otherwise raises concerns regarding investor protection, the intermediary must promptly remove the offering from its platform, cancel the offering, and

return (or, for funding portals, direct the return of) any funds that have been committed by investors in the offering.

§ 227.302. Account opening.

(a) *Accounts and Electronic Delivery.* (1) No intermediary or associated person of an intermediary may accept an investment commitment 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)) until the investor has opened an account with the intermediary and the intermediary has obtained from the investor consent to electronic delivery of materials.

(2) An intermediary must provide all information that is required to be provided by the intermediary under Subpart C (§§ 227.300-305), including, but not limited to, educational materials, notices and confirmations, through electronic means. Unless otherwise indicated in the relevant rule of Subpart C, in satisfying this requirement, an intermediary must provide the information through an electronic message that contains the information, through an electronic message that includes a specific link to the information as posted on intermediary's platform, or through an electronic message that provides notice of what the information is and that it is located on the intermediary's platform or on the issuer's website. Electronic messages include, but are not limited to, e-mail messages.

(b) *Educational Materials.* (1) In connection with establishing an account for an investor, an intermediary must deliver educational materials to such investor that explain in plain language and are otherwise designed to communicate effectively and accurately:

(i) The process for the offer, purchase and issuance of securities through the intermediary and the risks associated with purchasing securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6));

(ii) The types of securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) available for purchase on the intermediary's platform and the risks associated with each type of security, including the risk of having limited voting power as a result of dilution;

(iii) The restrictions on the resale of a security offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6));

(iv) The types of information that an issuer is required to provide under § 227.202, the frequency of the delivery of that information and the possibility that those obligations may terminate in the future;

(v) The limitations on the amounts an investor may invest pursuant to § 227.100(a)(2);

(vi) The limitations on an investor's right to cancel an investment commitment and the circumstances in which an investment commitment may be cancelled by the issuer;

(vii) The need for the investor to consider whether investing in a security offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) is appropriate for that investor; and

(viii) That following completion of an offering conducted through the intermediary, there may or may not be any ongoing relationship between the issuer and intermediary.

(2) An intermediary must make the most current version of its educational material available on its platform at all times and, if at any time, the intermediary makes a material revision to its educational materials, it must make the revised educational materials available to all investors before accepting any additional investment commitments or effecting any further transactions in securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

(c) *Promoters.* In connection with establishing an account for an investor, an intermediary must inform the investor that any person who promotes an issuer's offering for compensation, whether past or prospective, or who is a founder or an employee of an issuer that engages in promotional activities on behalf of the issuer on the intermediary's platform, must clearly disclose in all communications on the intermediary's platform, respectively, the receipt of the compensation and that he or she is engaging in promotional activities on behalf of the issuer.

(d) *Compensation Disclosure.* When establishing an account for an investor, an intermediary must clearly disclose the manner in which the intermediary is compensated in connection with offerings and sales of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

§ 227.303. Requirements with respect to transactions.

(a) *Issuer Information.* 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 make available to the Commission and to investors any information required to be provided by the issuer of the securities under §§ 227.201 and 203(a).

(1) This information must be made publicly available on the intermediary's platform, in a manner that reasonably permits a person accessing the platform to save, download, or otherwise store the information;

(2) This information must be made publicly available on the intermediary's platform for a minimum of 21 days before any securities are sold in the offering, during which time the intermediary may accept investment commitments;

(3) This information, including any additional information provided by the issuer, must remain publicly available on the intermediary's platform until the offer and sale of securities in

reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) is completed or cancelled; and

(4) An intermediary may not require any person to establish an account with the intermediary to access this information.

(b) *Investor Qualification.* Each time before accepting any investment commitment (including any additional investment commitment from the same person), an intermediary must:

(1) Have a reasonable basis for believing that the investor satisfies the investment limitations established by Section 4(a)(6)(B) of the Act (15 U.S.C. 77d(a)(6)(B)) and Regulation Crowdfunding (§§ 227.100 *et seq.*). An intermediary may rely on an investor's representations concerning compliance with the investment limitation requirements concerning the investor's annual income, net worth, and the amount of the investor's other investments made pursuant to Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) unless the intermediary has reason to question the reliability of the representation.

(2) Obtain from the investor:

(i) A representation that the investor has reviewed the intermediary's educational materials delivered pursuant to § 227.302(b), understands that the entire amount of his or her investment may be lost, and is in a financial condition to bear the loss of the investment; and

(ii) A questionnaire completed by the investor demonstrating the investor's understanding that:

(A) There are restrictions on the investor's ability to cancel an investment commitment and obtain a return of his or her investment;

(B) It may be difficult for the investor to resell securities acquired in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)); and

(C) Investing in securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) involves risk, and the investor should not invest any funds in an offering made in reliance on Section 4(a)(6) of the Securities Act unless he or she can afford to lose the entire amount of his or her investment.

(c) *Communication Channels.* An intermediary must provide on its platform communication channels by which persons can communicate with one another and with representatives of the issuer about offerings made available on the intermediary's platform, provided:

(1) If the intermediary is a funding portal, it does not participate in these communications other than to establish guidelines for communication and remove abusive or potentially fraudulent communications;

(2) The intermediary permits public access to view the discussions made in the communication channels;

(3) The intermediary restricts posting of comments in the communication channels to those persons who have opened an account with the intermediary on its platform; and

(4) The intermediary requires that any person posting a comment in the communication channels clearly and prominently disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or is otherwise compensated, whether in the past or prospectively, to promote the issuer's offering.

(d) *Notice of Investment Commitment.* An intermediary must promptly, upon receipt of an investment commitment from an investor, give or send to the investor a notification disclosing:

(1) The dollar amount of the investment commitment;

(2) The price of the securities, if known;

(3) The name of the issuer; and

(4) The date and time by which the investor may cancel the investment commitment.

(e) *Maintenance and Transmission of Funds.* (1) An intermediary that is a registered broker must comply with the requirements of 17 CFR 240.15c2-4.

(2) An intermediary that is a funding portal must direct investors to transmit the money or other consideration directly to a qualified third party that has agreed in writing to hold the funds for the benefit of, and to promptly transmit or return the funds to, the persons entitled thereto in accordance with paragraph (e)(3)of this section. For purposes of this Subpart C (§§ 227.300-305), a qualified third party means a bank that has agreed in writing either to hold the funds in escrow for the persons who have the beneficial interests therein and to transmit or return such funds directly to the persons entitled thereto when so directed by the funding portal as described in paragraph (e)(3)of this section, or to maintain a bank account (or accounts) for the exclusive benefit of investors and the issuer.

(3) A funding portal that is 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)) shall promptly direct the qualified third party to:

(i) Transmit funds from the qualified third party to the issuer when the aggregate amount of investment commitments from all investors is equal to or greater than the target amount of the offering and the cancellation period as set forth in § 227.304 has elapsed, *provided that* in no event may the funding portal direct this transmission of funds earlier than 21 days after the date on which the intermediary makes publicly available on its platform the information required to be provided by the issuer under §§ 227.201 and 203(a);

(ii) Return funds to an investor when an investment commitment has been cancelled in accordance with § 227.304 (including for failure to obtain effective reconfirmation as required under § 227.304(c)); and

(iii) Return funds to investors when an issuer does not complete the offering.

(f) *Confirmation of Transaction.* (1) An intermediary must, at or before the completion of a transaction in a security in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), give or send to each investor a notification disclosing:

(i) The date of the transaction;

(ii) The type of security that the investor is purchasing;

(iii) The identity, price, and number of securities purchased by the investor, as well as the number of securities sold by the issuer in the transaction and the price(s) at which the securities were sold;

(iv) If a debt security, the interest rate and the yield to maturity calculated from the price paid and the maturity date;

(v) If a callable security, the first date that the security can be called by the issuer; and

(vi) The source and amount of any remuneration received or to be received by the intermediary in connection with the transaction, including the amount and form of any remuneration that is received, or will be received, by the intermediary from persons other than the issuer.

(2) An intermediary satisfying the requirements of paragraph (1) of this section is exempt from the requirements of 17 CFR 240.10b-10 with respect to a transaction in a security offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

§ 227.304. Completion of offerings, cancellations and reconfirmations.

(a) *Generally.* An investor may cancel an investment commitment for any reason until 48 hours prior to the deadline identified in the issuer's offering materials. During the 48 hours prior to such deadline, an investment commitment may not be cancelled except as provided in paragraph (c) below.

(b) *Early Completion of Offering.* If an issuer reaches the target offering amount prior to the deadline identified in its offering materials pursuant to § 227.201(g), the issuer may close the offering on a date earlier than the deadline identified in its offering materials pursuant to § 227.201(g), *provided that:*

(1) The offering remains open for a minimum of 21 days pursuant to § 227.303(a);

(2) The intermediary provides notice to any potential investors, and gives or sends notice to investors that have made investment commitments in the offering, of:

(i) The new, anticipated deadline of the offering;

(ii) The right of investors to cancel investment commitments for any reason until 48 hours prior to the new offering deadline; and

(iii) Whether the issuer will continue to accept investment commitments during the 48-hour period prior to the new offering deadline.

(3) The new offering deadline is scheduled for and occurs at least five business days after the notice required in subpart (2) is provided; and

(4) At the time of the new offering deadline, the issuer continues to meet or exceed the target offering amount.

(c) *Cancellations and Reconfirmations Based on Material Changes.* (1) If there is a material change to the terms of an offering or to the information provided by the issuer, the intermediary must give or send to any investor who has made an investment commitment notice of the material change and that the investor's investment commitment will be cancelled unless the investor reconfirms his or her investment commitment within five business days of receipt of the notice. If the investor fails to reconfirm his or her investment within those five business days, the intermediary within five business days thereafter must:

(i) Give or send the investor a notification disclosing that the commitment was cancelled, the reason for the cancellation and the refund amount that the investor is expected to receive; and

(ii) Direct the refund of investor funds.

(2) If material changes to the offering or to the information provided by the issuer regarding the offering occur within five business days of the maximum number of days that an offering is to remain open, the offering must be extended to allow for a period of five business days for the investor to reconfirm his or her investment.

(d) *Return of Funds If Offering Is Not Completed.* If an issuer does not complete an offering, an intermediary must within five business days:

(1) Give or send each investor a notification of the cancellation, disclosing the reason for the cancellation, and the refund amount that the investor is expected to receive;

(2) Direct the refund of investor funds; and

(3) Prevent investors from making investment commitments with respect to that offering on its platform.

§ 227.305. Payments to third parties.

(a) *Prohibition on Payments for Personally Identifiable Information.* An intermediary may not compensate any person for providing the intermediary with the personally identifiable information of any investor or potential investor in securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

(b) *Certain permitted payments.* Subject to paragraph (a) of this section, an intermediary may compensate a person for directing issuers or potential investors to the intermediary's platform, *provided that* unless the compensation is made to a registered broker or dealer, the compensation is not based, directly or indirectly, on the purchase or sale of a security offered in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) on or through the intermediary's platform.

(c) For purposes of this rule, personally identifiable information means information that can be used to distinguish or trace an individual's identity, either alone or when combined with other personal or identifying information that is linked or linkable to a specific individual.

SUBPART D – Funding Portal Regulation

§227.400. Registration of funding portals.

(a) *Registration.* A funding portal must register with the Commission, by filing a complete Form Funding Portal (§ 249.1500 of this chapter) in accordance with the instructions on the form, and become a member of the Financial Industry Regulatory Authority or any other applicable national securities association registered under Section 15A of the Exchange Act (15 U.S.C. 78*o*-3). The registration will be effective the later of:

(1) 30 calendar days after the date that the registration is received by the Commission; or

(2) The date the funding portal is approved for membership by the Financial Industry Regulatory Authority or any other applicable national securities association registered under Section 15A of the Exchange Act (15 U.S.C. 78*o*-3).

(b) *Amendments to Registration.* A funding portal must file an amendment to Form Funding Portal (§ 249.1500 of this chapter) within 30 days of any of the information previously submitted on Form Funding Portal becoming inaccurate for any reason.

(c) *Successor Registration.* (1) If a funding portal succeeds to and continues the business of a registered funding portal, the registration of the predecessor will remain effective as the registration of the successor if the successor, within 30 days after such succession, files a registration on Form Funding Portal (§ 249.1500 of this chapter) and the predecessor files a withdrawal on Form Funding Portal; *provided, however,* that the registration of the predecessor funding portal will be deemed withdrawn 45 days after registration on Form Funding Portal is filed by the successor.

(2) Notwithstanding paragraph (c)(1) of this section, if a funding portal succeeds to and continues the business of a registered funding portal and the succession is based solely on a change of the predecessor's date or state of incorporation, form of organization, or composition of a partnership, the successor may, within 30 days after the succession, amend the registration of the predecessor on Form Funding Portal (§ 249.1500 of this chapter) to reflect these changes.

(d) *Withdrawal.* A funding portal must promptly file a withdrawal of registration on Form Funding Portal (§ 249.1500 of this chapter) in accordance with the instructions on the form upon ceasing to operate as a funding portal. Withdrawal will be effective on the later of 30 days after receipt by the Commission, after the funding portal is no longer operational, or within such longer period of time as to which the funding portal consents or which the Commission by order may determine as necessary or appropriate in the public interest or for the protection of investors.

(e) *Applications and Reports.* The applications and reports provided for in this section shall be considered filed when a complete Form Funding Portal (§ 249.1500 of this chapter) is submitted with the Commission or its designee. Duplicate originals of the applications and reports provided for in this section must be filed with surveillance personnel designated by any registered national securities association of which the funding portal is a member.

(f) *Fidelity Bond.* As a condition to becoming registered as a funding portal, the funding portal must have in place and thereafter maintain, for the duration of the period when it maintains such registration, fidelity bond coverage that:

(1) Has a minimum coverage of $100,000;

(2) Covers any associated person of the funding portal unless otherwise excepted in the rules set forth by the Financial Industry Regulatory Authority or any applicable national securities association that is registered under Section 15A of the Exchange Act (15 U.S.C. 78*o*-3) of which it is a member; and

(3) Meets any other applicable requirements as set forth by the Financial Industry Regulatory Authority or any applicable national securities association that is registered under Section 15A of the Exchange Act (15 U.S.C. 78*o*-3) of which it is a member.

(g) *Nonresident Funding Portals.* Registration pursuant to this section by a nonresident funding portal shall be conditioned upon there being an information sharing arrangement in place between the Commission and the competent regulator in the jurisdiction under the laws of which the nonresident funding portal is organized or where it has its principal place of business, that is applicable to the nonresident funding portal.

(1) *Definition.* For purposes of this section, the term *nonresident funding portal* shall mean a funding portal incorporated in or organized under the laws of a jurisdiction outside of the United States or its territories, or having its principal place of business in any place not in the United States or its territories.

(2) *Power of Attorney.* (i) Each nonresident funding portal registered or applying for registration pursuant to this section shall obtain a written consent and power of attorney appointing an agent in the United States, other than the Commission or a Commission member, official or employee, upon whom may be served any process, pleadings or other papers in any action. This consent and power of attorney must be signed by the nonresident funding portal and the named agent(s) for service of process.

(ii) Each nonresident funding portal registered or applying for registration pursuant to this section shall, at the time of filing its application on Form Funding Portal (§ 249.1500 of this chapter), furnish to the Commission the name and address of its United States agent for service of process on Schedule C to the Form.

(iii) Any change of a nonresident funding portal's agent for service of process and any change of name or address of a nonresident funding portal's existing agent for service of process shall be communicated promptly to the Commission through amendment of the Schedule C to Form Funding Portal (§ 249.1500 of this chapter).

(iv) Each nonresident funding portal must promptly appoint a successor agent for service of process if the nonresident funding portal discharges its identified agent for service of process or if its agent for service of process is unwilling or unable to accept service on behalf of the nonresident funding portal.

(v) Each nonresident funding portal must maintain, as part of its books and records, the written consent and power of attorney identified in paragraph (g)(2)(i) of this section for at least three years after the agreement is terminated.

(3) *Access to Books and Records.*

(i) *Certification and Opinion of Counsel.* Any nonresident funding portal applying for registration pursuant to this section shall certify on Schedule C to Form Funding Portal (§ 249.1500 of this chapter) and provide an opinion of counsel that the nonresident funding portal can, as a matter of law, provide the Commission and any national securities association of which it is a member with prompt access to the books and records of such nonresident funding portal and can, as a matter of law, submit to onsite inspection and examination by the Commission and any national securities association of which it is a member.

(ii) *Amendments.* The nonresident funding portal shall re-certify, on Schedule C to Form Funding Portal (§ 249.1500 of this chapter), within 90 days after any changes in the legal or regulatory framework that would impact the nonresident funding portal's ability to provide, or the manner in which it provides, the Commission, or any national securities association of which it is a member, with prompt access to its books and records or that would impact the Commission's or such national securities association's ability to inspect and examine the nonresident funding portal. The re-certification shall be accompanied by a revised opinion of counsel describing how, as a matter of law, the nonresident funding portal can continue to meet its obligations to provide the Commission and such national securities association with prompt access to its books and records and to be subject to Commission and national securities association inspection and examination under the new regulatory regime.

§ 227.401. Exemption.

(a) A funding portal that is registered with the Commission pursuant to § 227.400 is exempt from the broker registration requirements of Section 15(a)(1) of the Exchange Act (15 U.S.C. 78*o*(a)(1)) in connection with its activities as a funding portal.

(b) Notwithstanding paragraph (a) of this section, for purposes of 31 CFR chapter X, a funding portal is "required to be registered" as a broker or dealer with the Commission under the Exchange Act.

§ 227.402. Conditional safe harbor.

(a) *General.* Under Section 3(a)(80) of the Exchange Act (15 U.S.C. 78c(a)(80)), a funding portal acting as 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)) may not: offer investment advice or recommendations; solicit purchases, sales, or offers to buy the securities offered or displayed on its platform or portal; compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its platform or portal; hold, manage, possess, or otherwise handle investor funds or securities; or engage in such other activities as the Commission, by rule, determines appropriate. This section is intended to provide clarity with respect to the ability of a funding portal to engage in certain activities, consistent with the prohibitions under Section 3(a)(80) of the Exchange Act. No presumption shall arise that a funding portal has violated the prohibitions under Section 3(a)(80) of the Exchange Act or Regulation Crowdfunding (§§ 227.100 *et seq.*) by reason of the funding portal or its associated persons engaging in activities in connection with the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act that do not meet the conditions specified in paragraph (b) of this section. The antifraud provisions and all other applicable provisions of the federal securities laws continue to apply to the activities described in paragraph (b) of this section.

(b) *Permitted Activities.* A funding portal may, consistent with the prohibitions under Section 3(a)(80) of the Exchange Act (15 U.S.C. 78c(a)(80)) and Regulation Crowdfunding (§§ 227.100 *et seq.*):

(1) Apply objective criteria to limit the securities offered in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through the funding portal's platform where:

(i) The criteria are reasonably designed to result in a broad selection of issuers offering securities through the funding portal's platform, are applied consistently to all potential issuers and offerings and are clearly displayed on the funding portal's platform; and

(ii) The criteria may include, among other things, the type of securities being offered (for example, common stock, preferred stock or debt securities), the geographic location of the issuer and the industry or business segment of the issuer, *provided* that a funding portal may not deny access to an issuer based on the advisability of investing in the issuer or its offering, except to the extent described in paragraph (b)(10) of this section;

(2) Apply objective criteria to highlight offerings on the funding portal's platform where:

(i) The criteria are reasonably designed to highlight a broad selection of issuers offering securities through the funding portal's platform, are applied consistently to all issuers and offerings and are clearly displayed on the funding portal's platform;

(ii) The criteria may include, among other things, the type of securities being offered (for example, common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the number or amount of investment commitments made, progress in meeting the issuer's target offering amount or, if applicable, the maximum offering amount; and the minimum or maximum investment amount; *provided* that a funding portal may not highlight an issuer or offering based on the advisability of investing in the issuer or its offering; and

(iii) The funding portal does not receive special or additional compensations for highlighting one or more issuers or offerings on its platform;

(3) Provide search functions or other tools that investors can use to search, sort, or categorize the offerings available through the funding portal's platform according to objective criteria where;

(i) The objective criteria may include, among other things, the type of securities being offered (for example, common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the number or amount of investment commitments made, progress in meeting the issuer's target offering amount or, if applicable, the maximum offering amount; and the minimum or maximum investment amount; and

(ii) The objective criteria may not include, among other things, the advisability of investing in the issuer or its offering, or an assessment of any characteristic of the issuer, its business plan, its key management or risks associated with an investment.

(4) Provide communication channels by which investors can communicate with one another and with representatives of the issuer through the funding portal's platform about offerings through the platform, so long as the funding portal (and its associated persons):

(i) Does not participate in these communications, other than to establish guidelines for communication and remove abusive or potentially fraudulent communications;

(ii) Permits public access to view the discussions made in the communication channels;

(iii) Restricts posting of comments in the communication channels to those persons who have opened an account on its platform; and

(iv) Requires that any person posting a comment in the communication channels clearly disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or is otherwise compensated, whether in the past or prospectively, to promote an issuer's offering;

(5) Advise an issuer about the structure or content of the issuer's offering, including assisting the issuer in preparing offering documentation;

(6) Compensate a third party for referring a person to the funding portal, so long as the third party does not provide the funding portal with personally identifiable information of any potential investor, and the compensation, other than that paid to a registered broker or dealer, is not based, directly or indirectly, on the purchase or sale of a security in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) offered on or through the funding portal's platform;

(7) Pay or offer to pay any compensation to a registered broker or dealer for services in connection with the offer or sale of securities by the funding portal in reliance on Section 4(a)(6) of the Act(15 U.S.C. 77d(a)(6)), provided that:

(i) Such services are provided pursuant to a written agreement between the funding portal and the registered broker or dealer;

(ii) Such compensation is permitted under Regulation Crowdfunding (§§ 227.100 *et seq.*) and is not otherwise prohibited under § 227.305; and

(iii) Such compensation complies with and is not prohibited by the rules of any registered national securities association of which the funding portal is required to be a member;

(8) Receive any compensation from a registered broker or dealer for services provided by the funding portal in connection with the offer or sale of securities by the funding portal in reliance on Section 4(a)(6) of the Act (15 U.S.C. 77d(a)(6)), provided that:

(i) Such services are provided pursuant to a written agreement between the funding portal and the registered broker or dealer;

(ii) Such compensation is permitted under Regulation Crowdfunding (§§ 227.100 *et seq.*); and

(iii) Such compensation complies with and is not prohibited by the rules of any registered national securities association of which the funding portal is required to be a member;

(9) Advertise the existence of the funding portal and identify one or more issuers or offerings available on the portal on the basis of objective criteria, as long as:

(i) The criteria are reasonably designed to identify a broad selection of issuers offering securities through the funding portal's platform, and are applied consistently to all potential issuers and offerings;

(ii) The criteria may include, among other things, the type of securities being offered (for example, common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the expressed interest by investors, as measured by number or amount of investment commitments made, progress in meeting the issuer's target offering amount or, if applicable, the maximum offering amount; and the minimum or maximum investment amount; and

(iii) The funding portal does not receive special or additional compensation for identifying the issuer or offering in this manner;

(10) Deny access to its platform to, or cancel an offering of, an issuer that the funding portal believes may present the potential for fraud or otherwise raises investor protection concerns;

(11) Accept, on behalf of an issuer, an investment commitment for securities offered in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) by that issuer on the funding portal's platform;

(12) Direct investors where to transmit funds or remit payment in connection with the purchase of securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)); and

(13) Direct a qualified third party, as required by § 227.303(e), to release proceeds to an issuer upon completion of a crowdfunding offering or to return proceeds to investors in the event an investment commitment or an offering is cancelled.

§ 227.403. Compliance.

(a) *Policies and Procedures.* A funding portal must implement written policies and procedures reasonably designed to achieve compliance with the federal securities laws and the rules and regulations thereunder relating to its business as a funding portal.

(b) *Anti-Money Laundering.* A funding portal must comply with the requirements of 31 CFR chapter X applicable to registered brokers.

(c) *Privacy.* A funding portal must comply with the requirements of 17 CFR 248 as they apply to brokers.

(d) *Inspections and Examinations.* A funding portal shall permit the examination and inspection of all of its business and business operations that relate to its activities as a funding portal, such as its premises, systems, platforms, and records by representatives of the Commission and of the national securities association of which it is a member.

§ 227.404. Records to be made and kept by funding portals.

(a) *Generally.* A funding portal shall make and preserve the following records for five years, the first two years in an easily accessible place:

(1) All records related to an investor who purchases or attempts to purchase securities through the funding portal;

(2) All records related to issuers who offer and sell or attempt to offer and sell securities through the funding portal and the control persons of such issuers;

(3) Records of all communications that occur on or through its platform;

(4) All records related to persons that use communication channels provided by a funding portal to promote an issuer's securities or communicate with potential investors;

(5) All records required to demonstrate compliance with the requirements of Subparts C (§§ 227.300-305) and D (§§ 227.400-404);

(6) All notices provided by such funding portal to issuers and investors generally through the funding portal's platform or otherwise, including, but not limited to, notices addressing hours of funding portal operations (if any), funding portal malfunctions, changes to funding portal procedures, maintenance of hardware and software, instructions pertaining to access to the funding portal and denials of, or limitations on, access to the funding portal;

(7) All written agreements (or copies thereof) entered into by such funding portal relating to its business as such;

(8) All daily, monthly and quarterly summaries of transactions effected through the funding portal, including:

(i) Issuers for which the target offering amount has been reached and funds distributed; and

(ii) Transaction volume, expressed in:

(A) Number of transactions;

(B) Number of securities involved in a transaction;

(C) Total amounts raised by, and distributed to, issuers; and

(D) Total dollar amounts raised across all issuers, expressed in U.S. dollars; and

(9) A log reflecting the progress of each issuer who offers or sells securities through the funding portal toward meeting the target offering amount.

(b) *Organizational Documents.* A funding portal shall make and preserve during the operation of the funding portal and of any successor funding portal, all organizational documents relating to the funding portal, including but not limited to, partnership agreements, articles of incorporation or charter, minute books and stock certificate books (or other similar type documents).

(c) *Format.* The records required to be maintained and preserved pursuant to paragraph (a) of this section must be produced, reproduced, and maintained in the original, non-alterable format in which they were created or as permitted under 17 CFR §240.17a-4(f).

(d) *Third Parties.* The records required to be made and preserved pursuant to this section may be prepared or maintained by a third party on behalf of a funding portal. An agreement with a third party shall not relieve a funding portal from the responsibility to prepare and maintain records as specified in this rule. A funding portal must file with the registered national securities association of which it is a member, a written undertaking in a form acceptable to the registered national securities association, signed by a duly authorized person of the third party, stating in effect that such records are the property of the funding portal and will be surrendered promptly on request of the funding portal. The undertaking shall include the following provision:

> With respect to any books and records maintained or preserved on behalf of [name of funding portal], the undersigned hereby acknowledges that the books and records are the property of [name of funding portal], and hereby undertakes to permit examination of such books and records at any time, or from time to time, during business hours by representatives of the Securities and Exchange Commission and the national securities association of which the funding portal is a member, and to promptly furnish to the Commission, and the national securities association of which the funding portal is a member, a true, correct, complete and current hard copy of any, all, or any part of, such books and records.

(e) *Review of Records.* All records of a funding portal are subject at any time, or from time to time, to reasonable periodic, special, or other examination by the representatives of the Commission and the national securities association of which a funding portal is a member.

(f) *Financial Recordkeeping and Reporting of Currency and Foreign Transactions.* Every funding portal, as it is subject to the requirements of the Currency and Foreign Transactions Reporting Act of 1970 (15 U.S.C. 5311 *et seq.*), shall comply with the reporting, recordkeeping and record retention requirements of 31 CFR chapter X. Where 31 CFR chapter X and §§ 227.404(a) and 404(b) require the same records or reports to be preserved for different periods of time, such records or reports shall be preserved for the longer period of time.

SUBPART E – Miscellaneous Provisions

§ 227.501. Restrictions on resales.

(a) Securities issued in a transaction exempt from registration pursuant to Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) may not be transferred by the purchaser of such securities during the one-year period beginning on the date of purchase, unless such securities are transferred:

(1) To the issuer of the securities;

(2) To an accredited investor;

(3) As part of an offering registered with the Commission; or

(4) To a member of the family of the purchaser or the equivalent, to a trust controlled by the purchaser, to a trust created for the benefit of a member of the family of the purchaser or the equivalent, or in connection with the death or divorce of the purchaser or other similar circumstance.

(b) For purposes of this § 227.501, the term *accredited investor* shall have the same meaning given to such term in 17 CFR 230.501. To transfer securities to an accredited investor during the one-year period beginning on the date the securities were issued in a transaction exempt from registration pursuant to Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), the seller shall reasonably believe that the person receiving such securities is an accredited investor.

(c) For purposes of this section, the term *member of the family of the purchaser or the equivalent* includes a child, stepchild, grandchild, parent, stepparent, grandparent, spouse or spousal equivalent, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of the purchaser, and shall include adoptive relationships.

Instruction to paragraph (c). For purposes of this paragraph (c), the term *spousal equivalent* means a cohabitant occupying a relationship generally equivalent to that of a spouse.

§ 227.502. Insignificant deviations from a term, condition or requirement of Regulation Crowdfunding.

(a) A failure to comply with a term, condition, or requirement of Regulation Crowdfunding (§§ 227.100 *et seq.*) will not result in the loss of the exemption from the requirements of Section 5 of the Securities Act (15 U.S.C. 77e) for any offer or sale to a particular individual or entity, if the issuer relying on the exemption shows:

(1) The failure to comply was insignificant with respect to the offering as a whole;

(2) The issuer made a good faith and reasonable attempt to comply with all applicable terms, conditions and requirements of Regulation Crowdfunding (§§ 227.100 *et seq.*); and

(3) The issuer did not know of such failure where the failure to comply with a term, condition or requirement of Regulation Crowdfunding (§§ 227.100 *et seq.*) was the result of the failure of the intermediary to comply with the requirements of Section 4A(a) of the Securities Act (15 U.S.C. 77d-1(a)) and the related rules, or such failure by the intermediary occurred solely in offerings other than the issuer's offering.

(b) Notwithstanding the issuer's reliance on paragraph (a) of this section, the Commission may bring an enforcement action seeking any appropriate relief for the issuer's failure to comply with all applicable terms, conditions and requirements of Regulation Crowdfunding (§§ 227.100 *et seq.*).

§ 227.503. Disqualification

(a) No exemption under this Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) shall be available for a sale of securities if the issuer; any predecessor of the issuer; any affiliated issuer; any director, officer, general partner or managing member of the issuer; any beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power; any promoter connected with the issuer in any capacity at the time of such sale; any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with such sale of securities; or any general partner, director, officer or managing member of any such solicitor:

(1) Has been convicted, within 10 years before the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)) (or five years, in the case of issuers, their predecessors and affiliated issuers), of any felony or misdemeanor:

(i) In connection with the purchase or sale of any security;

(ii) Involving the making of any false filing with the Commission; or

(iii) Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;

(2) Is subject to any order, judgment or decree of any court of competent jurisdiction, entered within five years before the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)) that, at the time of such filing, restrains or enjoins such person from engaging or continuing to engage in any conduct or practice:

(i) In connection with the purchase or sale of any security;

(ii) Involving the making of any false filing with the Commission; or

(iii) Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;

(3) Is subject to a final order of a state securities commission (or an agency or officer of a state performing like functions); a state authority that supervises or examines banks, savings associations or credit unions; a state insurance commission (or an agency or officer of a state performing like functions); an appropriate federal banking agency; the U.S. Commodity Futures Trading Commission; or the National Credit Union Administration that:

(i) At the time of the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)), bars the person from:

(A) Association with an entity regulated by such commission, authority, agency or officer;

(B) Engaging in the business of securities, insurance or banking; or

(C) Engaging in savings association or credit union activities; or

(ii) Constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct and for which the order was entered within the 10-year period ending on the date of the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b));

Instruction to paragraph (a)(3). Final order shall mean a written directive or declaratory statement issued by a federal or state agency, described in § 227.503(a)(3), under applicable statutory authority that provides for notice and an opportunity for hearing, which constitutes a final disposition or action by that federal or state agency.

(4) Is subject to an order of the Commission entered pursuant to Section 15(b) or 15B(c) of the Exchange Act (15 U.S.C. 78*o*(b) or 78*o*-4(c)) or Section 203(e) or (f) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(e) or (f)) that, at the time of the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)):

(i) Suspends or revokes such person's registration as a broker, dealer, municipal securities dealer or investment adviser;

(ii) Places limitations on the activities, functions or operations of such person; or

(iii) Bars such person from being associated with any entity or from participating in the offering of any penny stock;

(5) Is subject to any order of the Commission entered within five years before the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)) that, at the time of such filing, orders the person to cease and desist from committing or causing a violation or future violation of:

(i) Any scienter-based anti-fraud provision of the federal securities laws, including without limitation Section 17(a)(1) of the Securities Act (15 U.S.C. 77q(a)(1)), Section 10(b) of the Exchange Act (15 U.S.C. 78j(b)) and 17 CFR 240.10b-5, Section 15(c)(1) of the Exchange Act (15 U.S.C. 78o(c)(1)) and Section 206(1) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-6(1)) or any other rule or regulation thereunder; or

(ii) Section 5 of the Securities Act (15 U.S.C. 77e);

(6) Is suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or a registered national or affiliated securities association for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade;

(7) Has filed (as a registrant or issuer), or was or was named as an underwriter in, any registration statement or Regulation A (17 CFR 230.251 *et seq.*) offering statement filed with the Commission that, within five years before the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)), was the subject of a refusal order, stop order, or order suspending the Regulation A exemption, or is, at the time of such filing, the subject of an investigation or proceeding to determine whether a stop order or suspension order should be issued; or

(8) Is subject to a United States Postal Service false representation order entered within five years before the filing of the information required by Section 4A(b) of the Securities Act (15

U.S.C. 77d-1(b)), or is, at the time of such filing, subject to a temporary restraining order or preliminary injunction with respect to conduct alleged by the United States Postal Service to constitute a scheme or device for obtaining money or property through the mail by means of false representations.

(b) Paragraph (a) of this section shall not apply:

(1) With respect to any conviction, order, judgment, decree, suspension, expulsion or bar that occurred or was issued before [effective date of final rule];

(2) Upon a showing of good cause and without prejudice to any other action by the Commission, if the Commission determines that it is not necessary under the circumstances that an exemption be denied;

(3) If, before the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)), the court or regulatory authority that entered the relevant order, judgment or decree advises in writing (whether contained in the relevant judgment, order or decree or separately to the Commission or its staff) that disqualification under paragraph (b) of this section should not arise as a consequence of such order, judgment or decree;

(4) If the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed under paragraph (b) of this section.

Instruction to paragraph (b)(4). An issuer will not be able to establish that it has exercised reasonable care unless it has made factual inquiry into whether any disqualifications exist. The nature and scope of the factual inquiry will vary based on the facts and circumstances concerning, among other things, the issuer and the other offering participants.

(c) For purposes of paragraph (a) of this section, events relating to any affiliated issuer that occurred before the affiliation arose will be not considered disqualifying if the affiliated entity is not:

(1) In control of the issuer; or

(2) Under common control with the issuer by a third party that was in control of the affiliated entity at the time of such events.

(d) A person that is subject to a statutory disqualification as defined in Section 3(a)(39) of the Exchange Act (15 U.S.C. 78c(a)(39)) may not act as, or be an associated person of, 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)) unless so permitted pursuant to Commission rule or order.

Instruction to paragraph (d). 17 CFR 240.17f-2 generally requires the fingerprinting of every person who is a partner, director, officer or employee of a broker, subject to certain exceptions.

* * * * *

PART 232 – REGULATION S-T – GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

4. The authority citation for part 232 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77z-3, 77sss(a), 78c(b), 781, 78m, 78n, 78o(d), 78w(a), 78ll, 80a-6(c), 80a-8, 80a-29, 80a-30, 80a-37, and 7201 et seq.; and 18 U.S.C. 1350.

* * * * *

5. Amend §232.101(a)(1):

a. In paragraph (xii) removing "and" at the end of the paragraph;

b. In paragraph (xiii) removing the period at the end of the paragraph and adding in its place a semicolon;

c. In paragraph (xvi) removing the period at the end of the paragraph and adding in its place "; and"; and

d. Adding paragraph (xvii).

The addition reads as follows:

§ 232.101 Mandated electronic submissions and exceptions.

(a) * * *

(1) * * *

(xvii) Form C (§239.900 of this chapter).

* * * * *

PART 239 – FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

6. The authority citation for part 239 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78o-7 note, 78u-5, 78w(a), 78ll, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

* * * * *

7. Add § 239.900 to read as follows:

§ 239.900 Form C.

This form shall be used for filings under Regulation Crowdfunding (§§ 227.100 *et seq.*).

Note: The text of Form C will not appear in the Code of Federal Regulations.

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM C

UNDER THE SECURITIES ACT OF 1933

[ ] Form C: Offering Statement
[ ] Form C-U: Progress Update: ______________________
[ ] Form C-A: Amendment
[ ] Check box if Amendment is material and investors will have five business days to reconfirm
[ ] Form C-AR: Annual Report
[ ] Form C-TR: Termination of Reporting

Name of issuer: ______________________
Legal status of issuer (form, jurisdiction and date of organization): ______________
Physical address of issuer: ______________________
Website of issuer: ______________________
Name, Commission file number and CRD number (as applicable) of intermediary through which the offering will be conducted:

____

Amount of compensation paid to the intermediary, including referral and other fees: ________
Type of security offered: ______________________
Number of securities to be offered: ______________________
Price (or method for determining price): ______________________
Target offering amount: ______________________
Maximum offering amount (if different from target offering amount): ______________
Oversubscriptions accepted: [ ] Yes [ ] No If yes, disclose how oversubscriptions will be allocated: [ ] Pro-rata basis [ ] First-come, first-served basis [ ] Other – provide a description

____

Deadline to reach the target offering amount: ______________________
Current number of employees: ______________________

Total Assets:	Most recent fiscal year: ________	Prior fiscal year: ________
Cash & Cash Equivalents:	Most recent fiscal year: ________	Prior fiscal year: ________
Accounts Receivable:	Most recent fiscal year: ________	Prior fiscal year: ________
Short-term Debt:	Most recent fiscal year: ________	Prior fiscal year: ________
Long-term Debt:	Most recent fiscal year: ________	Prior fiscal year: ________
Revenues/Sales:	Most recent fiscal year: ________	Prior fiscal year: ________
Cost of Goods Sold:	Most recent fiscal year: ________	Prior fiscal year: ________
Taxes Paid:	Most recent fiscal year: ________	Prior fiscal year: ________
Net Income:	Most recent fiscal year: ________	Prior fiscal year: ________

GENERAL INSTRUCTIONS

I. Eligibility Requirements for Use of Form C

This Form shall be filed by any issuer offering or selling securities in reliance on the exemption in Securities Act Section 4(a)(6) and in accordance with Section 4A and Regulation Crowdfunding (§ 227.100-503). This Form also shall be used for an annual report required pursuant to Rule 202 of Regulation Crowdfunding (§ 227.202) and for the termination of reporting required pursuant to Rule 203(b)(2) of Regulation Crowdfunding (§ 227.203(b)(2)). Careful attention should be directed to the terms, conditions and requirements of the exemption.

II. Preparation and Filing of Form C

Information on the cover page will be generated based on the information provided in XML format. Other than the cover page, this Form is not to be used as a blank form to be filled in, but only as a guide in the preparation of Form C. General information regarding the preparation, format and how to file this Form is contained in Regulation S-T, (§ 232 *et seq.*).

III. Information to be Included in the Form

Item 1. Offering Statement Disclosure Requirements

An issuer filing this Form for an offering in reliance on Section 4(a)(6) of the Securities Act and pursuant to Regulation Crowdfunding (§ 227.100-503) must file the Form prior to the commencement of the offering and include the information required by Rule 201 of Regulation Crowdfunding (§ 227.201).

Other than the information required to be provided in XML format, an issuer may provide the required information in the format included on the intermediary's platform, including by submitting copies of screen shots of the relevant information, as appropriate and necessary.

Item 2. Legends

(a) An issuer filing this Form for an offering in reliance on Section 4(a)(6) of the Securities Act and pursuant to Regulation Crowdfunding (§ 227.100-503) must include the following legends:

> A crowdfunding investment involves a risk. You should not invest any funds in this offering unless you can afford to lose your entire investment.
>
> In making an investment decision, investors must rely on their own examination of the issuer and the terms of the offering, including the merits and risks involved. These securities have not been recommended or approved by any federal or state securities commission or regulatory authority. Furthermore, these authorities have not passed upon the accuracy or adequacy of this document.
>
> The U.S. Securities and Exchange Commission does not pass upon the merits of any securities offered or the terms of the offering, nor does it pass upon the accuracy or completeness of any offering document or literature.
>
> These securities are offered under an exemption from registration; however, the U.S. Securities and Exchange Commission has not made an independent determination that these securities are exempt from registration.

(b) An issuer filing this Form for an offering in reliance on Section 4(a)(6) of the Securities Act and pursuant to Regulation Crowdfunding (§ 227.100-503) must disclose in the offering statement that it will file a report on EDGAR annually and post the report on its website, no later than 120 days after the end of each fiscal year covered by the report. The issuer must also disclose how an issuer may terminate its reporting obligations in the future in accordance with Rule 202(b) of Regulation Crowdfunding (§ 227.202(b)).

Item 3. Annual Report Disclosure Requirements

An issuer filing this Form for an annual report, as required by Regulation Crowdfunding (§ 227.100-503), must file the Form no later than 120 days after the issuer's fiscal year end covered by the report and include the information required by Rule 201(a), (b), (c), (d), (e), (f), (m), (p), (q), (r), (s), and (t) of Regulation Crowdfunding (§§ 227.201(a), (b), (c), (d), (e), (f), (m), (p), (q), (r), (s), and (t)). For purposes of paragraph (t), the issuer shall provide financial statements for the highest aggregate target offering amount previously provided in an offering statement.

SIGNATURE

Pursuant to the requirements of Sections 4(a)(6) and 4A of the Securities Act of 1933 and Regulation Crowdfunding (§ 227.100-503), the issuer certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form C and has duly caused this Form to be signed on its behalf by the duly authorized undersigned.

____
(Issuer)

By

____
(Signature and Title)

Pursuant to the requirements of Sections 4(a)(6) and 4A of the Securities Act of 1933 and Regulation Crowdfunding (§ 227.100-503), this Form C has been signed by the following persons in the capacities and on the dates indicated.

____
(Signature)

____
(Title)

____
(Date)

Instructions.

1. The form shall be signed by the issuer, its principal executive officer or officers, its principal financial officer, its controller or principal accounting officer and at least a majority of the board of directors or persons performing similar functions.

2. The name of each person signing the form shall be typed or printed beneath the signature.

PART 240 - GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

8. The authority citation for part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 et. seq., and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111-203, 939A, 124 Stat. 1376, (2010), unless otherwise noted.

9. Add § 240.12g-6 to read as follows:

§ 240.12g-6 Exemption for securities issued pursuant to Section 4(a)(6) of the Securities Act of 1933.

For purposes of determining whether an issuer is required to register a security with the Commission pursuant to Section 12(g)(1) of the Act (15 U.S.C. 78*l*(g)(1)), the definition of *held of record* shall not include securities issued pursuant to the offering exemption under Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

* * * * *

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

10. The authority citation for part 249 continues to read, in part, as follows:

Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; 12 U.S.C. 5461 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

11. Add § 249.1500 to read as follows:

§ 249.1500 Form Funding Portal

This form shall be used for filings by funding portals under Regulation Crowdfunding (§§ 227.100 *et seq.*).

Note: The text of Form Funding Portal will not appear in the Code of Federal Regulations.

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM FUNDING PORTAL

UNDER THE SECURITIES EXCHANGE ACT OF 1934

WARNING: Failure to complete this form truthfully, to keep this form current and to file accurate supplementary information on a timely basis, or the failure to keep accurate books and records or otherwise to comply with the provisions of law applying to the conduct of business as a funding portal, would violate the Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

Check the appropriate box:
This is:

- ☐ an initial application to register as a *funding portal* with the *SEC*.
- ☐ an amendment to any part of the *funding portal's* most recent Form Funding Portal, including a successor registration.
- ☐ a withdrawal of the *funding portal's* registration with the *SEC*.

Schedule A must be completed as part of all initial applications. Amendments to Schedule A must be provided on Schedule B.

Item 1 – Identifying Information

Exact name, principal business address, mailing address, if different, and telephone number of the funding portal:

A. Full name of the funding portal: ______________________________

B. Name(s) under which business is conducted, if different from Item 1A:

____

C. IRS Empl. Ident. No.: ______________________

D. If full legal name has changed since the *funding portal*'s most recent Form Funding Portal, enter the previous name and specify whether the name change is of the □ *funding portal* name (1A), or □ *business name* (1B).

Previous name: ______________________________

E. Funding portal's main street address (Do not use a P.O. Box):

____

____

F. Mailing address(es) (if different) and office locations (if more than one) :

____

____

G. Contact Information
Telephone Number:________________
Facsimile number: ________________
Website(s) URL: ________________
E-mail:______________________

H. Contact employee
Name:__________________________
Title:__________________________
Direct Telephone Number: ______________
Facsimile:______________________
Direct E-mail:____________________

I. Registrations

Was the *applicant* previously registered on Form Funding Portal as a *funding portal* or with the Commission in any other capacity?

□ Yes SEC File No. _________
□ No

J. Foreign registrations

1. Is the *applicant* registered with a foreign financial regulatory authority? Answer "no" even if affiliated with a business that is registered with a foreign financial regulatory authority.

□Yes □No

If "yes," complete Section J.2. below.

2. List the name, in English, of each *foreign financial regulatory authority* and country with which the *applicant* is registered. A separate entry must be completed for each *foreign financial regulatory authority* with which the *applicant* is registered.

Check only one box: ☐ Add ☐ Delete ☐ Amend

English Name of *Foreign Financial Regulatory Authority*

____

Registration Number (if any) ____

Name of Country ____

Item 2 – Form of Organization

A. Indicate legal status of *applicant*. __Corporation __Sole Proprietorship
__ Partnership __Limited Liability Company
__Other (specify) ____________________

B. If other than a sole proprietor, indicate date and place *applicant* obtained its legal status (*i.e.*, state or country where incorporated, where partnership agreement was filed, or where *applicant* entity was formed):

State/Country of formation______________________
Date of Formation____________________________

Item 3 – Successions

A. Is the *applicant* at the time of this filing succeeding to the business of a currently registered funding portal?

□ Yes □ No

Do not report previous successions already reported on Form Funding Portal.
If "yes," complete Section 3.B. below.

B. Complete the following information if succeeding to the business of a currently-registered *funding portal*. If the *applicant* acquired more than one *funding portal* in the succession being reported on this Form Funding Portal, a separate entry must be completed for each acquired firm.

Check only one box: ☐ Add ☐ Delete ☐ Amend

Name of Acquired *Funding Portal*

____

Acquired *Funding Portal*'s *SEC* File No.: ______

A. Briefly describe details of the *succession* including any assets or liabilities not assumed by the *successor*.

____

Item 4 – Control Persons

In this Item, identify every *person* that, directly or indirectly, *controls* the *applicant*, *controls* management or policies of the *applicant*, or that the *applicant* directly or indirectly *controls*.

____

____

If this is an initial application, the applicant also must complete Schedule A. Schedule A asks for information about direct owners and executive officers. If this is an amendment updating information reported on the Schedule A filed with the applicant's initial application, the applicant must complete Schedule B.

Item 5 – Disclosure Information

In this Item, provide information about the *applicant*'s disciplinary history and the disciplinary history of all associated persons of the *applicant*. This information is used to determine whether to approve an application for registration, to decide whether to revoke registration, to place limitations on the *applicant*'s activities as a funding portal, and to identify potential problem areas on which to focus during examinations. One event may result in the requirement to answer "yes" to more than one of the questions below.

If the answer is "yes" to any question in this Item, the *applicant* must complete the appropriate Disclosure Reporting Page ("DRP") – Criminal, Regulatory, Civil Judicial, Bankruptcy, Bond, Judgment – for which the corresponding DRP will pop-up automatically.

A. Criminal Action Disclosure

If the answer is "yes" to any question in Part A or B below, complete a Criminal Action DRP.

Check all that apply:

1. In the past ten years, has the *applicant* or any *associated person*:

(a) been convicted of any *felony*, or pled guilty or nolo contendere ("no contest") to any *charge* of a *felony*, in a domestic, foreign, or military court?

□Yes □ No

The response to the following question may be limited to charges that are currently pending:

(b) been *charged* with any *felony*?

□Yes □No

2. In the past ten years, has the *applicant* or any *associated person*:

(a) been convicted of any misdemeanor, or pled guilty or nolo contendere ("no contest"), in a domestic, foreign, or military court to any charge of a misdemeanor in a case involving: investment-related business, or any fraud, false statements, or omissions, wrongful taking of property, bribery, perjury, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses?

□Yes □No

The response to the following question may be limited to charges that are currently pending:

(b) been charged with a misdemeanor listed in Item 5-A(2)(a)?

□Yes □No

B. Regulatory Action Disclosure

If the answer is "yes" to any question in Item 5-B below, complete a Regulatory Action DRP.

Check all that apply:

1. Has the *SEC* or the Commodities Futures Trading Commission ("CFTC") ever:

(a) *found* the *applicant* or any *associated person* to have made a false statement or omission?

□Yes □No

(b) *found* the *applicant* or any *associated person* to have been *involved* in a violation of any *SEC* or *CFTC* regulation or statute?

□Yes □No

(c) *found* the *applicant* or any *associated person* to have been a cause of the denial, suspension, revocation, or restriction of the authorization of an *investment related* business to operate?

□Yes □No

(d) entered an *order* against the *applicant* or any *associated person* in connection with *investment-related* activity?

□Yes □No

(e) imposed a civil money penalty on the *applicant* or any *associated person*, or *ordered* the *applicant* or any *associated person* to cease and desist from any activity?

□Yes □No

2. Has any other federal regulatory agency, any state regulatory agency, or any *foreign financial regulatory authority*:

(a) ever *found* the *applicant* or any *associated person* to have made a false statement or omission, or been dishonest, unfair, or unethical?

□Yes □No

(b) ever *found* the *applicant* or any *associated person* to have been *involved* in a violation of *investment-related* regulations or statutes?

□Yes □No

(c) ever *found* the *applicant* or any *associated person* to have been the cause of a denial, suspension, revocation, or restriction of the authorization of an *investment-related* business to operate?

□Yes □No

(d) in the past ten years entered an *order* against the *applicant* or any *associated person* in connection with an *investment-related* activity?

□Yes □No

(e) ever denied, suspended, or revoked the registration or license of the *applicant* or that of any associated person, or otherwise prevented the *applicant* or any associated person of the *applicant*, by order, from associating with an investment-related business or restricted the activities of the *applicant* or any *associated person*?

□Yes □No

3. Has any self-regulatory organization or commodities exchange ever:

(a) found the *applicant* or any *associated person* to have made a false statement or omission?

□Yes □No

(b) found the *applicant* or any *associated person* to have been *involved* in a violation of its rules (other than a violation designated as a "minor rule violation" under a plan approved by the *SEC*)?

□Yes □No

(c) found the *applicant* or any *associated person* to have been the cause of a denial, suspension, revocation or restriction of the authorization of an *investment-related* business to operate?

□Yes □No

(d) disciplined the *applicant* or any *associated person* by expelling or suspending the *applicant* or the *associated person* from membership, barring or suspending the *applicant* or *the associated person* from association with other members, or by otherwise restricting the activities of the *applicant* or the *associated person*?

□Yes □No

4. Has the *applicant* or any *associated person* ever had an authorization to act as an attorney, accountant, or federal contractor revoked or suspended?

□Yes □No

5. Is the *applicant* or any *associated person* currently the subject of any regulatory *proceeding* that could result in a "yes" answer to any part of Item 5-B(1), 5-B(2), or 5-B(3)?

□Yes □No

C. Civil Judicial Disclosure

If the answer is "yes" to a question below, complete a Civil Judicial Action DRP

Check all that apply:

1. Has any domestic or foreign court:

(a) in the past ten years *enjoined* the *applicant* or any *associated person* in connection with any *investment-related* activity?

□Yes □No

(b) ever *found* that the *applicant* or any *associated person* was *involved* in a violation of *investment-related* statutes or regulations?

□Yes □No

(c) ever dismissed, pursuant to a settlement agreement, an *investment-related* civil action brought against the *applicant* or any *associated person* by a state or *foreign financial regulatory authority*?

□Yes □No

2. Is the *applicant* or any *associated person* now the subject of any civil *proceeding* that could result in a "yes" answer to any part of Item 5-C(1)?

□Yes □No

3. In the past ten years, has the *applicant* or a *control affiliate* of the *applicant* ever been a securities firm or a *control affiliate* of a securities firm that:

(a) has been the subject of a bankruptcy petition?

□Yes □No

(b) has had a trustee appointed or a direct payment procedure initiated under the Securities Investor Protection Act?

□Yes □No

4. Has a bonding company ever denied, paid out on, or revoked a bond for the *applicant*?

□Yes □No

5. Does the *applicant* have any unsatisfied judgments or liens against it?

□Yes □No

Item 6 – Non-Securities Related Business

Does *applicant* engage in any non-securities related business?

□Yes □No

If "yes," briefly describe the non-securities business.

____

____

Item 7 - Escrow Arrangements; Compensation Arrangements; and Fidelity Bond

A. Escrow. Complete the following information for each person that will hold investor funds in escrow pursuant to the requirements of Rule 303(e) of Regulation Crowdfunding (17 CFR 24_.309).

Check only one box: ☐ Add ☐ Delete ☐ Amend

Name of person:____

Address:____

Phone Number: ____

B. Compensation. Please describe any compensation arrangements *funding portal* has with issuers.

____

C. Fidelity Bond. Does *funding portal* maintain fidelity bond coverage that has a minimum coverage of $100,000, covers any associated person of the funding portal unless otherwise excepted in the rules set forth by FINRA or any other registered national securities association of which it is a member, and meets any other applicable requirements as set forth by FINRA or any applicable national securities association that is registered under Section 15A?

□Yes □No

If "yes," provide the following information.

Bonding Company Name:______________________________
Bonding Company Address:____________________________
Phone Number: ______________________________
Policy #______________ Expiration Date:______________

Item 8 – Withdrawal

If this is a withdrawal of registration:

A. The date the *funding portal* ceased business or withdrew its registration request:

Date (MM/DD/YYYY): ______________

B. Location of Books and Records after Registration Withdrawal

Complete the following information for each location at which the *applicant* will keeps books and records after withdrawing its registration.

Check only one box: ☐ Add ☐ Delete ☐ Amend

Name and address of entity where books and records are kept:

____

____

____

(area code) (telephone number) (area code) (fax number)

This is (check one): ☐ one of *applicant*'s branch offices or affiliates.
☐ a third party unaffiliated recordkeeper.
☐ other.

If this address is a private residence, check this box: ☐

Briefly describe the books and records kept at this location.

____

____

____

____

C. Is the *funding portal* now the subject of or named in any investment-related

1. Investigation

☐Yes ☐No

2. Investor initiated complaint

□Yes □No

3. Private civil litigation

□Yes □No

EXECUTION

The funding portal consents that service of any civil action brought by or notice of any proceeding before the Securities and Exchange Commission or any self-regulatory organization in connection with the funding portal's investment-related business may be given by registered or certified mail to the funding portal's contact person at the main address, or mailing address, if different, given in Items 1.E, 1.F., and 1.H. If the applicant is a nonresident funding portal, it must complete Schedule C to designate a U.S. agent for service of process.

The undersigned represents and warrants that he/she has executed this form on behalf of, and is duly authorized to bind, the funding portal. The undersigned and the funding portal represent that the information and statements contained herein and other information filed herewith, all of which are made a part hereof, are current, true and complete. The undersigned and the funding portal further represent that, if this is an amendment, to the extent that any information previously submitted is not amended, such information is currently accurate and complete.

Date: ____________________

Full Legal Name of Funding Portal: ____________________________

By ____
(signature)

Title: ______________________________

FORM FUNDING PORTAL
SCHEDULE A

Direct Owners and Executive Officers

1. Complete Schedule A only if submitting an initial application. Schedule A asks for information about the *applicant*'s direct owners and executive officers. Use Schedule B to amend this information.

2. Direct Owners and Executive Officers. List below the names of:

   (a) each Chief Executive Officer, Chief Financial Officer, Chief Operations Officer, Chief Legal Officer, Chief Compliance Officer, director and any other individuals with similar status or functions;

   (b) if *applicant* is organized as a corporation, each shareholder that is a direct owner of 5% or more of a class of the *applicant*'s voting securities, unless *applicant* is a public reporting company (a company subject to Section 13 or 15(d) of the Exchange Act);

   Direct owners include any *person* that owns, beneficially owns, has the right to vote, or has the power to sell or direct the sale of 5% or more of a class of the *applicant*'s voting securities. For purposes of this Schedule, a *person* beneficially owns any securities: (i) owned by his/her child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, sharing the same residence; or (ii) that he/she has the right to acquire, within 60 days, through the exercise of any option, warrant, or right to purchase the security.

   (c) if the *applicant* is organized as a partnership, <u>all</u> general partners and those limited and special partners that have the right to receive upon dissolution, or have contributed, 5% or more of the *applicant*'s capital;

   (d) in the case of a trust, (i) a *person* that directly owns 5% or more of a class of the *applicant*'s voting securities, or that has the right to receive upon dissolution, or has contributed, 5% or more of the *applicant*'s capital, (ii) the trust and (iii) each trustee; and

   (e) if the *applicant* is organized as a limited liability company ("LLC"), (i) those members that have the right to receive upon dissolution, or have contributed, 5% or more of the *applicant*'s capital, and (ii) if managed by elected managers, all elected managers.

3. In the DE/FE/NP column below, enter "DE" if the owner is a domestic entity, "FE" if the owner is an entity incorporated or domiciled in a foreign country, or "NP" if the owner or executive officer is a natural person.

4. Complete the Title or Status column by entering board/management titles; status as partner, trustee, sole proprietor, elected manager, shareholder, or member; and for shareholders or members, the class of securities owned (if more than one is issued).

5. Ownership codes are:

NA - less than 5%	B - 10% but less than 25%	D - 50% but less than 75%
A - 5% but less than 10%	C - 25% but less than 50%	E - 75% or more

6.

(a) In the *Control Affiliate* column, enter "Yes" if the *person* has *control* as defined in the Glossary of Terms to Form Funding Portal, and enter "No" if the *person* does not have *control*. Note that under this definition, most executive officers and all 25% owners, general partners, elected managers, and trustees are *control persons*.

(b) In the PR column, enter "PR" if the owner is a public reporting company under Section 13 or 15(d) of the Exchange Act.

(c) Complete each column.

FULL LEGAL NAME **(Natural Persons: Last Name, First Name, Middle Name)**	**DE/FE/NP**	**Title or Status**	**Date Title or Status Acquired**		**Ownership Code**	**Control Affiliate**		***CRD* No.** **(If None: S.S. No. and Date of Birth, IRS Tax No., or Employer ID No.)**
			MM	YYYY		Yes/No	PR	

FORM FUNDING PORTAL
SCHEDULE B

Amendments to Schedule A

1. Use Schedule B only to amend information requested on Schedule A. Refer to Schedule A for specific instructions for completing this Schedule B. Complete each column. File with a completed Execution Page.

2. In the Type of Amendment column, indicate "A" (addition), "D" (deletion), or "C" (change in information about the same *person*).

3. Ownership codes are:

NA - less than 5%	B - 10% but less than 25%	D - 50% but less than 75%
A - 5% but less than 10%	C - 25% but less than 50%	E - 75% or more
	G - Other (general partner, trustee, or elected member)	

4. List below all changes to Schedule A (Direct Owners and Executive Officers):

FULL LEGAL NAME (Natural Persons: Last Name, First Name, Middle Name)	**DE/FE/NP**	**Type of Amend-ment**	**Title or Status**	**Date Title or Status Acquired**		**Ownership Code**	***Control Affiliate***		***CRD* No. (If None: S.S. No. and Date of Birth, IRS Tax No., or Employer ID No.)**
				MM	YYYY		Yes/No	PR	

Schedule C of FORM FUNDING PORTAL
Nonresident Funding Portals

Applicant Name:

Date:__________ SEC File No:

Official Use

Service of Process and Certification Regarding Access to Records

Each nonresident funding portal applicant shall use Form to identify its United States agent for service of process and to certify that it can

(1) provide the Commission and the national securities association of which it is a member with prompt access to its books and records, and (2) submit to onsite inspection and examination by the Commission.

1. Service of Process:

   A. Name of United States person *applicant* designates and appoints as agent for service of process

   B. Address of United States person *applicant* designates and appoints as agent for service of process

   The above identified agent for service of process may be served any process, pleadings, subpoenas, or other papers in

   (a) any investigation or administrative proceeding conducted by the Commission that relates to the *applicant* or about which the

   applicant may have information; and

   (b) any civil or criminal suit or action or proceeding brought against the *applicant* or to which the *applicant* has been joined as defendant or respondent, in any appropriate court in any place subject to the jurisdiction of any state or of the United States or of any of its territories or possessions or of the District of Columbia, to enforce the Exchange Act. The *applicant* has stipulated and agreed that any such suit, action or administrative proceeding may be commenced by the service of process upon, and that service of an administrative subpoena shall be effected by service upon, the above-named Agent for Service of Process, and that service as aforesaid shall be taken and held in all courts and administrative tribunals to be valid and binding as if personal service thereof had been made.

2.

Certification regarding access to records:

Applicant can as a matter of law;

(1) provide the Commission and any national securities association of which it is a member with prompt access to its books and records, and

(2) submit to onsite inspection and examination by the Commission.

Applicant must attach to this Form Funding Portal a copy of the opinion of counsel it is required to obtain in accordance with Rule 400(g) of Regulation Crowdfunding.

Signature:

Name and Title:
Date:

CRIMINAL ACTION DISCLOSURE REPORTING PAGE (FP)

General Instructions

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-A of Form Funding Portal.

Check item(s) being responded to: ☐ 5-A(1)(a) ☐ 5-A(1)(b) ☐ 5-A(2)(a) ☐ 5-A(2)(b)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

Multiple counts of the same *charge* arising out of the same event(s) should be reported on the same DRP. Use this DRP to report all *charges* arising out of the same event. Unrelated criminal actions, including separate cases arising out of the same event, must be reported on separate DRPs. One event may result in more than one affirmative answer to the items listed above.

Part 1

Check all that apply:

A. The *person*(s) or entity(ies) for whom this DRP is being filed is (are) the:

- ☐ *Applicant*
- ☐ *Applicant* and one or more *associated persons*
- ☐ One or more of *applicant*'s *associated persons*

If this DRP is being filed for the *applicant*, and it is an amendment that seeks to remove a DRP concerning the *applicant* from the record, the reason the DRP should be removed is:

- ☐ The *applicant* is registered or applying for registration, and the event or *proceeding* was resolved in the *applicant*'s favor.
- ☐ The DRP was filed in error.

If this DRP is being filed for an *associated person*:

This *associated person* is: ☐ a firm ☐ a natural person
The *associated person* is: ☐ registered with the *SEC* ☐ not registered with the *SEC*

Full name of the *associated person* (including, for natural persons, last, first and middle names):

____

If the *associated person* has a *CRD* number, provide that number. __________

If this is an amendment that seeks to remove a DRP concerning the *associated person*, the reason the DRP should be removed is:

☐ The *associated person*(s) is (are) no longer associated with the *applicant*.
☐ The event or *proceeding* was resolved in the *associated person*'s favor.
☐ The event or *proceeding* occurred more than ten years ago.
☐ The DRP was filed in error. Explain the circumstances:

____

____

Part 2

1. If *charge*(s) were brought against a firm or organization over which the *applicant* or an *associated person* exercised *control*:

Enter the firm or organization's name ______________________________

Was the firm or organization engaged in an *investment-related* business? ☐ Yes ☐ No

What was the relationship of the *applicant* with the firm or organization? (In the case of an *associated person*, include any position or title with the firm or organization.)

____

2. Formal *charge*(s) were brought in: (include the name of Federal, Military, State or Foreign Court, Location of Court - City or County and State or Country, and Docket/Case number).

Name of court: ____________________
Location: ____________________
Docket/Case number: ____________________

3. Event Disclosure Detail (Use this for both organizational and individual *charges*.)

A. Date First *Charged* (MM/DD/YYYY): ________________ ☐ Exact ☐ Explanation

If not exact, provide explanation:

____

B. Event Disclosure Detail (include *charge*(s)/*charge* Description(s), and for each *charge* provide: (1) number of counts, (2) *felony* or *misdemeanor*, (3) plea for each *charge*, and (4) product type if *charge* is *investment-related*).

____

C. Did any of the *charge*(s) within the event *involve* a *felony*? ☐ Yes ☐ No

D. Current status of the event? ☐ Pending ☐ On Appeal ☐ Final

E. Event status date (Complete unless status is pending) (MM/DD/YYYY):

____

☐ Exact ☐ Explanation

If not exact, provide explanation:

____

4. Disposition Disclosure Detail: Include for each *charge* (a) Disposition Type (e.g., convicted, acquitted, dismissed, pretrial, etc.), (b) Date, (c) Sentence/Penalty, (d) Duration (if sentence-suspension, probation, etc.), (e) Start Date of Penalty, (f) Penalty/Fine Amount, and (g) Date Paid.

____

5. Provide a brief summary of circumstances leading to the *charge*(s) as well as the disposition. Include the relevant dates when the conduct that was the subject of the *charge*(s) occurred. (The response must fit within the space provided.)

____

____

REGULATORY ACTION DISCLOSURE REPORTING PAGE (FP)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-B of Form Funding Portal.

Check item(s) being responded to: ☐ 5-B(1)(a) ☐ 5-B(1)(b) ☐ 5-B(1)(c) ☐ 5-B(1)(d) ☐ 5-B(1)(e) ☐ 5-B(2)(a) ☐ 5-B(2)(b) ☐ 5-B(2)(c) ☐ 5-B(2)(d) ☐ 5-B(2)(e) ☐ 5-B(3)(a) ☐ 5-B(3)(b) ☐ 5-B(3)(c) ☐ 5-B(3)(d) ☐ 5-B(4) ☐ 5-B(5)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Items 5-B(1), 5-B(2), 5-B(3), 5-B(4) or 5-B(5). Use only one DRP to report details related to the same event. If an event gives rise to actions by more than one regulator, provide details for each action on a separate DRP.

Part 1

The *person*(s) or entity(ies) for whom this DRP is being filed is (are) the:

☐ *Applicant* (the *funding portal*)
☐ *Applicant* and one or more of the *applicant*'s *associated person*(s)
☐ One or more of *applicant*'s *associated person*(s)

If this DRP is being filed for the *applicant* and it is an amendment that seeks to remove a DRP concerning the *applicant* from the record, the reason the DRP should be removed is:

☐ The *applicant* is registered or applying for registration, and the event or *proceeding* was resolved in the *applicant*'s favor.
☐ The DRP was filed in error.

If this DRP is being filed for an *associated person*:

This *associated person* is: ☐ a firm ☐ a natural person
The *associated person* is: ☐ registered with the *SEC* ☐ not registered with the *SEC*

Full name of the *associated person* (including, for natural persons, last, first and middle names):

____

If the *associated person* has a *CRD* number, provide that number. __________

If this is an amendment that seeks to remove a DRP concerning the *associated person*, the reason the DRP should be removed is:

- ☐ The *associated person*(s) is (are) no longer associated with the *applicant*.
- ☐ The event or *proceeding* was resolved in the *associated person*'s favor.
- ☐ The DRP was filed in error. Explain the circumstances:

____

____

Part 2

1. Regulatory Action was initiated by:

☐ *SEC* ☐ Other Federal Authority ☐ State ☐ *SRO* ☐ Foreign Authority

(Full name of regulator, *foreign financial regulatory authority*, federal authority, state or *SRO*)

____

____

____

2. Principal Sanction (check appropriate item):

☐ Civil and Administrative Penalty(ies)/Fine(s) ☐ Disgorgement ☐ Restitution

☐ Bar ☐ Expulsion ☐ Revocation
☐ Cease and Desist ☐ Injunction ☐ Suspension
☐ Censure ☐ Prohibition ☐ Undertaking
☐ Denial ☐ Reprimand ☐ Other

Other Sanctions:

____

____

____

3. Date Initiated (MM/DD/YYYY): ____________________ ☐ Exact ☐ Explanation

If not exact, provide explanation:

____

____

____

____

4. Docket/Case Number: ____________________

5. *Associated person*'s Employing Firm when activity occurred that led to the regulatory action (if applicable):

6. Principal Product Type (check appropriate item):

☐ Annuity(ies) - Fixed ☐ Derivative(s) ☐ Investment Contract(s)
☐ Annuity(ies) - Variable ☐ Direct Investment(s) - DPP & LP Interest(s)
☐ Money Market Fund(s) ☐ No Product
☐ CD(s) ☐ Equity - OTC ☐ Mutual Fund(s)
☐ Commodity Option(s) ☐ Equity Listed (Common & Preferred Stock)
☐ Debt - Asset Backed ☐ Futures - Commodity ☐ Options
☐ Debt - Corporate ☐ Futures - Financial ☐ Penny Stock(s)
☐ Debt - Government ☐ Index Option(s) ☐ Unit Investment Trust(s)
☐ Debt - Municipal ☐ Insurance ☐ Other

Other Product Types:

7. Describe the allegations related to this regulatory action. (The response must fit within the space provided.)

8. Current status? ☐ Pending ☐ On Appeal ☐ Final

9. If on appeal, to whom the regulatory action was appealed (*SEC*, *SRO*, Federal or State Court) and date appeal filed:

If Final or On Appeal, complete all items below. For Pending Actions, complete Item 13 only.

10. How was matter resolved (check appropriate item):

☐ Acceptance, Waiver & Consent (AWC) ☐ Dismissed ☐ Vacated
☐ Consent ☐ *Order* ☐ Withdrawn
☐ Decision ☐ Settled ☐ Other
☐ Decision & *Order* of Offer of Settlement ☐ Stipulation and Consent

11. Resolution Date (MM/DD/YYYY): ________________ ☐ Exact ☐ Explanation

If not exact, provide explanation:

____

____

12. Resolution Detail:

A. Were any of the following Sanctions *Ordered* (check all appropriate items)?

☐ Monetary/Fine ☐ Revocation/Expulsion/Denial ☐ Disgorgement/Restitution
Amount: $__________ ☐ Censure ☐ Cease and Desist/Injunction
☐ Bar ☐ Suspension

B. Other Sanctions *Ordered*:

____

____

C. Sanction detail: If suspended, *enjoined* or barred, provide duration including start date and capacities affected (General Securities Principal, Financial Operations Principal, etc.). If requalification by exam/retraining was a condition of the sanction, provide length of time given to requalify/retrain, type of exam required and whether condition has been satisfied. If disposition resulted in a fine, penalty, restitution, disgorgement or monetary compensation, provide total amount, portion levied against the *applicant* or an *associated person*, date paid and if any portion of penalty was waived:

____

____

13. Provide a brief summary of details related to the action status and (or) disposition, and include relevant terms, conditions and dates.

____

____

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (FP)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-C. of Form Funding Portal.

Check item(s) being responded to: ☐ 5-C(1)(a) ☐ 5-C(1)(b) ☐ 5-C(1)(c) ☐ 5-C(2) ☐ 5-C(3)(a) ☐ 5-C(3)(b)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Item 5-C. Use only one DRP to report details related to the same event. Unrelated civil judicial actions must be reported on separate DRPs.

Part 1

The *person*(s) or entity(ies) for whom this DRP is being filed is (are) the:

☐ *Applicant* (the *funding portal*)
☐ *Applicant* and one or more of the *applicant*'s *associated person*(s)
☐ One or more of the *applicant*'s *associated person*(s)

If this DRP is being filed for the *applicant* and it is an amendment that seeks to remove a DRP concerning the *applicant* from the record, the reason the DRP should be removed is:

☐ The *applicant* is registered or applying for registration, and the event or *proceeding* was resolved in the *applicant*'s favor.
☐ The DRP was filed in error.

If this DRP is being filed for an *associated person*:

This *associated person* is: ☐ a firm ☐ a natural person
The *associated person* is: ☐ registered with the *SEC* ☐ not registered with the *SEC*

Full name of the *associated person* (including, for natural persons, last, first and middle names):

____

If the *associated person* has a *CRD* number, provide that number. __________

If this is an amendment that seeks to remove a DRP concerning the *associated person*, the reason the DRP should be removed is:

☐ The *associated person*(s) is (are) no longer associated with the *applicant*.
☐ The event or *proceeding* was resolved in the *associated person*'s favor.
☐ The DRP was filed in error. Explain the circumstances:

____

____

Part 2

1. Court Action initiated by: (Name of regulator, *foreign financial regulatory authority*, *SRO*, commodities exchange, agency, firm, private plaintiff, etc.)

2. Principal Relief Sought (check appropriate item):

☐ Cease and Desist ☐ Disgorgement ☐ Money Damages
(Private/Civil Complaint)
☐ Restraining Order ☐ Civil Penalty(ies)/Fine(s)
☐ Injunction ☐ Restitution
☐ Other ________

Other Relief Sought: ____

3. Filing Date of Court Action (MM/DD/YYYY): ________________ ☐ Exact
☐ Explanation

If not exact, provide explanation:

____

4. Principal Product Type (check appropriate item):

☐ Annuity(ies) - Fixed ☐ Derivative(s) ☐ Investment Contract(s)
☐ Annuity(ies) - Variable ☐ Direct Investment(s) - DPP & LP Interest(s)
☐ Money Market Fund(s) ☐ CD(s) ☐ Equity - OTC
☐ Mutual Fund(s) ☐ Commodity Option(s) ☐ No Product
☐ Equity Listed (Common & Preferred Stock) ☐ Options
☐ Debt - Asset Backed ☐ Futures - Commodity ☐ Penny Stock(s)
☐ Debt - Corporate ☐ Futures - Financial ☐ Unit Investment Trust(s)
☐ Debt - Government ☐ Index Option(s) ☐ Other
☐ Debt - Municipal ☐ Insurance

Other Product Types:

____

5. Formal Action was brought in (include the name of the Federal, State or Foreign Court, Location of Court - City or County and State or Country, and Docket/Case Number):

____

6. *Associated person*'s Employing Firm when activity occurred that led to the civil judicial action (if applicable):

____

7. Describe the allegations related to this civil action (the response must fit within the space provided):

____

____

8. Current status? ☐ Pending ☐ On Appeal ☐ Final

9. If on appeal, court to which the action was appealed (provide name of the court) and Date Appeal Filed (MM/DD/YYYY):

____

____

10. If pending, date notice/process was served (MM/DD/YYYY): ____________________

☐ Exact ☐ Explanation

If not exact, provide explanation:

____

If Final or On Appeal, complete all items below. For Pending Actions, complete Item 14 only.

11. How was matter resolved (check appropriate item):

☐ Consent ☐ Judgment Rendered ☐ Settled ☐ Dismissed ☐ Opinion
☐ Withdrawn ☐ Other ____________

12. Resolution Date (MM/DD/YYYY): ____________________ ☐ Exact ☐ Explanation

If not exact, provide explanation:

____

____

13. Resolution Detail:

A. Were any of the following Sanctions *Ordered* or Relief Granted (check appropriate items)?

☐ Monetary/Fine Amount: $____________ ☐ Revocation/Expulsion/Denial ☐ Disgorgement/Restitution ☐ Censure ☐ Cease and Desist/Injunction ☐ Bar ☐ Suspension

B. Other Sanctions *Ordered*:

____
____
____

C. Sanction detail: If suspended, *enjoined* or barred, provide duration including start date and capacities affected (General Securities Principal, Financial Operations Principal, etc.). If requalification by exam/retraining was a condition of the sanction, provide length of time given to requalify/retrain, type of exam required and whether condition has been satisfied. If disposition resulted in a fine, penalty, restitution, disgorgement or monetary compensation, provide total amount, portion levied against the *applicant* or an *associated person*, date paid and if any portion of penalty was waived:

____
____
____
____
____
____

14. Provide a brief summary of circumstances related to the action(s), allegation(s), disposition(s) and/or finding(s) disclosed above.

____
____
____

BANKRUPTCY/SIPC DISCLOSURE REPORTING PAGE (FP)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-C(3) of Form Funding Portal.

Check item(s) being responded to: ☐ 5-C(3)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Item 5-C(3). Use only one DRP to report details related to the same event. Unrelated civil judicial actions must be reported on separate DRPs.

Part 1

Check all that apply:

A. The *person*(s) or entity(ies) for whom this DRP is being filed is (are) the:

☐ *Applicant*
☐ *Applicant* and one or more *control affiliates*
☐ One or more of *control affiliates*

If this DRP is being filed for a *control affiliate*, give the full name of the *control affiliate* below (for individuals, Last name, First name, Middle name).

If the *control affiliate* is registered with the CRD, provide the CRD number. If not, indicate "non-registered" by checking the appropriate checkbox.

FP DRP - CONTROL AFFILIATE

____
Control *Affiliate CRD Number* This *control affiliate* is: ☐ a firm ☐ a natural person

Registered: ☐ Yes ☐ No

Full name of the *control affiliate* (including, for natural persons, last, first and middle names):

____

☐ This is an amendment that seeks to remove a DRP record because the *control affiliate(s)* is (are) no longer associated with the funding portal.

B. If the *control affiliate* is registered through the CRD, has the *control affiliate* submitted a DRP (with Form U-4) or BD DRP to the CRD System for the event? If the answer is "Yes,'' no other information on this DRP must be provided.

☐ Yes ☐ No

NOTE: The completion of this Form does not relieve the *control affiliate* of its obligation to update its CRD records.

Part 2

1. Action Type: (check appropriate item)

☐ Bankruptcy ☐ Declaration ☐ Receivership

☐ Compromise ☐ Liquidated ☐ Other___________

2. Action Date (MM/DD/YYYY):_________________ ☐ Exact ☐ Explanation

   If not exact, provide explanation:____

3. If the financial action relates to an organization over which the *applicant* or *control affiliate* exercise(d) *control*, enter organization name and the *applicant's* or *control affiliate's* position, title or relationship:

   ____

   Was the Organization investment-related? ☐ Yes ☐ No

4. Court action brought in (Name of Federal, State or Foreign Court), Location of Court (City or County and State or Country), Docket/Case Number and Bankruptcy Chapter Number (if Federal Bankruptcy Filing):

   ____

5. Is action currently pending? ☐ Yes ☐ No

6. If not pending, provide Disposition Type: (check appropriate item)

   ☐ Direct Payment Procedure ☐ Dismissed ☐ Satisfied/Released
   ☐ Discharged ☐ Dissolved ☐ SIPA Trustee Appointed

☐ Other _______

7. Disposition Date (MM/DD/YYYY): ☐ Exact ☐ Explanation

   If not exact, provide explanation: ____

8. Provide a brief summary of events leading to the action, and if not discharged, explain. (The information must fit within the space provided.):____

9. If a SIPA trustee was appointed or a direct payment procedure was begun, enter the amount paid by you; or the name of trustee:____

Currently Open? ☐ Yes ☐ No

Date Direct Payment Initiated/Filed or Trustee Appointed (MM/DD/YYYY):____________

☐ Exact ☐ Explanation

If not exact, provide explanation:____

10. Provide details to any status disposition. Include details as to creditors, terms, conditions, amounts due and settlement schedule (if applicable):____

BOND DISCLOSURE REPORTING PAGE (FP)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-C(4) of Form Funding Portal.

Check item(s) being responded to: ☐ 5-C(4)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Item 5-C(4). Use only one DRP to report details related to the same event. If an event gives rise to actions by more than one regulator, provide details for each action on a separate DRP.

1. Firm Name: (Policy Holder)

____

2. Bonding Company Name:

____

3. Disposition Type: (check appropriate item)

   ☐ Denied ☐ Payout ☐ Revoked

4. Disposition Date (MM/DD/YYYY): ☐ Exact ☐ Explanation

   If not exact, provide explanation:

____

____

5. If disposition resulted in Payout, list Payout Amount and Date Paid:

____

____

6. Summarize the details of circumstances leading to the necessity of the bonding company action:

JUDGMENT / LIEN DISCLOSURE REPORTING PAGE (FP)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-C(5) of Form Funding Portal.

Check item(s) being responded to: ☐ 5-C(5)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page. One event may result in more than one affirmative answer to Item 5-C(5). Use only one DRP to report details related to the same event. If an event gives rise to actions by more than one regulator, provide details for each action on a separate DRP.

1. Judgment/Lien Amount:____
2. Judgment/Lien Holder:____

3. Judgment/Lien Type: (check appropriate item)

   ☐ Civil ☐ Default ☐ Tax

4. Date Filed (MM/DD/YYYY):__________ ☐ Exact ☐ Explanation

   If not exact, provide explanation:________________________________
5. Is Judgment/Lien outstanding? ☐ Yes ☐ No

   If No, provide explanation:____

If No, how was matter resolved? (check appropriate item)

☐ Discharged ☐ Released ☐ Removed ☐ Satisfied

6. Court (Name of Federal, State or Foreign Court), Location of Court (City or County and State or Country) and Docket/Case Number:

____

7. Provide a brief summary of events leading to the action and any payment schedule details, including current status (if applicable):______________________________

FORM FUNDING PORTAL INSTRUCTIONS

A. GENERAL INSTRUCTIONS

1. EXPLANATION OF FORM

- This is the form that a funding portal must use to register with the Securities and Exchange Commission ("SEC" or "Commission"), to amend its registration and to withdraw from registration.
- The Commission may make publicly accessible all current Forms Funding Portal, including amendments and registration withdrawal requests, which may be searchable by the public, with the exception of certain personally identifiable information or other information with significant potential for misuse (including the contact employee's direct phone number and e-mail address and any IRS Employer Identification Number, social security number, date of birth, or any other similar information).

2. WHEN TO FILE FORM FUNDING PORTAL

- A funding portal's registration must become effective before offering or selling any securities in reliance on Section 4(a)(6) through a platform. Under Rule 400, a funding portal's registration will be effective the later of: (1) 30 calendar days after the date a complete Form Funding Portal is received by the Commission or (2) the date the funding portal is approved for membership by a national securities association registered under Section 15A of the Securities Exchange Act of 1934 ("Exchange Act").

- A registered funding portal must promptly file an amendment to Form Funding Portal when any information previously submitted on Form Funding Portal becomes inaccurate or incomplete for any reason.

- A successor funding portal may succeed to the registration of a registered funding portal by filing a registration on Form Funding Portal within 30 days after the succession.

- If a funding portal succeeds to and continues the business of a registered funding portal and the succession is based solely on a change of the predecessor's date or state of incorporation, form of organization, or composition of a partnership or similar reason, the successor may, within 30 days of the succession, amend the registration on Form Funding Portal to reflect these changes.

- A funding portal must also file a withdrawal on Form Funding Portal promptly upon ceasing to operate as a funding portal. Withdrawal will be effective on the later of 30 days after receipt by the Commission, after the funding portal is no longer operational, or within such longer period of time as to which the funding portal consents or which the

Commission by order may determine as necessary or appropriate in the public interest or for the protection of investors.

- A Form Funding Portal filing will not be considered complete unless it complies with all applicable requirements.

3. **ELECTRONIC FILING** – The *applicant* must file Form Funding Portal electronically using the web-enabled system, and must utilize this system to file and amend Form Funding Portal electronically to assure the timely acceptance and processing of those filings.

4. **CONTACT EMPLOYEE** – The individual listed as the contact employee must be authorized to receive all compliance information, communications, and mailings, and be responsible for disseminating it within the *applicant*'s organization.

5. **FEDERAL INFORMATION LAW AND REQUIREMENTS**

- The principal purpose of this form is to provide a mechanism by which a funding portal can register with the Commission, amend its registration and withdraw from registration. The Commission maintains a file of the information on this form and will make certain information collected through the form publicly available. The SEC will not accept forms that do not include the required information.

- Section 4A(a) of the Securities Act of 1933 [15 U.S.C. §77d-1(a)] and Sections 3(h) and 23(a) the Exchange Act [15 U.S.C. §§78c(h) and 78w(a)] authorize the SEC to collect the information required by Form Funding Portal. The SEC collects the information for regulatory purposes. Filing Form Funding Portal is mandatory for persons that are registering as funding portals with the SEC.

- Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate on this Form and any suggestions for reducing this burden. This collection of information has been reviewed by the Office of Management and Budget in accordance with the clearance requirements of 44 U.S.C. §3507. The information contained in this form is part of a system of records subject to the Privacy Act of 1974, as amended. The Securities and Exchange Commission has published in the Federal Register the Privacy Act Systems of Records Notice for these records.

B. FILING INSTRUCTIONS

1. FORMAT

- Items 1-7 must be answered and all fields requiring a response must be completed before the filing will be accepted. Item 8 must be answered if the funding portal wishes to withdraw from registration.

- *Applicant* must complete the execution screen certifying that Form Funding Portal and amendments thereto have been executed properly and that the information contained therein is accurate and complete.

- To amend information, the *applicant* must update the appropriate Form Funding Portal screens.

- A paper copy, with original manual signatures, of the initial Form Funding Portal filing and amendments to Disclosure Reporting Pages must be retained by the *applicant* and be made available for inspection upon a regulatory request.

2. **DISCLOSURE REPORTING PAGES (DRP)** – Information concerning the *applicant* or control affiliate that relates to the occurrence of an event reportable under Item 5 must be provided on the *applicant*'s appropriate DRP (FP). If a *control affiliate* is an individual or organization registered through the CRD, such *control affiliate* need only complete the *control affiliate* name and CRD number of the *applicant's* appropriate DRP. Details for the event must be submitted on the *control affiliate's* appropriate DRP or DRP(U-4). If a *control affiliate* is an individual or organization not registered through the CRD, provide complete answers to all of the questions and complete all fields requiring a response on the *applicant's* appropriate DRP (FP) screen.

3. **DIRECT OWNERS** - Amend the Direct Owners and Executive Officers screen when changes in ownership occur.

4. **NONRESIDENT APPLICANTS** – Any applicant that is a nonresident funding portal must complete Schedule C and attach the opinion of counsel referred to therein.

C. EXPLANATION OF TERMS

1. GENERAL

APPLICANT - The funding portal applying on or amending this form.

ASSOCIATED PERSON - Any partner, officer, director or manager of the funding portal (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling or controlled by the funding portal, or any employee of the funding portal, except that any person associated with a funding portal whose functions are solely clerical or ministerial shall not be included in the meaning of such term for purposes of section 15(b) of the Exchange Act (other than paragraphs (4) and (6) thereof).

CONTROL - The power, directly or indirectly, to direct the management or policies of the funding portal, whether through contract, or otherwise. A person is presumed to control a funding portal if that person: (1) is a director, general partner or officer exercising executive responsibility (or has a similar status or functions); (2) directly or indirectly has the right to vote

25 percent or more of a class of a voting security or has the power to sell or direct the sale of 25 percent or more of a class of voting securities of the funding portal; or (3) in the case of a partnership, has contributed, or has a right to receive, 25 percent or more of the capital of the funding portal. (This definition is used solely for the purposes of Form Funding Portal).

CONTROL AFFILIATE – A person named in Item 4 [as a control person] or any other individual or organization that directly or indirectly controls, is under common control with, or is controlled by, the *applicant*, including any current employee of the *applicant* except one performing only clerical, administrative, support or similar functions, or who, regardless of title, performs no executive duties or has no senior policy making authority.

FOREIGN FINANCIAL REGULATORY AUTHORITY – Includes (1) a foreign securities authority; (2) other governmental body or foreign equivalent of a *self-regulatory organization* empowered by a foreign government to administer or enforce its laws relating to the regulation of *investment* or *investment-related* activities; and (3) a foreign membership organization, a function of which is to regulate the participation of its members in the activities listed above.

FUNDING PORTAL - A broker acting as an intermediary in a transaction involving the offer or sale of securities offered and sold in reliance on Section 4(a)(6), that does not, directly or indirectly: (1) offer investment advice or recommendations; (2) solicit purchases, sales or offers to buy the securities displayed on its platform; (3) compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its platform; or (4) hold, manage, possess, or otherwise handle investor funds or securities.

JURISDICTION – Any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin Islands, any other territory of the United States, or any subdivision or regulatory body thereof.

NONRESIDENT FUNDING PORTAL – A funding portal incorporated in or organized under the laws of a jurisdiction outside of the United States or its territories, or having its principal place of business in any place not in the United States or its territories.

PERSON - An individual, partnership, corporation, trust, or other organization.

SELF-REGULATORY ORGANIZATION (SRO) – The Financial Industry Regulatory Authority ("FINRA") or any other national securities association registered with the Commission or any national securities exchange or registered clearing agency, as such terms are defined in Section 3 of the Exchange Act.

SUCCESSOR –A funding portal that assumes or acquires substantially all of the assets and liabilities, and that continues the business of, a registered predecessor funding portal that ceases its funding portal activities. See Rule 400(c) of Regulation Crowdfunding (17 CFR 24_.400(c)).

2. FOR THE PURPOSE OF ITEM 5

CHARGED - Being accused of a crime in a formal complaint, information, or indictment (or equivalent formal charge).

ENJOINED – Includes being subject to a mandatory injunction, prohibitory injunction, preliminary injunction, or temporary restraining order.

FELONY – For jurisdictions that do not differentiate between a felony and a misdemeanor, a felony is an offense punishable by a sentence of at least one year imprisonment and/or a fine of at least $1,000. The term also includes a general court martial.

FOUND – Includes adverse final actions, including consent decrees in which the respondent has neither admitted nor denied the findings, but does not include agreements, deficiency letters, examination reports, memoranda of understanding, letters of caution, admonishments, and similar informal resolutions of matters.

INVESTMENT OR INVESTMENT-RELATED – Pertaining to securities, commodities, banking, savings association activities, credit union activities, insurance, or real estate (including, but not limited to, acting as or being associated with a funding portal broker-dealer, municipal securities dealer, government securities broker or dealer, issuer, investment company, investment adviser, futures sponsor, bank, security-based swap dealer, major security-based swap participant, savings association, credit union, insurance company, or insurance agency).

INVOLVED – Doing an act or aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act.

MINOR RULE VIOLATION – A violation of a self-regulatory organization rule that has been designated as "minor" pursuant to a plan approved by the SEC or Commodity Futures Trading Commission. A rule violation may be designated as "minor" under a plan if the sanction imposed consists of a fine of $2,500 or less and if the sanctioned person does not contest the fine. (Check with the appropriate self-regulatory organization to determine if a particular rule violation has been designated as "minor" for these purposes).

MISDEMEANOR – For jurisdictions that do not differentiate between a felony and a misdemeanor, a misdemeanor is an offense punishable by a sentence of less than one year imprisonment and/or a fine of less than $1,000. The term also includes a special court martial.

ORDER – A written directive issued pursuant to statutory authority and procedures, including orders of denial, suspension, or revocation; does not include special stipulations, undertakings or agreements relating to payments, limitations on activity or other restrictions unless they are included in an order.

PROCEEDING – Includes a formal administrative or civil action initiated by a governmental agency, self-regulatory organization or a foreign financial regulatory authority; a felony criminal indictment or information (or equivalent formal charge); or a misdemeanor criminal information (or equivalent formal charge). Does not include other civil litigation, investigations, or arrests or similar charges effected in the absence of a formal criminal indictment or information (or equivalent formal charge).

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Date: October 23, 2013

Wright Letter 2:	Letter from Martin Wright, Aug. 7, 2012
Wright Place Letter:	Letter from Dr. Letitia S. Wright, May 4, 2012

Verdant Ventures Letter:	Letter from Ross Randrup, Managing Member, Verdant Ventures LLC, Jun. 17, 2012
Vermont Investors Letter:	Letter from Sebastian Sweatman, Vermont Investors Forum, Apr. 25, 2012
Vim Funding Letter:	Letter from Shane M. Fleenor, Vim Funding, Inc., Creator of Funding Launchpan, Co-founder and CLO, Apr. 27, 2012
Vogele Letter:	Letter from John Vogele, Dec. 26, 2012
VS Technology Letter:	Letter from Michael Van Steenburg, CEO of VS Technology Inc., Aug. 31, 2012
VTNGLOBAL Letter:	Letter from Peter Ojo, CEO, VTNGLOBAL, May 31, 2012
West Letter:	Letter from Perry D. West, Esq., Apr. 13, 2012
Whitacre Letter:	Letter from William L. Whitacre, Esq., Apr. 18, 2012
Whitaker Letter:	Letter from John R. Fahy, Partner, Whitaker Chalk Swindle Schwartz PLLC, Nov. 8, 2012
Windhom Letter:	Letter from Stevario Windhom, Jun. 13, 2012
Winfiniti Letter:	Letter from Dan Grady, CEO, Winfiniti, Inc., Apr. 11, 2012
Williams Letter:	Letter from John P. Williams, Feb. 7, 2013
Williams K. Letter:	Letter from Keith Williams, Mar. 2, 2013
Wright Letter 1:	Letter from Martin Wright, Aug. 7, 2012

Stephenson Letter:	Letter from Andrew D. Stephenson, Esq., Washington, May 14, 2012
Sutter Securities Letter:	Letter from Robert A. Muh, Chief Executive Officer, Sutter Securities Incorporated, Oct. 25, 2012
Sykes Letter:	Letter from Chad Sykes, Apr. 15, 2012
Tally Letter:	Letter from John Tally, May 28, 2012
TechnologyCrowdFund Letter 1:	Letter from Robert B. Nami, CEO/President, TechnologyCrowdFund.com, May 1, 2012
TechnologyCrowdFund Letter 2:	Letter from Robert B. Nami, President/CEO, TechnologyCrowdFund.com, May 30, 2012
TechnologyCrowdFund Letter 3:	Letter from Robert B. Nami, President/CEO, TechnologyCrowdFund.com, Jun. 5, 2012
TechnologyCrowdFund Letter 4:	Letter from Robert B. Nami, President/CEO, TechnologyCrowdFund.com, Jun. 7, 2012
TechnologyCrowdFund Letter 5:	Letter from Robert B. Nami, CEO/President TechnologyCrowdFund, Jun. 28, 2012
TechnologyCrowdFund Letter 6:	Letter from Robert B. Nami, CEO/President TechnologyCrowdFund, Jan. 16, 2013
The Growth Group Letter:	Letter from Elliott Dahan, Managing Partner, The Growth Group, May 1, 2012
The Motley Fool Letter:	Letter from Ilan L. Moscovitz and John Maxfield, The Motley Fool, Jun. 27, 2012
Tomkinson Letter:	Letter from Paul Tomkinson, Sept. 21, 2012
Totsie Productions Letter:	Letter from Kevin J. Tostado, Producer, Totsie Productions, Jan. 20, 2013
Tri Valley Law Letter:	Letter from Marc A. Greendorfer, Tri Valley Law, Apr. 27, 2012

Schumer Letter:	Letter from Jacob J. Schumer, Staff Editor, Vanderbilt Journal of Entertainment and Technology Law, Sept. 4, 2012
Schwartz Letter:	Letter from Andrew A. Schwartz, Associate Professor of Law, University of Colorado, Jun. 13, 2013
Shefman Letter:	Letter from Michael Shefman, Aug. 21, 2013
Sidman Letter 1:	Letter from Charles L. Sidman, MBA, PhD, Manager, Crowdfunding Investment Angels, Nov. 30, 2012
Sidman Letter 2:	Letter from Charles L. Sidman, MBA, PhD, Manager, Crowdfunding Investment Angels, Mar. 8, 2013
Sjogren Letter:	Letter from Karl M. Sjogren, Apr. 25, 2013
Sklar Law Letter:	Letter from Navid More, Associate Attorney, Sklar Law, P.C., Jun. 24, 2012
Skweres Letter:	Letter from Mary Ann Skweres, Independent Film Professional, Jun. 3, 2012
Spinrad Letter 1:	Letter from Paul Spinrad, Jul. 26, 2012
Spinrad Letter 2:	Letter from Paul Spinrad, Jan. 2, 2013
STA Letter:	Letter from Charles V. Rossi, President, The Securities Transfer Association, Inc., Sept. 17, 2012
Stafford Letter:	Letter from Darrell M. Stafford, Apr. 11, 2012
Start.ac Letter:	Letter from Rod Turner, CEO and Founder, Start.ac CrowdFunding business, Jun. 12, 2012

Rey Media Letter:	Letter from David Rey, Rey Media, Apr. 24, 2013
RFPIA Letter 1:	Letter from T.W. Kennedy, BE., CEO, Kennedy Associates, Apr. 20, 2012
RFPIA Letter 2:	Letter from T.W. Kennedy, B.E., Regulated Funding Portal Industry Association, Jul. 25, 2012
RFPIA Letter 3:	Letter from T.W. Kennedy, B.E., Regulated Funding Portal Industry Association, Aug. 18, 2012
RFPIA Letter 4:	Letter from T.W. Kennedy, B.E., Regulated Funding Portal Industry Association, Aug. 18, 2012
RFPIA Letter 5:	Letter from T.W. Kennedy, B.E., Regulated Funding Portal Industry Association, Jul. 9, 2013
Risingtidefunding.com Letter:	Letter from Neal C. McCane, CFA, Co-Founder, risingtidefunding.com, Sept. 26, 2012
Richter Letter:	Letter from Paul W. Richter, PW Richter PLC, Feb. 7. 2013
Roberts Letter:	Letter from Ward Roberts, May 25, 2012
RocketHub Letter 1:	Letter from Alon Hillel-Tuch, Co-Founder & CFO, RocketHub.com, May 1, 2012
RocketHub Letter 2:	Letter from Alon Hillel-Tuch, Founder & CFO, RocketHub.com, Nov. 14, 2012
Rocketjet Letter:	Letter from Daniel E. Nelson, PhD, JD, Chairman, Rocketjet Corporation, Apr. 13, 2012
Romano Letter:	Letter from Robert Romano, Apr. 12, 2012

P2PVenture.org Letter:	Letter from Frederic Baud, President P2PVenture.org, France, Sept. 1, 2012
Parker Letter:	Letter from Joe Parker, CEO, Apr. 12, 2012
Pearfunds Letter:	Letter from Hector Vizcarrondo, Co-founder & CEO, Pearfunds, LLC, Jul. 30, 2012
Pena Letter:	Letter from Fred Pena, May 10, 2012
Petazzoni Letter:	Letter from Enrico Petazzoni, Feb. 15, 2013
Philipose Letter 1:	Letter from Roy Philipose, Jun. 28, 2012
Philipose Letter 2:	Letter from Roy Philipose, Jun. 30, 2012
PMIRARQ Letter:	Letter from Steven A. Cinelli, Founder & CEO, PMIRARQ, Jul. 26, 2012
PPM Logix Letter:	Letter from Mike Stapleton, PPM Logix, May 22, 2012
Priore Letter:	Letter from Robert Priore, May 2, 2012
PREA Letter:	Letter from Paul White, Professional Real Estate Advisors Inc., Jul. 22, 2013
Projectheureka Letter:	Letter from Anthony and Erika Endres, Projectheureka LLC, Sep. 10, 2013
Ramos Letter:	Letter from Robert Ramos, Aug. 14, 2013
RDA Letter:	Letter from Harry Shamir, Principal, RDA Co., Apr. 16, 2012
RentalCompare Letter:	Letter from Darryl Aken, RentalCompare, Apr. 24, 2013
Replay Games Letter:	Letter from Paul Trowe, Replay Games, Sept. 4, 2012

Matthew Letter:	Letter from Matthew L., Aug. 19, 2012
Maugain Letter:	Letter from Etienne Maugain, Apr. 12, 2012
Merkley Letter:	Letter from Sen. Jeffrey A. Merkley, *et al.*, U.S. Senate, Dec. 10, 2012
Mollick Letter:	Letter from Dr. Ethan Mollick, Assistant Professor of Management, The Wharton School, University of Pennsylvania, Dec. 17, 2012
Moore Letter:	Letter from Jason Moore, Manager, Apr. 23, 2012
Moss Letter:	Letter from Frank H. Moss, Jr., Adjunct Professor of Info Systems & Tech, Sept. 26, 2012
Movie Stream Productions Letter:	Letter from Dorian S. Cole, Movie Stream Productions, Jun. 1, 2012
NanoIVD Letter:	Letter from Sunnie P. Kim, Founder, CEO, NanoIVD, Inc., May 18, 2012
NASAA Letter:	Letter from Jack Herstein, President, North American Securities Administrators Association, Jul. 3, 2012
NCA Letter:	Letter from National Crowdfunding Association, May 11, 2012
NSBA Letter:	Letter from David R. Burton, General Counsel, National Small Business Association, Jun. 12, 2012
Ohio Division of Securities Letter:	Letter from Andrea L. Seidt, Commissioner, Ohio Division of Securities, Jan. 9, 2013
Old Takoma Letter:	Letter from Patricia Baker, Executive Director, Old Takoma Business Association, May 24, 2013

LeGaye Letter:	Letter from Daniel E. LeGaye, The LeGaye Law Firm, P.C., Sept. 7, 2012
Li Letter:	Letter from H. Bruce Li, Ph.D. P.E., Apr. 27, 2012
Leonhardt Letter 1:	Letter from Howard J. Leonhardt, CEO, Leonhardt Ventures and CalXStars Business Accelerator, Co-Leader Startup, California, Sept. 29, 2012
Leonhardt Letter 2:	Letter from Howard J. Leonhardt, Founder, Leonhardt Ventures, Jul. 11, 2013
Liles Letter 1:	Letter from Mike Liles, Jr., Seattle, Apr. 17, 2012
Liles Letter 2:	Letter from Mike Liles, Jr., Apr. 18, 2012
Lingam Letter 1:	Letter from Kiran Lingam, Esq., Apr. 11, 2012
Lingam Letter 2:	Letter from Kiran Lingam, Apr. 24, 2012
Lingam Letter 3:	Letter from Kiran Lingam, May 1, 2012
Litwak Letter:	Letter from Mark Litwak, Apr. 17, 2012
Lumeo.com Letter:	Letter from Brian McDonough, CEO & Founder, Lumeo.com, Sept. 6, 2012
Loofbourrow Letter:	Letter from Joe Loofbourrow, Apr. 24, 2012
MacDonald Letter:	Letter from Larry A. MacDonald, May 1, 2012
Markay Letter:	Letter from Mark W. Kanter, Founder, Markay Company, Jun. 25, 2012
Markel Letter:	Letter from Thomas O. Markel, Jr., Apr. 26, 2012

Hemlof Letter:	Letter from Loris Hemlof, Australia, Sept. 1, 2012
Hensel Letter:	Letter from Karl Hensel, May 15, 2012
High Tide Letter:	Letter from Albert Hartman, CEO, High Tide, Jun. 4, 2012
Holofy Letter:	Letter from Chris Nunes, Esq., CEO, Holofy, May 15, 2013
Hutchens Letter:	Letter from Matthew C. Hutchens, Sep. 29, 2013
Immix Letter:	Letter from Jerry Carleton, Robert Scott, Kane Lemley, and John French, Immix Law Group PC, Oct. 4, 2012
InitialCrowdOffering Letter:	Letter from Perry D. West, Esq., InitialCrowdOffering.com, May 4, 2012
International Franchise Association Letter:	Letter from Jay Perron, Vice President, Government Relations and Public Policy, International Franchise Association, Jan. 31, 2013
Isenberg Letter:	Letter from Daniel Isenberg, Ph.D., Apr. 15, 2012
Jain Letter:	Letter from Runjan A. Jain, Apr. 12, 2012
Koller Letter:	Letter from Jonathan Koller, May 2, 2012
Le Jeune Letter:	Letter from Yann Le Jeune, CEO, French Crowdfund Platform, Sept. 1, 2012
Landon Letter 1:	Letter from Christine Landon, Jul. 18, 2012
Landon Letter 2:	Letter from Christine Landon, Jul. 18, 2012
Larkey Letter:	Letter from Caren L. Larkey, Film Producer, May 23, 2012

Frankfurt Letter:	Letter from Thomas Selz, *et al.*, Frankfurt Kurnit Klein & Selz PC, Dec. 28, 2012
Friedman Letter:	Letter from Howard M. Friedman, Professor of Law Emeritus, University of Toledo, Apr. 27, 2012
Front Page Letter:	Letter from Robert Hoskins, Vice President, Media Relations, Front Page Public Relations, Mar. 2, 2013
Frost Letter:	Letter from Henry Frost, Sept. 17, 2012
FundaGeek Letter:	Letter from Cary Harwin, President, Co-Founder, FundaGeek.com, May 26, 2012
Genedyne Letter 1:	Letter from Thomas Braun, Genedyne Corporation, Aug. 16, 2012
Genedyne Letter 2:	Letter from Thomas Braun, Genedyne Corporation, Sept. 11, 2012
Gomez Letter 1:	Letter from Christian Gomez, Hayward, California, Nov. 12, 2012
Gomez Letter 2:	Letter from Chris Gomez, Hayward, California, Nov. 24, 2012
Gornick Letter:	Letter from Stephen Gornick, May 20, 2012
Gregory Letter:	Letter from Paul M. Gregory, Aug. 2, 2012
Grow VC Letter:	Letter from Jouko Ahvenainen and Valto Loikkanen, Co-founders, Grow VC, Jun. 15, 2012
Hakanson Letter:	Letter from Sten Erik Hakanson, Sep. 18, 2013
Hansen Letter:	Letter from Brian G. Hansen, Oct. 17, 2012

Dex Offshore Letter 3:	Letter from David Simpson, Dex Offshore Entertainment LLC, Jul. 23, 2012
Dex Offshore Letter 4:	Letter from David Simpson, Dex Offshore Entertainment LLC, Jul. 24, 2012
Donovan Letter:	Letter from Doug Donovan, Oct. 1, 2012
Donovan P. Letter:	Letter from Patrick Donovan, Sep. 27, 2013
Durward Letter:	Letter from James Durward, May 7, 2012
EarlyShares Letter 1:	Letter from Maurice Lopes, CEO, EarlyShares.com, Inc., Jul. 10, 2012
EarlyShares Letter 2:	Letter from Maurice Lopes, CEO, EarlyShares.com, Inc., Aug. 16, 2012
EnVironmental Letter:	Letter from Richard W. Marks, President, EnVironmental Transportation Solutions, LLC, Jun. 14, 2012
Equistratus Letter:	Letter from T.H. Ison, Equistratus, Mar. 22, 2013.
Escrow.com Letter:	Letter from Brandon Abbey, President and Managing Director, Escrow.com, Aug. 31, 2012
ExpertBeacon Letter:	Letter from Mark Law, CEO, ExpertBeacon.com, Seattle, Washington, Apr. 14, 2012
Fairhurst Letter:	Letter from Kraig Fairhurst, Apr. 11, 2012
Feldman Letter:	Letter from Aleksandr Feldman, Aug. 17, 2012
Ferguson Letter:	Letter from Zachary Ferguson, Jun. 13, 2013
Franken Letter:	Letter from Sen. Al Franken, U.S. Senator, Jan. 4, 2013

Crowdfunding Offerings Ltd. Letter 2:	Letter from Marshall Neel, Esq., Crowdfunding Offerings, Ltd., May 11, 2012
Crowdfunding Offerings Ltd. Letter 3:	Letter from Marshall Neel, Esq., Co-Founder, Crowdfunding Offerings, Ltd., May 11, 2012
Crowdfunding Offerings Ltd. Letter 4:	Letter from Marshall Neel, Esq., Co-Founder, Crowdfunding Offerings, Ltd., May 11, 2012
Crowdfunding Offerings Ltd. Letter 5:	Letter from Anthony D. Edwards, Esq., Founder, Crowdfunding Offerings, Ltd., May 11, 2012
Crowdfunding Offerings Ltd. Letter 6:	Letter from Anthony D. Edwards, Esq., Founder, Crowdfunding Offerings, Ltd., May 11, 2012
Crowdfunding Offerings Ltd. Letter 7:	Letter from Marshall Neel, Esq., Co-Founder, Crowdfunding Offerings, Ltd., Aug. 15, 2012
Crowdlever Letter 1:	Letter from Matt Morse, Sr., Feb. 1, 2013
Crowdlever Letter 2:	Letter from Matt Morse, Sr., Apr. 15, 2013
Cunningham Letter:	Letter from William Michael Cunningham, AM, MBA, Jan. 15, 2013
CyberIssues.com Letter:	Letter from T.W. Kennedy, BE, CEO of CyberIssues.com, Jun. 28, 2013
Dex Offshore Letter 1:	Letter from David E. Simpson, CFA, Founder, CEO of Dex Offshore Entertainment LLC, Apr. 14, 2012
Dex Offshore Letter 2:	Letter from David E. Simpson, Dex Offshore Entertainment LLC, Apr. 16, 2012

Coleman Letter:	Letter from Matthew R. Nutting, Esq., Coleman & Horowitt, LLP, Jan. 28, 2013
Commonwealth of Massachusetts Letter:	Letter from William F. Galvin, Secretary of the Commonwealth, Massachusetts, Aug. 8, 2012
CommunityLeader Letter:	Letter from Richard Weintraub, Chief Compliance Officer, CommunityLeader, Aug. 17, 2012
CompTIA Letter:	Letter from Lamar Whitman, Director, Public Advocacy, CompTIA, Jun. 28, 2012
Cones Letter:	Letter from John Cones, Apr. 19, 2012
Corporate Resolutions Letter:	Letter from Joelle Scott, Director of Business Intelligence, Corporate Resolutions Inc., Apr. 19, 2012
Crowd Startup Capital Letter:	Letter from Travis E. Chapman, Esq., Crowd Startup Capital, May 11, 2012
CrowdCheck Letter 1:	Letter from Sara Hanks, CEO, CrowdCheck, Inc., Apr. 30, 2012
CrowdCheck Letter 2:	Letter from Brian Knight, Vice President, CrowdCheck, Inc., Dec. 5, 2012
CrowdFund Capital Markets Letter:	Letter from Robert J. Thibodeau, President, CrowdFund Capital Markets, May 7, 2012
CrowdFund Connect Letter:	Letter from J. Randy Shipley, Founder, CrowdFund Connect, Social Gravity Inc., Jul. 28, 2012
Crowdfunding Offerings Ltd. Letter 1:	Letter from Anthony D. Edwards, Esq., Founder, Crowdfunding Offerings, Ltd., May 11, 2012

CFIRA Letter 4:	Letter from Kim Wales and Christine Landon, CFIRA, Aug. 9, 2012
CFIRA Letter 5:	Letter from Kim Wales, Founding member, and DJ Paul, Founding Member& CSO, CFIRA, Aug. 22, 2012
CFIRA Letter 6:	Letter from Lon David Varvel, Founding Member, CFIRA, Sept. 14, 2012
CFIRA Letter 7:	Letter from Chris Tyrrell, Kim Wales and Charles Sidman, Founding Members, CFIRA, Oct. 10, 2012
CFIRA Letter 8:	Letter from Chris Tyrrell, Kim Wales and Charles Sidman, Founding Members, CFIRA, Oct. 29, 2012
CFIRA Letter 9:	Letter from Kim Wales, Founding Member, CFIRA, Nov. 26, 2012
CFIRA Letter 10:	Letter from Scott Purcell, Board Member, CFIRA, Dec. 3, 2012
CFIRA Letter 11:	Letter from Kim Wales, Founding Member, CFIRA, Dec. 4, 2012
CFIRA Letter 12:	Letter from CFIRA, Jan. 21, 2013
CFIRA Letter 13:	Letter from Ryan Feit, Co-Founder & CEO, SeedInvest, and Kim Wales, Founding Member, CFIRA, Mar. 11, 2013
City First Letter:	Letter from John Hamilton, President, City First Enterprises, Jul. 4, 2013
CitySpark Letter:	Letter from David B. Haynie, CitySpark.com, Apr. 25, 2012
Coan Letter:	Letter from Marc C. Coan, Apr. 11, 2012

Bennet Letter:	Letter from Sen. Michael F. Bennet, U.S. Senator, Dec. 12, 2012
Black Letter:	Letter from Michael Black, Nov. 4, 2012
Blechman Letter:	Letter from Bruce Blechman, Apr. 13, 2012
BlueTree Letter:	Letter from Catherine V. Mott, Founder, BlueTree Allied Angels, Aug. 21, 2012
BrainThrob Laboratories Letter:	Letter from Erin C. DeSpain, President, BrainThrob Laboratories, Inc., Nov. 8, 2012
Brandon W Letter:	Letter from Brandon W., Apr. 16, 2012
Buffalo First Letter:	Letter from Kelly A. Maurer, Treasurer, Buffalo First Member, Buffalo Common Wealth LLC Assistant Treasurer, Buffalo Cooperative FCU, Apr. 16, 2012
Bulldog Investors Letter:	Letter from Philip Goldstein, Bulldog Investors, Jul. 18, 2012
Cera Technology Letter:	Letter from Michael Mace, CEO, Cera Technology, Apr. 13, 2012
CFA Institute Letter:	Letter from Kurt N. Schacht and Linda L. Rittenhouse, CFA Institute, Aug. 16, 2012
CFIRA Letter 1:	Letter from Sherwood E. Neiss, Crowdfund Investing Regulatory Advocates (CFIRA), May 15, 2012
CFIRA Letter 2:	Letter from Candace S. Klein, Chair and Vincent R. Molinari, Co-Chair, CFIRA, May 30, 2012
CFIRA Letter 3:	Letter from Candace S. Klein, Chair and Vincent R. Molinari, Co-Chair, CFIRA, Jun. 5, 2012

ASBC Letter:	Letter from American Sustainable Business Council, Jul. 16, 2012
AngelList Letter:	Letter from Naval Ravikant, CEO, AngelList, May 23, 2012
AppleSeedz Letter:	Letter from EL Mazyck, President, AppleSeedz.com, Jul. 23, 2012
Applied Dynamite Letter:	Letter from Randall Lucas, CEO, Applied Dynamite Inc., May 4, 2012
ARS Letter:	Letter from Mark Norych, Esq., Executive Vice President, General Counsel, Board Member, Arbitration Resolution Services, Inc., Jul. 19, 2013
Arctic Island Letter:	Letter from Scott Purcell, Founder, Arctic Island Crowdfunding Portal, Jun. 26, 2012
Ayeni Letter:	Letter from Debo Ayeni, Dec. 23, 2012
Bach Letter:	Letter from David Bach, Apr. 18, 2012
Barnes Letter:	Letter from Ryan Barnes, Aug. 22, 2012
Basko Letter:	Letter from Sue Basko, Lawyer, Jun. 18, 2012
Becotte Letter:	Letter from Chase Becotte, Aug. 31, 2012
Bedford Letter:	Letter from Shante Jones, Vice President, Bedford Stuvyesant Unity Youth Resources, Inc., Feb. 14, 2013
BeFounders Letter:	Letter from William J. Mills, JD, BeFounders, Apr. 24, 2012
Begich Letter:	Letter from Sen. Mark Begich, U.S. Senator, Jul. 18, 2013

Note: The following exhibit will not appear in the Code of Federal Regulations.

Exhibit A

Comments Letters Received Regarding Title III of the JOBS Act

Proposal to Implement Regulation Crowdfunding (File No. S7-09-13)

ABA Letter 1:	Letter from Catherine T. Dixon, Chair, Federal Regulation of Securities Committee, American Bar Association, Mar. 20, 2013
ABA Letter 2:	Letter from Catherine T. Dixon, Chair, Federal Regulation of Securities Committee, American Bar Association, Jun. 26, 2013
ACA Letter:	Letter from Divina K. Westerfield, Esq., Manager, American Crowdfunding Association Inc., Oct. 8, 2013
ACFIA Letter 1:	Letter from John Vassilliw, American Crowdfunding Investment Association, Dec. 15, 2012
ACFIA Letter 2:	Letter from John Vassilliw, American Crowdfunding Investment Association, Jan. 3, 2013
ACFIA Letter 3:	Letter from John Vassilliw, American Crowdfunding Investment Association, Jan. 3, 2013
Acos Letter:	Letter from Jim Acos, Jun. 10, 2012
AKickInCrowd.com Letter:	Letter from Tony Reynolds, Founder, AKickInCrowd.Com, May 11, 2012
Alabama Development Office Letter:	Letter from S. Douglas Smith, Founding Director of the Alabama Development Office and the Alabama Department of Economic and Community Affairs, Oct. 22, 2012

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70751 / October 24, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15587

In the Matter of

Stryker Corporation,

Respondent.

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission (the "Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (the "Exchange Act"), against Stryker Corporation ("Stryker" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over it and the subject matter of these proceedings and to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.
FACTS

On the basis of this Order and the Respondent's Offer, the Commission finds[1] that:

Summary

1. From approximately August 2003 to February 2008 (the "relevant period"), Stryker made approximately $2.2 million in unlawful payments to various government employees including public health care professionals (collectively, the "foreign officials") in Mexico, Poland, Romania, Argentina, and Greece. Stryker incorrectly described these expenses in the company's books and records as legitimate consulting and service contracts, travel expenses, charitable donations, or commissions, when in fact the payments were improperly made by Stryker to obtain or retain business. Stryker earned approximately $7.5 million in illicit profits as a result of these payments.

2. During the relevant period, Stryker incorrectly described unlawful payments to foreign officials in its accounting books and records in violation of Section 13(b)(2)(A) of the Securities Exchange Act of 1934 (the "Exchange Act") and failed to devise and maintain an adequate system of internal accounting controls in violation of Section 13(b)(2)(B) of the Exchange Act.

Respondent

3. Stryker is a Michigan corporation with its principal executive offices in Kalamazoo, Michigan. Stryker manufactures and distributes medical devices and products in more than 100 countries around the world. Its common stock is registered with the Securities and Exchange Commission pursuant to Section 12(b) of the Exchange Act and is listed on the New York Stock Exchange under the symbol "SYK." Stryker is an "issuer" within the meaning of the Foreign Corrupt Practices Act ("FCPA"), 15 U.S.C. § 78dd-1.

Background

4. During the relevant period, Stryker sold its medical products around the world. In certain countries, Stryker sold products through wholly-owned regional subsidiaries and through third-party dealers and distributors. Stryker's medical products include implants, surgical equipment, and neurotechnology devices. In 2008, approximately 36% of Stryker's over $6.7 billion in total sales occurred outside of the United States. The financial results of all of the Stryker subsidiaries discussed herein were consolidated into Stryker's financial statements.

5. Stryker's foreign subsidiaries were organized in a decentralized, country-based structure, wherein a manager of a particular country's operations had primary responsibility for all business within a given country. During the relevant period, each of Stryker's foreign subsidiaries operated pursuant to individual policies and directives implemented by country or regional management. Stryker had corporate policies addressing anti-corruption, but these

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

policies were inadequate and insufficiently implemented on the regional and country level. Accordingly, Stryker failed to devise and maintain an adequate system of internal accounting controls sufficient to provide reasonable assurance that the company maintained accountability for its assets and that transactions were executed in accordance with management's authorization.

Unlawful Payments in Mexico

6. Between March 2004 and January 2007, Stryker's wholly-owned subsidiary in Mexico ("Stryker Mexico") made three payments totaling more than $76,000 to foreign officials employed by a Mexican governmental agency (the "Mexican Agency") responsible for providing social security for government employees. Stryker made these payments to win bids to sell its medical products to certain public hospitals in Mexico. Stryker Mexico earned more than $2.1 million in profits as a result of these illicit payments.

7. These payments were made at the direction of Stryker Mexico employees, including country level management, and paid to the foreign officials through third party agents.

8. For example, in January 2006, Stryker Mexico learned that the Mexican Agency was threatening to revoke a contract that Stryker Mexico had won to provide knee and hip products to certain public hospitals unless Stryker Mexico paid an employee of the Mexican Agency.

9. As a result of the demand by the employee of the Mexican Agency, Stryker Mexico directed its outside counsel in Mexico (the "Mexican Law Firm") to make a payment to the employee, on Stryker Mexico's behalf, in order for Stryker to keep the winning bid.

10. At Stryker Mexico's direction, the Mexican Law Firm paid the foreign official approximately $46,000 on behalf of Stryker Mexico and, as a result of this payment, the Mexican Agency did not revoke Stryker Mexico's status as the winning bidder. The Mexican Law Firm then invoiced Stryker Mexico for $46,000 for purported legal services rendered, even though no such services were provided. Stryker Mexico recorded these improper payments as legitimate legal expenses in its books and records.

11. Stryker Mexico earned over $1.1 million in illicit profits on this contract alone.

12. Stryker Mexico made two additional payments through intermediaries during the relevant period in much the same fashion, with the purpose of retaining or obtaining business from public hospitals. The additional payments were in excess of $34,000 and earned Stryker illicit profits of nearly $1 million.

Unlawful Payments in Poland

13. Between August 2003 and November 2006, Stryker's wholly-owned subsidiary in Poland ("Stryker Poland") made 32 improper payments to foreign officials in Poland for the purpose of obtaining or retaining business at public hospitals. In total, Stryker Poland made approximately $460,000 in unlawful payments resulting in more than $2.4 million of illicit profits.

14. These improper payments were recorded in Stryker's books and records as legitimate expenses, including reimbursement for business travel, consulting and service contract payments, and charitable donations.

15. For example, in May 2004, Stryker Poland paid for a foreign official then employed as the director of a public hospital in Poland, and her husband, to travel to New York City and Aruba. Although the official purpose of the trip was for the foreign official to attend a single-day tour of Stryker's manufacturing and research facility in Mahwah, New Jersey, Stryker paid for the couple's six-night stay at a hotel in New York City, attendance at two Broadway shows, and a five-day trip to Aruba before their return flight to Poland.

16. According to Stryker Poland's records, expenses for the trip, including airfare, accommodations, and entertainment, totaled approximately $7,000, all of which Stryker Poland recorded as legitimate travel expenses.

17. Stryker Poland's internal documents confirm a quid pro quo arrangement between Stryker Poland and the foreign official. For example, the form containing the schedule for the foreign official's facility tour states that the purpose of the visit was to "strengthen [the public doctor's] conviction that Stryker products are the best solution for her hospital," and notes that "we won a big tender for [one product] (about $350,000) and in this year they are going to buy our products for $500,000."

18. Stryker Poland also made additional improper travel payments, payments under purported consulting agreements totaling approximately $47,000, and gifts and donations of nearly $400,000, each of which was made to a state-employed healthcare professional for the purpose of Stryker Poland's obtaining or retaining the business of public hospitals.

Unlawful Payments in Romania

19. From at least 2003 through July 2007, Stryker's wholly-owned subsidiary in Romania ("Stryker Romania") made 192 improper payments to foreign officials totaling approximately $500,000 in order to obtain or retain business with affiliated public hospitals.

20. Stryker Romania recorded these payments as legitimate sponsorships of foreign officials' attendance, travel and lodging at conferences, and medical events, when in reality they were illicit payments made to obtain or retain business.

21. As a result of these payments, Stryker Romania earned more than $1.7 million in illicit profits.

22. For example, in April 2004, a Stryker Romania salesperson submitted a form to sponsor a foreign official's lodging abroad to attend a conference. The form stated that a "business benefit[]" from the sponsorship was that, in return, Stryker Romania would receive a contract for the sale of a particular medical device. In addition, Stryker Romania internally discussed that the foreign official in question was "waiting to be confirmed as chief physician" at a public hospital, "thus becoming important" for an upcoming bid for a contract. Stryker Romania recorded the payment as a legitimate business travel expense even though its own

internal documents demonstrated that the payment was made with the purpose of obtaining future business.

Unlawful Payments in Argentina

23. Between 2005 and 2008, Stryker's wholly-owned subsidiary in Argentina ("Stryker Argentina") made 392 commission payments, or "honoraria," to physicians employed in the public healthcare system in order to obtain or retain business with affiliated public hospitals.

24. Unlike traditional honorarium payments that are made in exchange for the provision of a service (such as making a speech), these honoraria were commissions that were calculated as a percentage of a total sale to a particular hospital and then paid to the public doctor associated with the sale. Stryker Argentina routinely made these payments by check to doctors at rates between 20% and 25% of the related sale.

25. In total, Stryker Argentina made more than $966,500 in improper honoraria payments during the relevant period, causing Stryker Argentina to earn more than $1.04 million in profits from the public hospitals with which the doctors were associated.

26. Stryker Argentina booked these payments as commission expenses in an account entitled "Honorarios Medicos," when in fact they were unlawful payments made to compensate doctors for purchasing Stryker products.

Unlawful Payments in Greece

27. In 2007, Stryker's wholly-owned subsidiary in Greece ("Stryker Greece") made a sizeable and atypical donation of $197,055 to a public university (the "Greek University") to fund a laboratory that was then being established by a foreign official who served as a prominent professor at the Greek University, and was the director of medical clinics at two public hospitals affiliated with the Greek University.

28. As a result of this donation, Stryker Greece earned a total of $183,000 in illicit profits.

29. The donation was made pursuant to a quid pro quo arrangement with the foreign official, pursuant to which Stryker Greece understood it would obtain and retain business from the public hospitals with which the foreign official was affiliated, in exchange for making the donation to the foreign official's pet project.

30. In an email from the country manager of Stryker Greece to the regional manager, the country manager emphasized that she believed the donation to the Greek University was necessary to secure future sales for Stryker Greece.

31. The country manager wrote: "I think that anything below 30K will leave [the foreign official] disappointed. He did promise that he would direct his young assistants into using our trauma and sports medicine products. [The foreign official] is . . . difficult to get as a 'friend' and really tough to have as a disappointed customer." The regional manager asked,

"What do we get for the sponsorship – or is it just a gift?" The country manager confirmed the quid pro quo, stating, "For the sponsorship we get the Spine business and a promise for more products in his Department. . ."

32. At a later date, another country manager stated, "I am willing to support what [the foreign official] is asking for in order to secure the sales he is bringing in." The regional manager then approved the request. Soon thereafter, the country manager said of his meeting with the foreign official: "Things went well (how couldn't they—I offered him the amount he is asking for . . .). . . . My impression is that we will start business again."

33. Stryker Greece made the donation to the Greek University in three installments, each of which was improperly booked as a legitimate marketing expense in an account entitled "Donations and Grants."

IV.
FCPA VIOLATIONS

Books and Records Violations

34. As detailed above, Stryker's foreign subsidiaries made over $2.2 million in unlawful payments to foreign officials that were incorrectly described in the company's books and records. Stryker improperly recorded these payments as legitimate consulting and service contract payments, business travel expenses, charitable donations, or commissions.

35. As a result of the conduct described above, Stryker violated Section 13(b)(2)(A) of the Exchange Act, which requires every issuer with a class of securities registered pursuant to Section 12 of the Exchange Act to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer. Public companies are responsible for ensuring that their foreign subsidiaries comply with Exchange Act Section 13(b)(2)(A).

Internal Controls Violations

36. As detailed above, Stryker and its foreign subsidiaries failed to devise and maintain an adequate system of internal accounting controls sufficient to provide reasonable assurance that the company maintained accountability for its assets and that transactions were executed in accordance with management's authorization. Due to this lack of oversight, Stryker incorrectly booked over $2.2 million in illicit payments to foreign officials as legitimate expenses without properly examining the circumstances surrounding the accounting treatment of these payments. In many instances, even a cursory review of the underlying documentation, such as travel authorization forms and itineraries, would have revealed the illegitimate nature of the payments.

37. As a result of the conduct described above, Stryker violated Section 13(b)(2)(B) of the Exchange Act, which requires all public companies to, among other things, devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded in accordance with management's general or specific authorization; and transactions are recorded as necessary to permit preparation of financial statements in

conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets. Public companies are responsible for ensuring that their foreign subsidiaries comply with Exchange Act Section 13(b)(2)(B).

Stryker's Remedial Efforts

38. In response to the Commission's investigation, Stryker retained outside counsel to assist Stryker in conducting an internal investigation into Stryker's compliance with the FCPA in the jurisdictions that were the subject of the staff's inquiry, as well as in jurisdictions where issues arose through Stryker's audit and hotline processes. Stryker voluntarily produced reports and other materials to the Commission staff summarizing the findings of its internal investigation. In total, Stryker produced over 800,000 pages of documents at Stryker's expense, including courtesy translations of numerous key documents.

39. Since the time of the conduct detailed above, Stryker implemented a company-wide anti-corruption compliance program, which includes: (a) enhanced corporate policies and standard operating procedures setting forth specific due diligence and documentation requirements for relationships with foreign officials, health care professionals, consultants, and distributors; (b) compliance monitoring and corporate auditing specifically tailored to anti-corruption, including the hiring of a chief compliance officer and a sizeable full-time dedicated staff in both its internal audit and compliance functions to ensure FCPA compliance and the implementation of periodic self-assessments; (c) enhanced financial controls and governance; (d) expanded anti-corruption training to all Stryker employees; and (e) the maintenance of an Ethics Hotline which serves as a mechanism for employees to report any actual or suspected illegal or unethical behavior.

40. In addition to its internal anti-corruption enhancements, from 2007 through the present, Stryker engaged a third-party consultant to perform FCPA compliance assessments and compile written reports for Stryker's operations in dozens of foreign jurisdictions across the world at least annually. Stryker voluntarily produced documents that permitted the Commission staff to assess how Stryker's internal audit and compliance functions used the results of each of the assessments to implement additional enhancements to its infrastructure, to target jurisdictions for future assessments, and to create management action plans in collaboration with local management.

41. Based on the improvements described above, Stryker has demonstrated a commitment to designing and funding a meaningful compliance program in order to prevent and detect violations of the FCPA and other applicable anti-bribery laws.

V.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Stryker's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Stryker shall cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act;

B. Respondent shall, within ten days of the entry of this Order, pay $13,283,523 to the United States Treasury, including $7,502,635 in disgorgement, $2,280,888 in prejudgment interest thereon, and a civil monetary penalty of $3,500,000. If timely payment is not made, interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Stryker as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Andrew M. Calamari, Regional Director, New York Regional Office, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY 10281-1022.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3706 / October 28, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15589

In the Matter of **GW & WADE, LLC,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against GW & Wade, LLC ("GW & Wade" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

Summary

1. Historically, registered investment adviser GW & Wade had custody of certain client assets that it could access and transfer to third parties but it failed to obtain an examination of those assets by an independent public accountant and to identify those assets in its public disclosures. GW & Wade also had not adopted or implemented policies and procedures reasonably designed to prevent violations of the securities laws and rules governing custody of client assets or kept required books and records for certain custodied accounts. In addition, GW & Wade did not adequately implement its policies and procedures for calculating its advisory fees in discretionary accounts, which resulted in billing overcharges to certain clients.

Respondent

2. GW & Wade (SEC File No. 801-27292) is a Massachusetts limited liability company with its principal place of business in Wellesley, Massachusetts. GW & Wade has been registered with the Commission as an investment adviser since 1986. As of April 1, 2013, GW & Wade provided discretionary and non-discretionary investment management services to approximately 1600 clients (6,700 accounts) and managed approximately \$3.8 billion in assets. GW & Wade has an affiliated broker-dealer, GW & Wade Asset Management Company, LLC (SEC File No. 8-42013), which has been registered with the Commission since 1990.

Background

3. GW & Wade is a registered investment adviser that manages assets for primarily high net worth retail clients. GW & Wade typically invests client assets in mutual funds.

4. GW & Wade has had several types of client arrangements that gave it access to, and, in certain cases, the ability to transfer, client funds but for which it did not have proper safeguards as a custodian. In one type of client arrangement, GW & Wade maintained Letters of Authorization ("LOAs") signed by some clients but otherwise in blank for over 900 accounts. When a client requested that GW & Wade transfer funds, GW & Wade would fill them out. The practice enabled GW & Wade to transfer client funds without having to obtain client signatures in every instance. GW & Wade investment advisory representatives on occasion also cut out the signature from a previously executed LOA and pasted it onto a new LOA to effect authorized transfers of client funds.

5. This practice exposed GW & Wade's clients to potential harm and ultimately contributed to a third-party fraud that occurred in one client account in June 2012 when an individual hacked into a client's email account and, posing as the client, sent emails to GW & Wade requesting that the client's funds be wired to a foreign bank. For each wire request, the

individual posing as the client stated that he could not access a telephone (*e.g.*, in a meeting and at a funeral) but needed funds disbursed the same day. GW & Wade filled out an LOA with a photocopied client signature and provided it to its clearing firm, which wired the funds to the foreign bank. Because GW & Wade maintained pre-signed LOAs in its files and did not have any procedures in place to confirm the authenticity of transfer requests made by email, the client's funds were wired without the client's knowledge or authorization. The third-party fraud was not discovered until three separate wires totaling $290,000 had been sent to the foreign bank. GW & Wade compensated the client for all losses associated with these unauthorized wires.

6. In addition to the accounts for which GW & Wade maintained pre-signed LOAs, GW & Wade also had custody of assets in accounts where it (i) had been granted third-party delegation on check-writing accounts, and (ii) possessed log-in information and passwords for outside accounts (*e.g.*, employee retirement and brokerage accounts).

7. With respect to these client arrangements giving rise to custody, the firm failed to obtain an examination by an independent public accountant and to identify the assets of which it had custody in its public filings. As a result, these assets were not subject to surprise audits (as the Advisers Act custody rule requires), and GW & Wade's disclosures regarding custody in its Forms ADV (the publicly-filed form used by investment advisers to register with the Commission) were inaccurate. For instance, in its responses to Item 9.A.(2) of Part 1A of the Form ADV and Item 15 of Part 2A of the Form ADV (the brochure), GW & Wade understated the amount of client funds in its custody and did not accurately disclose all types of custody arrangements it had with clients.

8. As evidenced in part by the June 2012 hacking incident described above, GW & Wade's policies and procedures for its custody arrangements also were inadequate to protect client assets. In addition, the firm's books and records were deficient because GW & Wade did not maintain records of account activity in outside accounts where it possessed password-access and the ability to transfer funds.

9. GW & Wade also failed to implement adequately its policies and procedures for calculating its advisory fee and billing clients. With respect to its discretionary accounts, GW & Wade has a policy of excluding the mutual fund class C shares held by its clients from its advisory fee calculation because mutual fund class C shares may carry up to a 1% annual fee for sales-related expenses, pursuant to Rule 12b-1 of the Investment Company Act of 1940 ("Rule 12b-1 fees"). In this case, GW & Wade's affiliated broker-dealer receives the Rule 12b-1 fees paid on the class C shares held by GW & Wade clients. GW & Wade has a manual process for backing out the mutual fund C shares from its advisory fee calculation. Typically, the assistant to a particular client's investment advisory representative is responsible for calculating the advisory fee and properly segregating class C shares from the calculation. This manual bill review and fee calculation process resulted in some clients being overcharged because their advisory fees erroneously included fees attributable to their class C share holdings.

Violations

10. As a result of the conduct described above, GW & Wade willfully[1] violated Section 206(4) of the Advisers Act and Rule 206(4)-2 promulgated thereunder. Section 206(4) prohibits an investment adviser from engaging in acts, practices or courses of business that are fraudulent, deceptive, or manipulative, as defined by the Commission in rules and regulations promulgated under the statute. Rule 206(4)-2 requires registered advisers with custody of client assets to implement certain enumerated controls designed to protect those assets from loss, misappropriation, misuse, or the adviser's insolvency, including subjecting custodied assets to surprise, independent examination on an annual basis. By failing to do so, GW & Wade willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-2 promulgated thereunder.

11. As a result of the conduct described above, GW & Wade willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder. Rule 206(4)-7 requires registered advisers, among other items, to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act. By failing to adopt and implement policies and procedures reasonably designed to prevent violations of the securities laws and rules governing custody of client assets, GW & Wade willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder.

12. As a result of the conduct described above, GW & Wade willfully violated Section 207 of the Advisers Act, which makes it "unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission . . . or willfully to omit to state in any such application or report any material fact which is required to be stated therein." By failing to identify certain of its custody arrangements and fully disclose its assets under custody in its public filings with the Commission, GW & Wade willfully violated Section 207 of the Advisers Act.

13. As a result of the conduct described above, GW & Wade willfully violated Section 204 of the Advisers Act and Rules 204-2(a)(3) and 204-2(b)(1) promulgated thereunder, which require investment advisers registered with the Commission to make and keep for certain periods such records and make and disseminate such reports as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors. Rule 204-2(a)(3) requires an adviser to maintain a memorandum of each order given by the adviser for the purchase or sale of any security, of any instruction received by the adviser from the client concerning the purchase, sale, receipt or delivery of a particular security, and of any modification or cancellation of any such order or instruction. Rule 204-2(b)(1) requires advisers with custody of client assets to make and keep a journal or other record showing all purchases, sales, receipts and deliveries of securities (including certificate numbers) for such accounts and all other debits and credits to such accounts. By failing to keep adequate books and records of activity in outside client accounts of

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[1] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

which GW & Wade has custody, GW & Wade willfully violated Section 204 of the Advisers Act and Rules 204-2(a)(3) and 204-2(b)(1) promulgated thereunder.

Respondent's Cooperation and Remedial Acts

14. In determining to accept GW & Wade's settlement offer, the Commission considered remedial acts promptly undertaken by GW & Wade and cooperation afforded the Commission staff. In particular, after its violations were identified but prior to resolution of this proceeding, GW & Wade, among other things, (i) implemented a Wire, Checks, and Journal Disbursements Policy, which eliminates the use of pre-signed LOAs and requires investment advisory representatives to confirm transfer requests with clients by telephone; (ii) agreed to implement (and is in the process of implementing) account management system under which access to most outside client accounts will be read-only; (iii) implemented policies and procedures for tracking and safeguarding password and log-in information for outside client accounts and for maintaining appropriate books and records of all transactions in custodied outside accounts, irrespective of whether GW & Wade conducts transactions in those accounts; (iv) implemented a policy for heightened review of client bills to prevent advisory fee overcharges; and (v) reimbursed all clients holding class C mutual fund shares who were overcharged advisory fees during 2011 and 2012.

Undertakings

15. GW & Wade undertakes to:

A. Retain, at its expense and within thirty (30) days of the issuance of this Order, an independent consultant (the "Consultant") not unacceptable to the staff of the Division of Enforcement. Respondent shall require the Consultant to conduct a comprehensive review of GW & Wade's written compliance policies and procedures reasonably designed to ensure that it is meeting its custody and related books and records obligations, charging its advisory fee accurately, and otherwise safeguarding client assets, in compliance with the Advisers Act.

B. Require the Consultant to complete its review and submit a written report (the "Report") to GW & Wade and Commission staff within one hundred twenty (120) days of the issuance of this Order. GW & Wade shall require that the Report describe the review performed, the conclusions reached, and recommendations for any changes in or improvements to GW & Wade's supervisory and compliance policies and procedures.

C. Within sixty (60) days of receiving the Report, adopt and implement all recommendations contained in the Report; provided, however, that as to any recommendation that GW & Wade considers to be, in whole or in part, unduly burdensome or impractical, GW & Wade may submit in writing to the Consultant, within thirty (30) days of receiving the Report, an alternative policy, practice, or procedure designed to achieve the same objective or purpose. Within forty-five (45) days of receiving the Report, GW & Wade and the Consultant shall attempt in good faith to reach an agreement relating to each recommendation that GW & Wade considers to be unduly burdensome or impractical. GW & Wade shall ultimately abide by the determinations of the Consultant.

D. Require the Consultant to enter into an agreement that provides for the period of engagement and for a period of two years from completion of the engagement, the Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with GW & Wade, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Consultant will require that any firm with which the Consultant is affiliated or of which the Consultant is a member, and any person engaged to assist the Consultant in performance of the Consultant's duties under this Order shall not, without prior written consent of Commission staff, enter into any employment consultant, attorney-client, auditing or other professional relationship with GW & Wade, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

E. To ensure the independence of the Consultant, GW & Wade shall not have the authority to terminate the Consultant without prior written approval of Commission staff and shall compensate the Consultant and persons engaged to assist the Consultant for services rendered pursuant to this Order at their reasonable and customary rates.

F. For good cause shown, the Commission's staff may extend any of the procedural dates relating to the undertakings. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

16. Within 365 days of the issuance of this Order, GW & Wade undertakes to reimburse in full all of its clients who since January 1, 2005, have paid excess advisory fees in accounts due to GW & Wade's failure to exclude mutual fund class C share holdings from the advisory fee calculation.

17. GW & Wade undertakes to provide notice of these proceedings to its clients, as follows:

A. Within thirty (30) days of the issuance of this Order, GW & Wade undertakes to revise the Form ADV to include the paragraphs contained in Section III of this Order.

B. Within thirty (30) days of the issuance of this Order, GW & Wade undertakes to mail a copy of the Form ADV which incorporates the paragraphs contained in Section III of this Order to each of GW & Wade's existing clients.

C. GW & Wade further undertakes, for a period of one year from the date of issuance of this Order, to provide a copy of the Form ADV to each prospective client prior to entering into any written or oral investment advisory contract.

18. GW & Wade shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and GW & Wade agrees to provide such evidence. The certification and supporting material shall be submitted to Kevin M. Kelcourse, Assistant Director, Asset Management Unit, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, Suite 2300, Boston, Massachusetts 02110, with a copy to the Office of Chief Counsel of the Enforcement Division (Securities and Exchange Commission, 100 F Street, NE, Washington, DC, 20549), no later than sixty (60) days from the date of the completion of the undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Sections 204, 206(4), and 207 of the Advisers Act, and Rules 204-2, 206(4)-2 and 206(4)-7 promulgated thereunder.

B. Respondent is censured.

C. Respondent shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $250,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying GW & Wade as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Kevin M. Kelcourse, Assistant Director, Asset Management Unit, Boston Regional Office, Securities and Exchange Division, 33 Arch Street, Suite 2300, Boson, Massachusetts 02110. If transmitting payment electronically by wire or directing payment from a bank account via Pay.gov, Respondent shall send a letter to Mr. Kelcourse confirming the date of payment, method of payment (e.g., wire or Pay.gov), and tracking information (e.g., agency tracking identification number).

D. Respondent shall comply with the undertakings enumerated in Section III.15-18 above.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-70763; File No. 4-546)

October 28, 2013

Joint Industry Plan; Notice of Filing and Immediate Effectiveness of Amendment to the Options Order Protection and Locked/Crossed Market Plan to Add Topaz Exchange, LLC as a Participant

Pursuant to Section 11A(a)(3) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 608 thereunder,[2] notice is hereby given that on August 7, 2013, Topaz Exchange, LLC ("Topaz" or "Exchange") filed with the Securities and Exchange Commission ("Commission") an amendment to the Options Order Protection and Locked/Crossed Market Plan ("Plan").[3] The amendment added Topaz as a Participant[4] to the Plan. The Commission is publishing this notice to solicit comments on the amendment from interested persons.

I. <u>Description and Purpose of the Amendment</u>

The current Participants in the Linkage Plan are BOX Options, C2, CBOE, BATS, ISE,

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1 15 U.S.C. 78k-1(a)(3).

2 17 CFR 242.608.

3 On July 30, 2009, the Commission approved a national market system plan relating to Options Order Protection and Locked/Crossed Markets proposed by Chicago Board Options Exchange, Incorporated ("CBOE"), International Securities Exchange, LLC ("ISE"), The NASDAQ Stock Market LLC ("Nasdaq"), NASDAQ OMX BX, Inc. ("BOX"), NASDAQ OMX PHLX, Inc. ("Phlx"), NYSE Amex, LLC ("NYSE Amex"), and NYSE Arca, Inc. ("NYSE Arca"). <u>See</u> Securities Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (August 6, 2009). <u>See also</u> Securities Exchange Act Release Nos. 61546 (February 19, 2010), 75 FR 8762 (February 25, 2010) (adding BATS Exchange, Inc. ("BATS") as a Participant); 63119 (October 15, 2010), 75 FR 65536 (October 25, 2010) (adding C2 Options Exchange, Incorporated ("C2") as a Participant); 66969 (May 11, 2012), 77 FR 29396 (May 17, 2012) (adding BOX Options Exchange LLC ("BOX Options") as a Participant). Miami International Securities Exchange, LLC ("MIAX") joined the Plan on December 5, 2012.

4 The term "Participant" is defined as an Eligible Exchange whose participation in the Plan has become effective pursuant to Section 3(c) of the Plan.

Nasdaq, BOX, Phlx, NYSE Amex,[5] NYSE Arca, and MIAX. The amendment to the Plan added Topaz as a Participant in the Plan. Topaz has submitted a signed copy of the Plan to the Commission in accordance with the procedures set forth in the Plan regarding new Participants. Section 3(c) of the Plan provides for the entry of new Participants to the Plan. Specifically an Eligible Exchange[6] may become a Participant in the Plan by: (i) executing a copy of the Plan, as then in effect; (ii) providing each current Participant with a copy of such executed Plan; (iii) effecting an amendment to the Plan, as specified in Sections 3(c) and 4(b) of the Plan.

Section 4(b) of the Plan puts forth the process by which an Eligible Exchange may effect an amendment to the Plan. Specifically, an Eligible Exchange must: (a) execute a copy of the Plan with the only change being the addition of the new participant's name in Section 3(a) of the Plan; and (b) submit the executed Plan to the Commission. The Plan then provides that such an amendment will be effective when the amendment is approved by the Commission or otherwise becomes effective pursuant to Section 11A of the Act and Rule 608 thereunder.

II. Effectiveness of the Linkage Plan Amendment

The foregoing Plan amendment has become effective pursuant to Rule 608(b)(3)(iii) of

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5 NYSE Amex was recently renamed NYSE MKT LLC. See Securities Exchange Act Release No. 67037 (May 21, 2012), 77 FR 31415 (May 25, 2012) (SR-NYSEAmex-2012-32).

6 Section 2(6) of the Plan defines an "Eligible Exchange" as a national securities exchange registered with the Commission pursuant to Section 6(a) of the Act, 15 U.S.C. 78f(a), that: (a) is a "Participant Exchange" in the Options Clearing Corporation ("OCC") (as defined in OCC By-laws, Section VII); (b) is a party to the Options Price Reporting Authority ("OPRA") Plan (as defined in the OPRA Plan, Section 1); and (c) if the national securities exchange chooses not to become party to this Plan, is a participant in another plan approved by the Commission providing for comparable Trade-Through and Locked and Crossed Market protection. Topaz has represented that it has met the requirements for being considered an Eligible Exchange. See letter from Michael Simon, Secretary, Topaz Exchange, LLC to Elizabeth Murphy, Secretary, Commission, dated August 1, 2013.

the Act[7] because it involves solely technical or ministerial matters. At any time within sixty days of the filing of this amendment, the Commission may summarily abrogate the amendment and require that it be refiled pursuant to paragraph (b)(1) of Rule 608,[8] if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors or the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanisms of, a national market system or otherwise in furtherance of the purposes of the Act.

III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the amendment is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number 4-546 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number 4-546. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the

7 17 CFR 242.608(b)(3)(iii).

8 17 CFR 242.608(b)(1).

Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the amendment that are filed with the Commission, and all written communications relating to the amendment between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the principal office of Topaz. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number 4-546 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-70764; File No. 4-443)

October 28, 2013

Joint Industry Plan; Notice of Filing and Immediate Effectiveness of Amendment to the Plan for the Purpose of Developing and Implementing Procedures Designed to Facilitate the Listing and Trading of Standardized Options to Add Miami International Securities Exchange, LLC ("MIAX") as a Plan Sponsor

Pursuant to Section 11A(a)(3) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 608 thereunder,[2] notice is hereby given that on December 6, 2012, Miami International Securities Exchange, LLC ("MIAX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") an amendment to the Plan for the Purpose of Developing and Implementing Procedures Designed to Facilitate the Listing and Trading of Standardized Options ("OLPP").[3] The amendment proposes to add MIAX as a Sponsor of the OLPP. The Commission is publishing this notice to solicit comments on the proposed rule change from

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1 15 U.S.C. 78k-1(a)(3).

2 17 CFR 242.608.

3 On July 6, 2001, the Commission approved the OLPP, which was proposed by the American Stock Exchange LLC ("Amex"), Chicago Board Options Exchange, Incorporated ("CBOE"), International Securities Exchange LLC ("ISE"), Options Clearing Corporation ("OCC"), Philadelphia Stock Exchange, Inc. ("Phlx"), and Pacific Exchange, Inc. ("PCX") (n/k/a NYSE Arca). See Securities Exchange Act Release No. 44521, 66 FR 36809 (July 13, 2001). On February 5, 2004, Boston Stock Exchange, Inc. ("BSE") was added as a Sponsor to OLPP. See Securities Exchange Act Release No. 49199, 69 FR 7030 (February 12, 2004). On March 21, 2008, the Nasdaq Stock Market, LLC ("Nasdaq") was added as a Sponsor to the OLPP. See Securities Exchange Act Release No. 57546, 73 FR 16393 (March 27, 2008). On February 17, 2010, BATS Exchange, Inc. ("BATS") was added as a Sponsor to the OLPP. See Securities Exchange Act Release No. 61528, 75 FR 8415 (February 24, 2010). On October 22, 2010, C2 Options Exchange Incorporated ("C2") was added as a Sponsor to the OLPP. See Securities Exchange Act Release No. 63162, 75 FR 66401 (October 28, 2010). On May 9, 2012, BOX Options Exchange LLC ("BOX") was added as a Sponsor to the OLPP. See Securities Exchange Act Release No. 66952, 77 FR 28641 (May 15, 2012). On June 29, 2012, Nasdaq OMX BX, Inc. was added as a Sponsor to the OLPP. See Securities Exchange Act Release No. 67327, 77 FR 40125 (July 6, 2012) ("BX").

interested persons.

I. Description and Purpose of the Amendment

The current Sponsors of the OLPP are BATS, BOX, BX, CBOE, C2, ISE, Nasdaq, NYSE Amex, NYSE Arca, OCC, and Phlx. The proposed amendment to the OLPP would add MIAX as a Sponsor of the OLPP. A national securities exchange may become a Sponsor if it satisfies the requirement of Section 7 of the OLPP. Specifically an Eligible Exchange[4] may become a Sponsor of the OLPP by: (i) executing a copy of the OLPP, as then in effect; (ii) providing each current Plan Sponsor with a copy of such executed Plan; and (iii) effecting an amendment to the OLPP, as specified in Section 7(ii) of the OLPP.

Section 7(ii) of the OLPP sets forth the process by which an Eligible Exchange may effect an amendment to the OLPP. Specifically, an Eligible Exchange must: (a) execute a copy of the OLPP with the only change being the addition of the new sponsor's name in Section 8 of the OLPP;[5] and (b) submit the executed OLPP to the Commission. The OLPP then provides that such an amendment will be effective at the later of either the amendment being approved by the Commission or otherwise becoming effective pursuant to Section 11A of the Act. MIAX has submitted a signed copy of the OLPP to the Commission and to each Plan Sponsor in accordance with the procedures set forth in the OLPP regarding new Plan Sponsors.

II. Effectiveness of the Proposed Linkage Plan Amendment

The foregoing proposed OLPP amendment has become effective pursuant to Rule

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4 The OLPP defines an "Eligible Exchange" as a national securities exchange registered with the Commission pursuant to Section 6(a) of the Exchange Act, 15 U.S.C. 78f(a), that (1) has effective rules for the trading of options contracts issued and cleared by the OCC approved in accordance with the provisions of the Exchange Act and the rules and regulations thereunder and (2) is a party to the Plan for Reporting Consolidated Options Last Sale Reports and Quotation Information (the "OPRA Plan"). MIAX has represented that it has met both the requirements for being considered an Eligible Exchange.

5 The Commission notes that the list of plan sponsors is set forth in Section 9 of the OLPP.

608(b)(3)(iii)[6] because it involves solely technical or ministerial matters. At any time within sixty days of the filing of this amendment, the Commission may summarily abrogate the amendment and require that it be refiled pursuant to paragraphs (a)(1) of Rule 608,[7] if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors or the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanisms of, a national market system or otherwise in furtherance of the purposes of the Act.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed amendment is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number 4-443 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington DC 20549–1090.

All submissions should refer to File Number 4-443. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the

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6 17 CFR 242.608(b)(3)(iii).

7 17 CFR 242.608(a)(1).

Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at MIAX's principal office. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. 4-443 and should be submitted on or before [insert date 21 days from date of publication in the Federal Register].

By the Commission.

Elizabeth M. Murphy
Secretary

Kevin M. O'Neill
By: Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-70765; File No. 4-443)

October 28, 2013

Joint Industry Plan; Notice of Filing and Immediate Effectiveness of Amendment to the Plan for the Purpose of Developing and Implementing Procedures Designed to Facilitate the Listing and Trading of Standardized Options to Add Topaz Exchange, LLC as a Plan Sponsor

Pursuant to Section 11A(a)(3) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 608 thereunder,[2] notice is hereby given that on August 7, 2013, Topaz Exchange, LLC ("Topaz" or "Exchange") filed with the Securities and Exchange Commission ("Commission") an amendment to the Plan for the Purpose of Developing and Implementing Procedures Designed to Facilitate the Listing and Trading of Standardized Options ("OLPP").[3] The amendment proposes to add Topaz as a Sponsor of the OLPP. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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1 15 U.S.C. 78k-1(a)(3).

2 17 CFR 242.608.

3 On July 6, 2001, the Commission approved the OLPP, which was proposed by the American Stock Exchange LLC ("Amex"), Chicago Board Options Exchange, Incorporated ("CBOE"), International Securities Exchange LLC ("ISE"), Options Clearing Corporation ("OCC"), Philadelphia Stock Exchange, Inc. ("Phlx"), and Pacific Exchange, Inc. ("PCX") (n/k/a NYSE Arca). See Securities Exchange Act Release No. 44521, 66 FR 36809 (July 13, 2001). On February 5, 2004, Boston Stock Exchange, Inc. ("BSE") was added as a Sponsor to OLPP. See Securities Exchange Act Release No. 49199, 69 FR 7030 (February 12, 2004). On March 21, 2008, the NASDAQ Stock Market, LLC ("Nasdaq") was added as a Sponsor to the OLPP. See Securities Exchange Act Release No. 57546, 73 FR 16393 (March 27, 2008). On February 17, 2010, BATS Exchange, Inc. ("BATS") was added as a Sponsor to the OLPP. See Securities Exchange Act Release No. 61528, 75 FR 8415 (February 24, 2010). On October 22, 2010, C2 Options Exchange Incorporated ("C2") was added as a Sponsor to the OLPP. See Securities Exchange Act Release No. 63162, 75 FR 66401 (October 28, 2010). On May 9, 2012, BOX Options Exchange LLC ("BOX") was added as a Sponsor to the OLPP. See Securities Exchange Act Release No. 66952, 77 FR 28641 (May 15, 2012). On June 29, 2012, Nasdaq OMX BX, Inc. ("BX") was added as a Sponsor to the OLPP. See Securities Exchange Act Release No. 67327, 77 FR 40125 (July 6, 2012). On December 5, 2012, Miami International Securities Exchange, LLC ("MIAX") was added as a Sponsor to the OLPP.

I. Description and Purpose of the Amendment

The current Sponsors of the OLPP are BATS, BOX, BX, CBOE, C2, ISE, MIAX, Nasdaq, NYSE Amex, NYSE Arca, OCC, and Phlx. The proposed amendment to the OLPP would add Topaz as a Sponsor of the OLPP. A national securities exchange may become a Sponsor if it satisfies the requirement of Section 7 of the OLPP. Specifically an Eligible Exchange[4] may become a Sponsor of the OLPP by: (i) executing a copy of the OLPP, as then in effect; (ii) providing each current Plan Sponsor with a copy of such executed Plan; and (iii) effecting an amendment to the OLPP, as specified in Section 7(ii) of the OLPP.

Section 7(ii) of the OLPP sets forth the process by which an Eligible Exchange may effect an amendment to the OLPP. Specifically, an Eligible Exchange must: (a) execute a copy of the OLPP with the only change being the addition of the new sponsor's name in Section 8 of the OLPP;[5] and (b) submit the executed OLPP to the Commission. The OLPP then provides that such an amendment will be effective at the later of either the amendment being approved by the Commission or otherwise becoming effective pursuant to Section 11A of the Act. Topaz has submitted a signed copy of the OLPP to the Commission and to each Plan Sponsor in accordance with the procedures set forth in the OLPP regarding new Plan Sponsors.

II. Effectiveness of the Proposed Linkage Plan Amendment

The foregoing proposed OLPP amendment has become effective pursuant to Rule

4 The OLPP defines an "Eligible Exchange" as a national securities exchange registered with the Commission pursuant to Section 6(a) of the Exchange Act, 15 U.S.C. 78f(a), that (1) has effective rules for the trading of options contracts issued and cleared by the OCC approved in accordance with the provisions of the Exchange Act and the rules and regulations thereunder and (2) is a party to the Plan for Reporting Consolidated Options Last Sale Reports and Quotation Information (the "OPRA Plan"). Topaz has represented that it has met both the requirements for being considered an Eligible Exchange.

5 The Commission notes that the list of plan sponsors is set forth in Section 9 of the OLPP.

608(b)(3)(iii)[6] because it involves solely technical or ministerial matters. At any time within sixty days of the filing of this amendment, the Commission may summarily abrogate the amendment and require that it be refiled pursuant to paragraphs (a)(1) of Rule 608,[7] if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors or the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanisms of, a national market system or otherwise in furtherance of the purposes of the Act.

III. Solicitation of Comments

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- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington DC 20549–1090.

All submissions should refer to File Number 4-443. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the

6 17 CFR 242.608(b)(3)(iii).

7 17 CFR 242.608(a)(1).

Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at Topaz's principal office. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File No. 4-443 and should be submitted on or before [insert date 21 days from date of publication in the Federal Register].

By the Commission.

Elizabeth M. Murphy
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-70762; File No. 4-546)

October 28, 2013

Joint Industry Plan; Notice of Filing and Immediate Effectiveness of Amendment to the Options Order Protection and Locked/Crossed Market Plan to Add the Miami International Securities Exchange, LLC as a Participant

Pursuant to Section 11A(a)(3) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 608 thereunder,[2] notice is hereby given that on December 6, 2012, Miami International Securities Exchange, LLC ("MIAX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") an amendment to the Options Order Protection and Locked/Crossed Market Plan ("Plan").[3] The amendment added MIAX as a Participant[4] to the Plan. The Commission is publishing this notice to solicit comments on the amendment from interested persons.

I. Description and Purpose of the Amendment

The current Participants in the Linkage Plan are BOX Options, C2, CBOE, BATS, ISE,

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1 15 U.S.C. 78k-1(a)(3).

2 17 CFR 242.608.

3 On July 30, 2009, the Commission approved a national market system plan relating to Options Order Protection and Locked/Crossed Markets proposed by Chicago Board Options Exchange, Incorporated ("CBOE"), International Securities Exchange, LLC ("ISE"), The NASDAQ Stock Market LLC ("Nasdaq"), NASDAQ OMX BX, Inc. ("BOX"), NASDAQ OMX PHLX, Inc. ("Phlx"), NYSE Amex, LLC ("NYSE Amex"), and NYSE Arca, Inc. ("NYSE Arca"). See Securities Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (August 6, 2009). See also Securities Exchange Act Release Nos. 61546 (February 19, 2010), 75 FR 8762 (February 25, 2010) (adding BATS Exchange, Inc. ("BATS") as a Participant); 63119 (October 15, 2010), 75 FR 65536 (October 25, 2010) (adding C2 Options Exchange, Incorporated ("C2") as a Participant); 66969 (May 11, 2012), 77 FR 29396 (May 17, 2012) (adding BOX Options Exchange LLC ("BOX Options") as a Participant). Topaz Exchange, LLC ("Topaz") joined the Plan on August 1, 2013.

4 The term "Participant" is defined as an Eligible Exchange whose participation in the Plan has become effective pursuant to Section 3(c) of the Plan.

Nasdaq, BOX, Phlx, NYSE Amex,[5] NYSE Arca, and Topaz. The amendment to the Plan added MIAX as a Participant in the Plan. MIAX has submitted a signed copy of the Plan to the Commission in accordance with the procedures set forth in the Plan regarding new Participants. Section 3(c) of the Plan provides for the entry of new Participants to the Plan. Specifically an Eligible Exchange[6] may become a Participant in the Plan by: (i) executing a copy of the Plan, as then in effect; (ii) providing each current Participant with a copy of such executed Plan; (iii) effecting an amendment to the Plan, as specified in Sections 3(c) and 4(b) of the Plan.

Section 4(b) of the Plan puts forth the process by which an Eligible Exchange may effect an amendment to the Plan. Specifically, an Eligible Exchange must: (a) execute a copy of the Plan with the only change being the addition of the new participant's name in Section 3(a) of the Plan; and (b) submit the executed Plan to the Commission. The Plan then provides that such an amendment will be effective when the amendment is approved by the Commission or otherwise becomes effective pursuant to Section 11A of the Act and Rule 608 thereunder.

II. Effectiveness of the Linkage Plan Amendment

The foregoing Plan amendment has become effective pursuant to Rule 608(b)(3)(iii) of

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5 NYSE Amex was recently renamed NYSE MKT LLC. See Securities Exchange Act Release No. 67037 (May 21, 2012), 77 FR 31415 (May 25, 2012) (SR-NYSEAmex-2012-32).

6 Section 2(6) of the Plan defines an "Eligible Exchange" as a national securities exchange registered with the Commission pursuant to Section 6(a) of the Act, 15 U.S.C. 78f(a), that: (a) is a "Participant Exchange" in the Options Clearing Corporation ("OCC") (as defined in OCC By-laws, Section VII); (b) is a party to the Options Price Reporting Authority ("OPRA") Plan (as defined in the OPRA Plan, Section 1); and (c) if the national securities exchange chooses not to become party to this Plan, is a participant in another plan approved by the Commission providing for comparable Trade-Through and Locked and Crossed Market protection. MIAX has represented that it has met the requirements for being considered an Eligible Exchange. See letter from Barbara Comly, EVP, General Counsel & Corporate Secretary, Miami International Holdings, Inc., to Elizabeth Murphy, Secretary, Commission, dated December 5, 2012.

the Act[7] because it involves solely technical or ministerial matters. At any time within sixty days of the filing of this amendment, the Commission may summarily abrogate the amendment and require that it be refiled pursuant to paragraph (b)(1) of Rule 608,[8] if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors or the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanisms of, a national market system or otherwise in furtherance of the purposes of the Act.

III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the amendment is consistent with the Act. Comments may be submitted by any of the following methods:

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Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

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7 17 CFR 242.608(b)(3)(iii).

8 17 CFR 242.608(b)(1).

Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the amendment that are filed with the Commission, and all written communications relating to the amendment between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the principal office of MIAX. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number 4-546 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70759 / October 28, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3707 / October 28, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30767 / October 28, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15590

In the Matter of **Further Lane Asset Management, LLC, Osprey Group, Inc., and Jose Miguel Araiz a/k/a Joseph Michael Araiz** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Further Lane Asset Management, LLC ("FLAM"), Osprey Group, Inc. ("OGI"), and Jose Miguel Araiz a/k/a Joseph Michael Araiz ("Araiz") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and over the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds that:

Summary

1. FLAM, a registered investment adviser, and Araiz, FLAM's principal owner and Chief Executive Officer, advised Windmill Fund Multi Strategy Fund, LP ("Windmill Fund"), a $2 million fund-of-funds. As a result of an in-kind redemption of a Windmill Fund investment in an underlying fund, Araiz and FLAM caused Windmill Fund to acquire a promissory note from an entity owned by Araiz. Windmill Fund's governing documents did not disclose, and neither Araiz nor FLAM informed investors in writing prior to the in-kind redemption, that Windmill Fund might acquire related party promissory notes or otherwise materially deviate from its fund-of-funds investment strategy. Araiz and FLAM subsequently caused Windmill Fund to invest in a second promissory note (with a non-affiliated entity) without written disclosure to Windmill Fund investors.

2. In addition, Araiz, FLAM, and OGI, an affiliated unregistered investment adviser, engaged in securities transactions with advisory clients on a principal basis through Further Lane Securities LP ("FLS"), FLAM's and OGI's affiliated broker-dealer, without providing prior written disclosure to, or obtaining consent from, the clients.

3. Further, although FLAM maintained custody of assets of hedge funds that FLAM managed, Araiz and FLAM failed to arrange for an annual surprise examination to verify the funds' assets or for fund investors to receive account statements at least quarterly from the funds' qualified custodian, in violation of the Advisers Act's custody rule.

4. FLAM also failed to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder. Finally, Araiz and FLAM failed to maintain certain books and records. Araiz aided and abetted and caused these violations.

Respondents

5. Araiz, age 52, is a resident of New York, New York. During the relevant period, Araiz was the President, Chief Executive Officer, and Chief Compliance Officer of FLAM and FLS. Araiz owns 99% of FLAM and 100% of OGI, Osprey Opportunity Fund, GP, LLC ("Osprey GP"), Toro Total Return Fund GP, LLC ("Toro GP") and Osprey Securities Corp. ("OSC"). Araiz, directly and through OSC, owns 100% of FLS. Araiz controls FLAM and OGI and makes investment decisions on behalf of these advisers.

6. FLAM is a New York limited liability company headquartered in New York, New York, with offices in East Hampton, New York and San Francisco, California. FLAM has been registered with the Commission as an investment adviser since September 2000. As of April 1, 2013, FLAM had approximately $85 million in assets under management. FLAM serves or has served as the investment adviser to three hedge funds –Windmill Fund, Manta Ray Strategic Income Fund, LP ("Manta Ray Fund"), and Toro Total Return Fund, LP ("Toro Fund"). FLAM also provides advisory services to individuals and entities who maintain separately managed accounts (collectively, "Separate Advisory Accounts").

7. OGI is a Delaware corporation headquartered in New York, New York at the same premises as FLAM. OGI is an unregistered investment adviser related to and under common control with FLAM, which manages Osprey Opportunity Fund, LP ("Osprey Fund"), a hedge fund.

Other Relevant Entities

8. FLS is a Delaware limited partnership headquartered in New York, New York at the same premises as FLAM. FLS is a FINRA member firm and has been registered with the Commission as a broker-dealer since 1995. FLS is the introducing broker for all Separate Advisory Account clients of FLAM. Separate Advisory Accounts are custodied with an external clearing broker-dealer.

9. OSC is a Delaware corporation headquartered in New York, New York at the same premises as FLAM. Araiz owns OSC which, in turn, owns 95% of FLS.

10. Osprey GP (f/k/a Osprey Group Asset Management LLC) is a Delaware limited liability company headquartered in New York, New York at the same premises as FLAM. Araiz owns 100% of Osprey GP.

11. Toro GP is a Delaware limited liability company headquartered in New York, New York at the same premises as FLAM. Araiz owns 100% of Toro GP.

12. Osprey Fund is a Delaware limited partnership formed in 2000. Osprey Fund is a hedge fund and OGI serves as its investment adviser and Osprey GP as its general partner. During the relevant period, Osprey Fund had approximately 50 investors, including Araiz and his wife, and $60 million in assets.

13. Windmill Fund is a Delaware limited partnership formed in 2005. Windmill Fund is a hedge fund and FLAM serves as its investment adviser and general partner. During the relevant period, Windmill Fund had approximately 15 investors, including Araiz and his wife, and $2 million in assets.

14. Manta Ray Fund was a Delaware limited partnership formed in 2007 that is now in the final process of liquidation. Manta Ray Fund was a hedge fund and FLAM served as its investment adviser and general partner. During the relevant period, Manta Ray Fund had approximately 10 investors, including Araiz's wife, and $2 million in assets.

15. Toro Fund is a Delaware limited partnership formed in 2008. Toro Fund is a hedge fund and FLAM serves as its investment adviser and Toro GP as its general partner. During the relevant period, Toro Fund had approximately 20 investors, including Araiz's wife, and $8 million in assets.

The Commission's Office of Compliance Inspections and Examinations Issued FLAM a Deficiency Letter in 2003

16. In September 2003, following an examination of FLAM by the Commission's Office of Compliance Inspections and Examinations ("OCIE"), the OCIE staff issued a deficiency letter to FLAM addressed to Araiz ("2003 Deficiency Letter"). The 2003 Deficiency Letter advised FLAM that if it was deemed to have custody of a client's assets and securities and did not comply with the provisions outlined in certain no-action letters, FLAM would be subject to all of the requirements of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder, including, among other things, the requirement to undergo an annual surprise examination by an independent public accountant.

17. In addition, the letter cited FLAM for undisclosed principal transactions, and noted that, "[i]n the future, FLAM should obtain the consent of its clients to each principal transaction prior to settlement date and provide its clients with the written disclosure required by Section 206(3) of the Advisers Act[.]"

Araiz and FLAM Engaged in Related Party Transactions and Made Material Changes in Windmill Fund's Trading Strategy

18. Araiz and FLAM provided investors in Windmill Fund with the fund's February 2006 private placement memorandum ("PPM"). The PPM described the fund as a "fund-of-funds" that would invest in other hedge funds or alternative investment vehicles, including in affiliated hedge funds. The PPM disclosed that while FLAM did not expect to invest Windmill Fund assets in other securities, FLAM had the authority to make such investments if they were "attractive and consistent with the [Windmill Fund's] overall strategy" (i.e., as a fund-of-funds).

19. In or about October 2008, as a result of an in-kind redemption of a Windmill Fund investment in an underlying fund, Araiz and FLAM caused Windmill Fund to

acquire a $772,668 promissory note (the "OSC Promissory Note") issued by OSC, an entity owned by Araiz. The OSC Promissory Note had an initial maturity date of October 1, 2010 – which Araiz and FLAM subsequently extended to October 1, 2012 – and earned interest at a rate between 4.5% and 5.5% per annum. Windmill Fund's PPM did not disclose, and neither Araiz nor FLAM informed investors in writing, that Windmill Fund might acquire related party promissory notes or otherwise materially deviate from its fund-of-funds investment strategy.

20. In or about October 2009, Araiz and FLAM provided Windmill Fund investors with a document ("Tear Sheet"). In the "Fund Strategy" section, the Tear Sheet described Windmill Fund as a "fund of alternative investments" and disclosed that the fund would "use a blend of hedge funds, mutual funds, and ETF's [sic] to attain optimal returns with reduced risks." The Tear Sheet compared the performance of Windmill Fund to that of the HFRI Fund of Funds Composite Index. Notwithstanding that the OSC Promissory Note represented approximately 30% of the fund's assets, neither Araiz nor FLAM provided written disclosure to Windmill Fund investors that they had materially changed the fund's investment strategy or that the fund had acquired a promissory note issued by an affiliated entity.

21. FLAM, in its capacity as adviser to Windmill Fund, earned an annual management fee from the fund. FLAM received total management fees of $25,256 attributable to Windmill Fund's investment in the OSC Promissory Note.

22. OSC made payments on the OSC Promissory Note from time to time, with the final payment of principal and accrued interest occurring in December 2012.

23. Separately, in or about November 2011, Araiz and FLAM caused Windmill Fund to acquire a $550,000 promissory note from a non-affiliated entity (the "Non-Affiliated Promissory Note"). By December 31, 2011, the OSC Promissory Note and the Non-Affiliated Promissory Note collectively constituted approximately 58% of Windmill Fund's assets. Taken together, these investments thus constituted a material change in the fund's investment strategy – from a fund-of-funds to a fund that invested primarily in fixed-income instruments – that was inconsistent with the overall strategy disclosed in the PPM.

FLAM and OGI Engaged in Undisclosed Principal Transactions with Advisory Clients Without Consent

24. From at least August 2008 through July 2012, FLAM and OGI, through FLS, engaged in fixed-income transactions on a principal basis, without providing prior written disclosure to, or obtaining advisory clients' consent for, such transactions.

25. First, FLAM engaged in transactions through FLS on behalf of the Separate Advisory Accounts without providing prior written disclosure to, or obtaining consent from, the Separate Advisory Accounts.

26. Second, FLAM and OGI engaged in transactions through FLS on behalf of hedge fund clients – Toro Fund, Manta Ray Fund, and Osprey Fund – without written disclosure to

or consent from all fund investors. The limited partnership agreements for these hedge funds each contained a provision prohibiting FLAM and OGI from "buy[ing] securities (and/or other investments) from or sell[ing] securities (and/or other investments) to [the applicable fund], without the written consent of all [fund investors]." Despite this specific prohibition in the funds' limited partnership agreements, FLAM, the investment adviser to Toro Fund and Manta Ray Fund, and OGI, the investment adviser to Osprey Fund, failed to notify and obtain written consent from the funds' investors to engage in principal transactions on behalf of the funds.

27. Araiz, as FLAM's 99% owner, President, Chief Executive Officer and Chief Compliance Officer and as OGI's controlling principal, failed to ensure that FLAM and OGI complied with the Advisers Act and the rules thereunder when the firm engaged in principal transactions with advisory clients.

28. FLS earned markups and markdowns of at least $312,760 on the undisclosed principal transactions.

Araiz and FLAM Violated the Custody Rule

29. Araiz and FLAM failed to comply with Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder. FLAM had custody of funds and securities of its clients, both through FLAM's physical possession of the promissory notes and through FLAM and its affiliates serving as general partners of Windmill Fund, Manta Ray Fund and Toro Fund. FLAM failed to form a reasonable belief that a qualified custodian was sending account statements to fund investors at least quarterly. Nor was FLAM subject to an annual surprise examination for the years 2008 through 2011.

30. Araiz, as FLAM's 99% owner, President, Chief Executive Officer and Chief Compliance Officer, failed to ensure that FLAM complied with Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder.

FLAM's Form ADV Disclosures Were Inaccurate

31. FLAM's Form ADV Parts I and II included inaccurate statements concerning FLAM's advisory business. Specifically, in its Part I from May 14, 2009 through June 7, 2012, FLAM stated that it did not have custody of client assets or securities (Item 9), notwithstanding FLAM's custody of Windmill Fund's funds and securities. Similarly, in its Part II from September 6, 2009 through March 31, 2011, FLAM stated that "[i]n no instance will FLS act as principal in transactions involving [FLAM's] managed accounts[]" (Item 9), notwithstanding the fact that FLS did engage in such transactions on behalf of the Separate Advisory Accounts.

32. Araiz, as FLAM's 99% owner, President, Chief Executive Officer and Chief Compliance Officer, was responsible for FLAM's Form ADV disclosures. Araiz signed FLAM's Form ADV Part I.

FLAM Failed to Adopt and Implement Written Policies and Procedures Reasonably Designed to Prevent Violations of the Advisers Act and the Rules Thereunder

33. FLAM failed to comply with the requirement in Rule 206(4)-7 of the Advisers Act that every Commission-registered investment adviser adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and the rules thereunder. FLAM also failed to comply with Rule 206(4)-7's mandate that it review no less than annually the adequacy of such policies and procedures and the effectiveness of their implementation, including whether such policies and procedures accurately reflected FLAM's business and whether changes in the Advisers Act or applicable regulations might require changes to its policies or procedures.

34. FLAM's compliance manual – which FLAM had adopted in July 2003 (the "2003 Manual") – was materially outdated and did not contain policies and procedures sufficient to address FLAM's specific compliance risks, including, for example, the supervision of remote offices. (FLAM has its headquarters in New York and an office in California.) In addition, in 2011, FLAM did not conduct an annual review of the policies and procedures to prevent violation of the Advisers Act and the rules thereunder.

35. Araiz, as FLAM's 99% owner, President, Chief Executive Officer and Chief Compliance Officer, failed to ensure that FLAM adopted and implemented written policies and procedures specifically designed for FLAM's advisory business, and that FLAM performed a review of such policies and procedures to ensure the effectiveness of their implementation at least annually.

Failure to Maintain Books and Records as Required by the Advisers Act and the Rules Thereunder

36. FLAM failed to maintain certain books and records as mandated by Section 204(a) of the Advisers Act and Rule 204-2 thereunder. Specifically, FLAM failed to maintain certain order tickets, correspondence with clients, contracts related to the firm's business and custody records, as required by Rules 204-2(a)(3), (a)(7), (a)(10) and (a)(17), respectively.

37. Araiz, as FLAM's 99% owner, President, Chief Executive Officer and Chief Compliance Officer, failed to ensure that FLAM maintained such records as required by the Advisers Act and rules thereunder.

Violations

38. As a result of the conduct described above, Araiz and FLAM willfully[1] violated Section 206(2) of the Advisers Act, which prohibits an investment adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon a client or prospective client. Proof of scienter is not required to establish a violation of Section 206(2) of the Advisers Act but, rather, may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)).

39. As a result of the conduct described above, FLAM and OGI willfully violated, and Araiz willfully aided and abetted and caused FLAM's and OGI's violations of, Section 206(3) of the Advisers Act, which prohibits an investment adviser from, directly or indirectly, "acting as principal for his own account, knowingly to sell any security or to purchase any security from a client … without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction."

40. As a result of the conduct described above, Araiz and FLAM willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. Section 206(4) prohibits investment advisers from engaging in "any act, practice, or course of business which is fraudulent, deceptive or manipulative," as defined by the Commission by rule. Rule 206(4)-8 prohibits an investment adviser to a "pooled investment vehicle" – such as Windmill Fund – from, directly or indirectly, making false or misleading statements to investors or prospective investors in those pools, and from otherwise defrauding investors or prospective investors. A violation of Section 206(4) and the rules thereunder does not require scienter. *Steadman*, 967 F.2d at 647.

41. As a result of the conduct described above, FLAM willfully violated, and Araiz willfully aided and abetted and caused FLAM's violations of, Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder. Before the amendment of Rule 206(4)-2, effective March 12, 2010, Rule 206(4)-2 provided, in pertinent part, that it constituted a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of Section 206(4) for any registered investment adviser to have custody of client funds or securities unless, among other things, the adviser had a reasonable basis for believing that a qualified custodian was sending quarterly account statements to each of the clients for which it maintained funds or securities, or to each beneficial owner of a pooled investment vehicle, identifying the amount of funds, and of each security in the account at the end of the period and setting forth all transactions in the account

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1 A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

during the period.[2] The pre-amendment rule also provided that, if the adviser sent the quarterly account statements itself, an independent public accountant generally must verify all of the client funds and securities by actual examination at least once during each calendar year on a date chosen by the accountant without prior notice to the investment adviser (a "surprise examination").[3] During the relevant period, however, investors in Windmill Fund, Manta Ray Fund and Toro Fund were never sent quarterly account statements from a qualified custodian containing information about the funds' accounts, and FLAM was not subject to an annual surprise examination.

42. As a result of the conduct described above, FLAM willfully violated, and Araiz willfully aided and abetted and caused FLAM's violations of, Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which requires an investment adviser registered with the Commission to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules thereunder by the adviser and its supervised persons, and requires at least annual reviews of the adequacy of such policies and procedures and the effectiveness of their implementation.

43. As a result of the conduct described above, FLAM willfully violated, and Araiz willfully aided and abetted and caused FLAM's violations of, Section 204(a) of the Advisers Act and Rules 204-2(a)(3), 204-2(a)(7), 204-2(a)(10) and 204-2(a)(17) thereunder, which require investment advisers registered with the Commission to maintain and preserve certain books and records. Rule 204-2(a)(3) requires registered investment advisers to "make and keep true, accurate and current ...memorand[a] of each order given by the investment adviser for the purchase or sale of any security ...." Rule 204-2(a)(7) requires registered investment advisers "make and keep true, accurate and current ... [o]riginals of all written communications received and copies all written communications sent by such investment adviser relating to ... any recommendation made or proposed to be made and any advice given or proposed to be given ...." Rule 204-2(a)(10) requires registered investment advisers to "make and keep true, accurate and current ...[a]ll written

2 The amended Rule 206(4)-2 is not materially different than the pre-amendment rule with respect to the custody violations at issue in this matter, except to the extent that the requirements were generally made more stringent. For example, under the amended rule, an adviser may no longer send its own account statements to clients in lieu of having a qualified custodian send quarterly statements to clients or to investors in a pooled investment vehicle (which the adviser could do under the pre-amendment rule if it was subject to a surprise examination each year). Under the amended rule, an adviser generally must be subject to an annual surprise examination and have a reasonable basis for believing that the qualified custodian is sending quarterly statements.

3 Both the pre- and post-amendment Rule 206(4)-2(b) provided similar exceptions from the surprise examination and quarterly account statement requirements for a pooled investment vehicle if certain criteria are met, including, among other things, an annual audit of the pool by an independent public accountant and delivery of audited financial statements to investors in the vehicle. These provisions, however, do not apply because Windmill Fund, Manta Ray Fund and Toro Fund were not audited.

agreements (or copies thereof) entered into by the investment adviser ... relating to the business of the investment adviser." Rule 204-2(a)(17) requires registered investment advisers to maintain "[a] copy of any internal control report obtained or received pursuant to [the custody rule]."

44. As a result of the conduct described above, Araiz and FLAM willfully violated Section 207 of the Advisers Act, which makes it unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed under the Advisers Act or willfully to omit to state in any such application or report any material fact which is required to be stated therein.

Respondents' Remedial Efforts

45. In determining to accept the Offers, the Commission considered remedial acts undertaken by Respondents and cooperation afforded the Commission staff. During the OCIE staff's examination, Respondents worked with outside counsel and an external consultant to begin addressing the deficiencies that were raised by the OCIE staff. Thereafter, Respondents retained a second external compliance consultant and hired a new, internal Chief Compliance Officer ("CCO"). The new CCO conducted a comprehensive review of FLAM's compliance program and worked with FLAM, the second external consultant, and outside counsel to continue the remediation of the compliance program and institute supervisory and management controls. The CCO prepared a report in February 2013, detailing her work, findings, and recommendations.

Undertakings

46. Respondent FLAM undertakes to take the following actions set forth in paragraphs 47 through 51, as applicable:

47. Chief Compliance Officer and Compliance Consultant. FLAM will continue to retain the second external consultant, or another consultant not unacceptable to Commission staff, to assist it and the CCO in implementing the CCO's recommendations, including, but not limited to, providing assistance in:

a. implementing new compliance policies and procedures;

b. implementing a new supervisory framework and internal controls; and

c. conducting an annual review for the years ending December 31, 2013 and December 31, 2014, to assess the adequacy and effectiveness of FLAM's new policies and procedures.

48. Separation of CCO From Other Officer Positions. For a period of five (5) years from the entry of this Order, FLAM shall employ a CCO, other than Araiz, whose sole responsibility will be to serve as CCO. During this period, the person FLAM designates as CCO shall not simultaneously hold any other officer or employee position at FLAM while serving as CCO.

49. Recordkeeping. FLAM shall preserve for a period of not less than six (6) years from the end of the fiscal year last used, the first two (2) years in an easily accessible place, any record of FLAM's compliance with the undertakings set forth in this Order.

50. Notice to Advisory Clients and Investors. Within ten (10) days of the entry of this Order, FLAM shall post prominently on its principal website a summary of this Order in a form and location acceptable to the Commission staff, with a hyperlink to the entire Order. FLAM shall maintain the posting and hyperlink on its website for a period of twelve (12) months from the entry of this Order. Within thirty (30) days of the entry of this Order, FLAM shall provide a copy of the Order to each of FLAM's existing advisory clients and investors in pooled investment vehicles managed by FLAM as of the entry of this Order via mail, email, or such other method as may be acceptable to the Commission staff, together with a cover letter in a form not unacceptable to the Commission staff. Furthermore, for a period of twelve (12) months from the entry of this Order, to the extent that FLAM is required to deliver a brochure to a client and/or prospective client pursuant to Rule 204-3 of the Advisers Act, FLAM shall also provide a copy of this Order to such client and/or prospective client at the same time that FLAM delivers the brochure.

51. Certifications of Compliance by FLAM. FLAM shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and FLAM agrees to provide such evidence. The certification and supporting material shall be submitted to Valerie A. Szczepanik, Assistant Director, Asset Management Unit, Securities and Exchange Commission, 3 World Financial Center, Room 400, New York, New York 10281-1022, or such other address as the Commission staff may provide, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

52. Affidavit of Compliance by Araiz. Araiz shall provide to the Commission staff an affidavit that he has complied fully with the sanctions described in Section IV.G of this Order. The Commission staff may make reasonable requests for further evidence of compliance, and Araiz agrees to provide such evidence. The affidavit shall be submitted to Valerie A. Szczepanik, Assistant Director, Asset Management Unit, Securities and Exchange Commission, 3 World Financial Center, Room 400, New York, New York 10281-1022, or such other address as the Commission staff may provide, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days after the twelve month suspension period described below.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Section 15(b) of the Exchange Act, Sections 203(e), 203(f) and 203(k) of the Advisers Act and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent FLAM cease and desist from committing or causing any violations and any future violations of Sections 204, 206(2), 206(3), 206(4) and 207 of the Advisers Act and Rules 204-2(a)(3), 204-2(a)(7), 204-2(a)(10), 204-2(a)(17), 206(4)-2, 206(4)-7 and 206(4)-8 promulgated thereunder.

B. Respondent FLAM is censured.

C. Respondent OGI shall cease and desist from committing or causing any violations and any future violations of Section 206(3) of the Advisers Act.

D. Respondent OGI is censured.

E. Respondent Araiz shall cease and desist from committing or causing any violations and any future violations of Sections 204, 206(2), 206(3), 206(4) and 207 of the Advisers Act and Rules 204-2(a)(3), 204-2(a)(7), 204-2(a)(10), 204-2(a)(17), 206(4)-2, 206(4)-7 and 206(4)-8 promulgated thereunder.

F. Respondent Araiz is censured.

G. Respondent Araiz be, and hereby is:

suspended from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent or nationally recognized statistical rating organization for a period of twelve months, effective on the second Monday following the entry of this Order; and

suspended from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter for a period of twelve months, effective on the second Monday following the entry of this Order.

H. Respondent Araiz shall, within ten days of the entry of this Order, pay a civil money penalty in the amount of $150,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

I. Respondents FLAM, OGI, and Araiz shall pay disgorgement of $338,017 and prejudgment interest of $9,105, for a total of $347,122, on a joint and several basis, to the Securities and Exchange Commission. Payments shall be made in the following installments:

(1) $25,000 within ten days of the entry of this Order;
(2) $161,061 within 180 days of entry of the Order; and
(3) $161,061, plus post-judgment interest on the payments described in Sections IV.I.(2) and IV.I.(3) pursuant to SEC Rule of Practice 600, within 360 days of entry of the Order.

Prior to making the payment described in Section IV.I.(3), Respondents shall contact the Commission staff to ensure the inclusion of post-judgment interest. If any payment is not made by the date the payment is required by this Section IV.I, the entire outstanding balance of disgorgement, prejudgment interest, plus any additional interest accrued pursuant to SEC Rule of Practice 600, shall be due and payable immediately, without further application.

J. Payments under this Order must be made in one of the following ways:

(1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Respondent's name as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Valerie A. Szczepanik, Assistant Director, Asset Management Unit, and to Robert J. Keyes, Associate Regional Director, Securities and Exchange Commission, 3 World Financial Center, Room 400, New York, New York 10281-1022.

K. Respondent FLAM shall comply with the undertakings enumerated in Section III, paragraphs 47 through 51 above.

L. Respondent Araiz shall comply with the undertaking enumerated in Section III, paragraph 52 above.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3705 / October 28, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30766 / October 28, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15588

In the Matter of

Knelman Asset Management Group, LLC and Irving P. Knelman,

Respondents.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(e), 203(f), AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Knelman Asset Management Group, LLC ("KAMG" or "the firm") and Irving P. Knelman ("Knelman").

II.

In anticipation of the institution of these proceedings, Respondents KAMG and Knelman have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents KAMG and Knelman consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to

Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

Summary

1. This matter involves violations of the Advisers Act by KAMG, a Commission-registered investment adviser, and Knelman, KAMG's managing director, chief executive officer ("CEO") and chief compliance officer ("CCO"). First, KAMG, the manager of Rancho Partners I, LLC ("Rancho"), a fund of private equity funds, and Knelman violated Advisers Act Rule 206(4)-2 (the "Custody Rule") by, among other things, failing to arrange annual surprise examinations of Rancho's assets, or alternatively, failing to provide Rancho's members with audited financial statements. Second, KAMG and Knelman used a distribution methodology that was contrary to Rancho's limited liability company agreement ("LLC Agreement") and private placement memorandum ("PPM"), and made improper discretionary cash distributions to some of Rancho's members. Third, KAMG and Knelman violated Advisers Act Rule 206(4)-7 (the "Compliance Rule") by failing to conduct annual reviews of the adequacy and effectiveness of KAMG's compliance policies and procedures, and by failing to adopt and implement controls designed to safeguard Rancho's assets. Fourth, KAMG and Knelman failed to accurately maintain certain books and records for Rancho mandated by the Advisers Act and its rules, and failed to maintain certain required proxy materials. Finally, KAMG and Knelman filed Forms ADV that falsely stated that the firm had no custody of client assets.

Respondents

2. **Knelman Asset Management Group, LLC,** a Delaware limited liability company founded in 2000 and based in Minneapolis, Minnesota, has been registered with the Commission as an investment adviser since September 2008. KAMG was also registered with the Commission from 2000 until September 2005, when it filed a Form ADV-W to withdraw its registration. KAMG provides discretionary investment management services to high net worth individuals, trusts, estates, and institutional clients and manages approximately $106.5 million in assets. KAMG has been the sole managing member of, and has provided investment advisory services to, Rancho, a fund of private equity funds that Knelman formed in 2000, since Rancho's inception.

3. **Irving P. Knelman**, age 64, is a resident of Edina, Minnesota. Knelman is KAMG's managing director and CEO. During all relevant times, Knelman was also KAMG's CCO.

Other Relevant Entity

4. **Rancho Partners I, LLC,** a Minnesota limited liability company formed by Knelman in August 2000 and based in Minneapolis, Minnesota, is a pooled investment vehicle and a fund of private equity funds.[1] Rancho has nineteen members, including KAMG. Three of Rancho's members are also KAMG advisory clients. As of December 31, 2012, Rancho's assets were fair valued at $1.3 million.

Background

5. In 2000, Knelman formed KAMG. Later that same year, Knelman formed Rancho to allow its members to invest in private equity partnerships and funds. Each investor purchased membership interests in Rancho, which in turn, purchased membership interests in five private equity funds. KAMG has been Rancho's investment adviser since its inception.

KAMG's Custody Failures

6. The Custody Rule – Rule 206(4)-2 under the Advisers Act – requires registered investment advisers with custody of client funds or securities to implement certain controls designed to protect those assets from loss, misappropriation, misuse, or the adviser's insolvency. Before the amendment of Rule 206(4)-2, effective March 12, 2010, the rule required these advisers to have a reasonable basis for believing that a qualified custodian was sending quarterly account statements to each of the clients for which it maintained funds or securities, or to send the quarterly account statements itself and obtain an annual surprise examination by an independent public accountant to verify all of the client assets. The amended rule generally requires these advisers to have a reasonable basis for believing that a qualified custodian is sending quarterly statements to clients and to be subject to an annual surprise examination. Both the pre- and post-amendment Rule 206(4)-2(b) provided exceptions to an adviser of a pooled investment vehicle from the quarterly account statement and surprise examination requirements if certain criteria are met, including an annual audit of the pool by a PCAOB registered and inspected independent public accountant and delivery to investors in the vehicle audited financial statements prepared in accordance with generally accepted accounting principles within 120 days of the fiscal year end.

7. As the managing member of Rancho, KAMG has custody of Rancho's assets and those assets were not maintained by a qualified custodian. From Rancho's formation in 2000 through August 2011, Rancho members did not receive quarterly account statements from a

[1] Rancho qualifies as a pooled investment vehicle because it holds itself out as being engaged primarily in the business of investing in securities. Rancho was and is not registered as an investment company in reliance on the exclusion from the definition of "investment company" in Section 3(c)(1) of the Investment Company Act for an entity having no more than 100 beneficial owners of its securities and that is not making and does not propose to make a public offering of its securities.

qualified custodian, and Rancho's funds were not subject to an annual surprise examination. In addition, Rancho's financial statements were not audited or distributed to Rancho members.

8. Rancho's LLC Agreement required KAMG to distribute annual financial statements to Rancho's members. By not doing so, KAMG and Knelman violated the terms of the LLC Agreement.

9. In 2005, the Commission's staff notified KAMG and Knelman that KAMG had failed to comply with the Custody Rule. That year, the Commission's staff conducted an examination of KAMG and issued a deficiency letter dated September 8, 2005. The letter summarized the requirements of the custody rule, stated that KAMG, as managing member of Rancho and another private fund, Rancho Partners II, LLC ("Rancho II"), was deemed to have custody of client assets, and that KAMG was not a qualified custodian.[2] The letter further stated that because Rancho and Rancho II members did not receive account statements directly from a qualified custodian, and the Rancho and Rancho II financial statements were not audited, KAMG had violated the Custody Rule. Finally, the letter stated that KAMG had also violated the Custody Rule because it held a stock certificate owned by Rancho II in a safe deposit box. The letter warned, "[KAMG] should immediately take steps to ensure it is in compliance with Rule 206(4)-2 if it has not already done so."

10. KAMG responded to the staff with a letter dated September 26, 2005, signed by Knelman, stating that it had resolved the stock certificate issue by moving the stock certificate to a safe deposit box at US Bank. The safe deposit box was maintained in the name of Rancho Partners II. KAMG's response did not address the firm's other Custody Rule deficiencies. In fact, KAMG and Knelman did not take any steps to address the firm's other deficiencies.

11. In 2010, after KAMG reregistered with the Commission, the staff conducted another exam of KAMG and learned that KAMG, as managing member, still had custody of Rancho's assets. The staff also learned that KAMG was violating the Custody Rule because KAMG did not have a reasonable basis for believing that a qualified custodian was sending quarterly statements to Rancho members and KAMG had not arranged for annual surprise exams of Rancho's assets. Alternatively, KAMG had not arranged for Rancho's financial statements to be audited annually and distributed to Rancho's members. In June 2011, the staff issued another letter to KAMG identifying custody rule violations and other deficiencies.

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[2] Rancho Partners II was formed in June 2003 to invest in one company that ultimately went public. Rancho II was terminated in January 2008. Rancho II's members were not the same as Rancho's members.

KAMG's Improper Distributions

12. Section 206(2) of the Advisers Act prohibits fraudulent conduct by an investment adviser on a client or prospective client. Section 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder prohibit fraudulent conduct by investment advisers to pooled investment vehicles.[3]

13. In making distributions to members, KAMG failed to abide by the terms of Rancho's LLC Agreement and PPM. From the time that Rancho received its first distribution from its venture capital partnership investments in April 2002, through July 2011, KAMG used the wrong methodology for making pro-rata distributions to Rancho members. KAMG also made improper discretionary cash distributions between 2007 and 2010 to some Rancho members. In 2011, KAMG performed a "true-up" exercise designed to correct the improper distributions, and reallocated $119,381 of distributions among the members.

14. Under Rancho's LLC Agreement and PPM dated as of September 1, 2000, KAMG was to make distributions *pro rata* in accordance with the Rancho members' positive capital account balance. When Rancho received money from the partnerships in which it invested, KAMG made distributions in cash or in stock, as credits to members' capital contributions, or as credits to members' management fees due.

15. From April 2002 through July 2011, KAMG calculated all types of distributions based on the members' capital *commitments* rather than on their *capital account balances* as required. KAMG distributed a total of $1,513,078 ($850,163 in capital contribution credits and $662,915 in cash) during this period utilizing this incorrect methodology.

16. In addition, on seven separate occasions between 2007 and 2010, KAMG made improper discretionary cash distributions totaling $92,640 to some, but not all, of Rancho's nineteen members. In total, thirteen of the nineteen members received at least one discretionary cash distribution. Six members, including KAMG and one of the KAMG advisory clients, received none.

17. Knelman authorized all of the distributions and, as managing director of KAMG, was responsible for ensuring that all distributions were made in accordance with the LLC Agreement and PPM.

18. During the relevant period, all Rancho member activity, including distribution detail, was maintained on an electronic spreadsheet that KAMG's outside accountants

[3] "[A]violation of Section 206(2) of the Advisers Act may rest on a finding of simple negligence." *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C.Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191 (1963)). "Proof of scienter is not required to establish a violation of Section 206(4) of the Advisers Act." *In the Matter of Wunderlich Securities, Inc.*, Investment Advisers Act Rel. No. 3211, 2011 WL 2098195, at *8 (May 27, 2011) (citing *SEC v. Steadman*, 967 F.2d 636, 647 (D.C.Cir. 1992)).

created. Beginning in or around 2005, KAMG's outside accountants maintained the spreadsheet for KAMG. KAMG, Knelman and the outside accountants failed to recognize that some of the distributions were improper.

19. KAMG was most disadvantaged by the improper distributions and, as a result of the true-up exercise, received the largest reallocation – $61,670. The next largest reallocation was $10,125. All of KAMG's members were advised of the true-up exercise and the circumstances giving rise to it.

KAMG's Compliance Failures

20. The Compliance Rule – Rule 206(4)-7 under the Advisers Act – requires investment advisers registered with the Commission (1) to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and rules adopted under the Act; (2) to review at least annually the adequacy of the policies and procedures and the effectiveness of their implementation; and (3) to designate a CCO, who is a supervised person, responsible for administering the policies and procedures.

21. KAMG's policies and procedures were not reasonably designed to prevent violations of the custody rule. The firm's compliance manual did not acknowledge that KAMG had custody over Rancho's assets. Thus, it had no written policies and procedures to ensure that it met the requirements of the custody rule regarding Rancho's assets. KAMG also failed to conduct annual reviews of its compliance policies and procedures and the effectiveness of their implementation and failed to institute a documented process to identify potential compliance risks and conflicts of interest.

22. KAMG designated Knelman as the firm's CCO, but he had no relevant experience in the compliance industry and failed to undergo any compliance training to become knowledgeable about that position. Knelman was ultimately responsible for making sure KAMG complied with the Custody Rule. Knelman knew or should have known that KAMG had not conducted any annual compliance reviews or instituted a documented process to identify potential compliance risks or conflicts of interest. Nevertheless, Knelman failed to establish written policies and procedures reasonably designed to prevent violations of the Advisers Act as they related to custody over Rancho's assets.

KAMG's Failure to Make and Keep Certain Books and Records

23. Section 204 of the Advisers Act provides that investment advisers registered with the Commission who make use of the mails or interstate commerce in connection with its advisory business shall make and keep for prescribed periods those records that the Commission, by rule, may prescribe as necessary, and that all records are "subject at any time, or from time to time, to such reasonable periodic, special, or other examinations by representatives of the Commission as the Commission deems necessary or appropriate in the public interest or for the protection of investors." Rule 204-2(a) sets forth certain categories of books and records that registered investment advisers are required to "make and keep true, accurate and current" with

respect to their investment advisory business. Rule 204-2(b) sets forth categories of additional documents that must be maintained by registered investment advisers that have custody of client assets. Rule 204-2(c)(2) requires that registered investment advisers that exercise voting authority with respect to client securities shall make and retain certain documents.

24. From September 2008 through 2011, as required by Rule 204-2(b)(1), KAMG failed to make and keep an accurate journal or other record for Rancho showing all purchases, sales, receipts and deliveries of securities (including certificate numbers) and all other debits and credits.

25. From September 2008 through 2011, as required by Rule 204-2(b)(2), KAMG failed to make and keep accurate separate ledger accounts for each Rancho member showing all purchases, sales, receipts and deliveries of securities, the date and price of each purchase and sale, and all debits and credits.

26. From September 2008 through 2011, as required by Rule 204-2(c)(2), KAMG failed to make and keep a copy of each proxy statement it had received, a record of each vote cast on behalf of a client, and a copy of any document created by KAMG that was material to its voting decisions or that memorialized the basis for its voting decisions.

27. As managing director, CEO, and CCO, Knelman was responsible for ensuring that KAMG accurately made and kept such books and records. Knelman directed his clerical employees and KAMG's outside accountants to maintain and update the required records, but no one ensured their accuracy.

KAMG's False Form ADV Disclosures

28. Section 207 of the Advisers Act makes it unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission, or willfully to omit to state in any such application or report any material fact which is required to be stated therein.[4]

29. KAMG's Form ADV, which was signed and filed by Knelman with the Commission on August 28, 2008, and all subsequent amendments to the Form ADV, which were signed and filed by Knelman from 2009 through 2011, contain untrue statements of material fact regarding KAMG's custody of client assets (Part IA, Item 9 and Part 2A, Item 15). Although KAMG had custody of Rancho's assets, KAMG stated in its Forms ADV that it did not maintain custody of client assets or securities.

[4] Scienter is not required to establish liability under Section 207 of the Advisers Act; it merely requires willfulness. *SEC v. K.W. Brown & Co.*, 555 F. Supp. 2d 1275, 1309 (S.D. Fla. 2007).

Violations

30. As a result of the conduct described above, KAMG and Knelman willfully[5] violated Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder.

31. As a result of the conduct described above, KAMG willfully violated, and Knelman willfully aided and abetted and caused KAMG's violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 promulgated thereunder.

32. As a result of the conduct described above, KAMG willfully violated, and Knelman willfully aided and abetted and caused KAMG's violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder.

33. As a result of the conduct described above, KAMG willfully violated and Knelman willfully aided and abetted and caused KAMG's violations of Section 204 and Rules 204-2(b)(1), 204-2(b)(2), 204-2(c)(2).

34. As a result of the conduct described above, KAMG and Knelman willfully violated Section 207 of the Advisers Act.

KAMG's Remedial Efforts

35. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent KAMG.

Undertakings

Respondent has undertaken to:

36. Compliance Training. Within one year of the entry of this Order, Knelman shall complete, and KAMG shall require its new CCO to complete, thirty (30) hours of compliance training relating to the Advisers Act.

37. Designation of a CCO. Within thirty (30) days of the entry of this Order, KAMG shall designate someone other than Knelman to be its CCO.

38. Continued Retention of Compliance Consultant. During the Commission's investigation, KAMG hired a compliance consultant (the "Consultant") to conduct a comprehensive review of KAMG's compliance program. The Consultant completed its initial

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[5] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)).

work and submitted a report detailing its work, findings, and recommendations to KAMG in February 2012, which KAMG shared with the Commission staff. KAMG has implemented all of the Consultant's recommendations. KAMG shall continue to retain, at its expense, the Consultant to conduct annual compliance reviews of KAMG for the years 2013 and 2014 as well quarterly compliance meetings and other services as detailed in a contract between KAMG and the Consultant dated August 19, 2013.

39. Recordkeeping. KAMG shall preserve for a period of no less than six (6) years from the end of the fiscal year last used, the first two (2) years in an easily accessible place, any record of KAMG's compliance with the undertakings set forth in this Order.

40. Notice to Rancho Members and Advisory Clients. Within thirty (30) days of the entry of this Order, KAMG shall provide a copy of the Order to each existing Rancho member and each of KAMG's existing advisory clients as of the entry of this Order via mail, email, or such other method as may be acceptable to the Commission staff, together with a cover letter in a form not unacceptable to the Commission staff. Furthermore, for a period of twelve (12) months from the entry of this Order, to the extent that KAMG is required to deliver a brochure to a client and/or prospective client pursuant to Rule 204-3 under the Advisers Act, KAMG shall also provide a copy of this Order to such client and/or prospective client at the same time that KAMG delivers the brochure.

41. Deadlines. For good cause shown, the Commission staff may extend any of the procedural dates relating to the undertakings. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

42. Certification of Compliance. KAMG and Knelman shall certify, in writing, compliance with the undertakings set forth above. The certifications shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and KAMG and Knelman agree to provide such evidence. The certification and supporting material shall be submitted to Paul A. Montoya, Assistant Regional Director, Securities and Exchange Commission, 175 West Jackson Blvd., Suite 900, Chicago Illinois 60604, or such other address as the Commission staff may provide, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of all of the undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent KAMG's and Respondent Knelman's Offers.

Accordingly, pursuant to Sections 203(e), 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondents KAMG and Knelman cease and desist from committing or causing any violations and any future violations of Sections 204, 206(2), 206(4) and 207 of the Advisers Act and Rules 204-2(b)(1), 204-2(b)(2), 204(2)(c)(2), 206(4)-2, 206(4)-7, and 206(4)-8 promulgated thereunder.

B. Respondent KAMG is censured.

C. Respondent Knelman be, and hereby is barred from acting as the chief compliance officer of any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization with the right to apply for reentry after three (3) years to the appropriate self-regulatory organization, or if there is none, to the Commission; and prohibited from serving or acting as the chief compliance officer for a registered investment company or for an affiliated person of an investment adviser of, depositor of, or principal underwriter for, a registered investment company, with the right to apply for reentry after three (3) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

D. Any reapplication for association by Respondent Knelman will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Respondent Knelman, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

E. Respondent KAMG shall pay a civil money penalty in the amount of $60,000 to the United States Treasury. Payment shall be made in the following installments: $30,000 within ten (10) days of the entry of this Order, $15,000 within sixty (60) days of the entry of this Order, and $15,000 within ninety (90) days of the entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying KAMG as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Paul Montoya, Assistant Regional Director, Chicago Regional Office, Securities and Exchange Commission, 175 West Jackson Blvd., Suite 900, Chicago, IL 60604.

F. Respondent Knelman shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $75,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in accordance with Subsection E above, with the cover letter identifying Knelman as a Respondent in these proceedings.

G. Respondent KAMG shall comply with the undertakings enumerated in Sections 36 through 42 above. Respondent Knelman shall comply with the undertakings enumerated in Sections 36 and 42 above.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70767 / October 29, 2013

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3511 / October 29, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15591

In the Matter of **Ronald Baldwin, Jr. CPA,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Ronald Baldwin, Jr. ("Respondent" or "Baldwin") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Baldwin, age 53, is and has been a certified public accountant licensed to practice in the State of Florida since 1996. He served as Chief Financial Officer of JBI, Inc. ("JBI") from January 1, 2010 until his resignation effective March 28, 2011.

2. JBI was, at all relevant times, a Nevada corporation with its principal place of business for a portion of the relevant period in Cambridge, Massachusetts and, later, in Thorhold, Ontario, Canada, with operations in New York, Florida, Ohio and Pennsylvania. JBI was a technology company focused on data restoration and recovery and environmentally engineered product development. At all relevant times, JBI's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"), and was quoted on the OTC Bulletin Board.

3. On January 4, 2012, the Commission filed a complaint against Baldwin in SEC v. JBI, Inc., et al. (Civil Action No. 1:12-cv-10012-MLW). On October 16, 2013, the court entered an order permanently enjoining Baldwin, by consent, from future violations of Section 17(a) of the Securities Act of 1933, Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5 and 13b2-1 and Rule 13a-14 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20 and 13a-1 thereunder. Baldwin was also prohibited for five years from acting as an officer or director of any issuer that has a class of securities registered under Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act. In addition, Baldwin was ordered to pay a $25,000 civil money penalty.

4. The Commission's complaint alleged, among other things, that Baldwin and others engaged in a scheme to commit securities fraud by stating materially false and inaccurate financial information on the financial statements of JBI for two reporting periods during 2009. Specifically, the complaint alleged that in an effort to boost JBI's value as a company, Baldwin and others overstated by almost 1,000% the value of certain of JBI's assets on the company's financial statements for the third quarter of 2009 and the year end 2009. JBI and others then used the

overvalued financial statements in two private capital raising efforts that raised more than $8.4 million from unwitting investors.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Baldwin's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Baldwin is suspended from appearing or practicing before the Commission as an accountant.

B. After five years from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the respondent's or the firm's quality control system that would indicate that the respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he/she has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Elizabeth M. Murphy
Secretary

By: Lynn M. Powalski
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70768 / October 29, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15592

In the Matter of

JOSEPH M. MANCUSO,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Joseph Mancuso ("Mancuso" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Mancuso, age 37, resides in New York, New York. During the relevant time period, Mancuso was a registered representative and proprietary trader at Schottenfeld Group, LLC ("Schottenfeld") a Delaware limited liability company and registered broker-dealer based in New York, New York. Mancuso held Series 7, 24, 55, and 63 securities licenses.

2. On October 21, 2013, a final judgment was entered by consent against Mancuso, permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled <u>Securities and Exchange Commission v. Joseph M. Mancuso</u>, Civil Action Number 13-CV-2555, in the United States District Court for the Southern District of New York.

3. The Commission's complaint alleged, <u>inter</u> <u>alia</u>, that, while working as a trader at Schottenfeld in 2007, Mancuso was tipped material, nonpublic information concerning the possible acquisitions of Avaya, Inc. ("Avaya"), 3Com Corp. ("3Com"), Axcan Pharma Inc. ("Axcan"), Hilton Hotels Corp. ("Hilton") and Kronos Inc. ("Kronos"), which had been conveyed in violation of a duty. The complaint further alleged that Mancuso purchased shares of Avaya, Axcan, 3Com, Hilton and Kronos based on that material, nonpublic information, and, following the public announcement of each acquisition, sold the securities, generating profits of approximately $350,000.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Mancuso's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Mancuso be, and hereby is: barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70770 / October 29, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15593

In the Matter of

SCOTT TIERNEY

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Scott Tierney ("Tierney" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Tierney, 45 years old, resides in Staten Island, New York. From February 1997 through April 2008, Tierney was a registered broker associated with Joseph Stevens & Company, Inc., a broker-dealer registered with the Commission.

2. On May 11, 2012, Tierney was convicted in the Supreme Court of the State of New York in People of the State of New York v. Joseph Stevens & Co., Inc., et al., Case Number 02394-2009 of: (1) three counts of fraud, a violation of New York General Business Law 352-c(1)(a) and (2) three counts of attempted grand larceny in the fourth degree, a violation of New York Penal Law 110-155.30(1). On May 11, 2012 Tierney was sentenced to three years' probation and ordered to make restitution of $243,918.34 together with a five-percent surcharge of $12,195.92, together totaling $256,114.26.

3. In connection with that conviction, Respondent admitted that:

(a) He participated in firm-wide schemes at Joseph Stevens & Co., Inc. in order to generate excessive and undisclosed commissions;

(b) At times, he encouraged customers to purchase shares so that he would receive extra commissions that were not disclosed to customers; and

(c) He participated in tactics to delay the execution of customer orders until an artificially inflated price was achieved to enrich himself and others at the expense of customers.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70775 / October 30, 2013

WHISTLEBLOWER AWARD PROCEEDING
File No. 2014-2

In the Matter of the Claim for Award

in connection with

Redacted

Redacted

Redacted

Notice of Covered Action Redacted

ORDER DETERMINING WHISTLEBLOWER AWARD CLAIM

On August 12, 2013, the Claims Review Staff issued a Preliminary Determination related to Notice of Covered Action Redacted (the "Covered Action"). The Preliminary Determination recommended that Claimant #1 receive a whistleblower award because -- voluntarily provided original information to the Commission that led to the successful enforcement of the Covered Action pursuant to Section 21F(b)(1) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78u-6(b)(1), and Rule 21F-3(a) thereunder, 17 C.F.R. § 240.21F-3(a). Further, the Claims Review Staff recommended that such award be set in the amount of thirty percent (30%), in total, of the monetary sanctions collected or to be collected in the Covered Action. In arriving at this recommendation, the Claims Review Staff considered the factors set forth in Rule 21F-6, 17 C.F.R. § 240.21F-6, in relation to the facts and circumstances of Claimant #1 application.[1]

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[1] The Preliminary Determination of the Claims Review Staff also denied an award to Claimant #2 Claimant #2 . However, Claimant #2 subsequently withdrew -- application for an award and is, therefore, no longer a claimant in this matter. Notably, this claimant subsequently sought to revoke -- withdrawal, but that request was denied because: (i) -- withdrawal was voluntary and unconditional, a fact which -- did not dispute; (ii) -- failed to provide a "good cause" explanation for seeking reinstatement of -- application, *see, generally, Aeronautical Radio, Inc. v. F.C.C.*, 983 F.2d 275, 282 (D.C. Cir. 1993); and (iii) -- did not identify any factual or legal basis to suggest that the Claims Review Staff's preliminary determination with respect to -- award application was incorrect and, thus, reinstating -- application would have needlessly tied up the processes and limited resources of the Commission's whistleblower program.

On September 6, 2013, Claimant #1 provided written notice to the Commission of decision not to contest the Preliminary Determination within the 60-day deadline set out in Rule 21F-10(e) promulgated under the Exchange Act, 17 C.F.R. § 240.21F-10(e), and, pursuant to Rule 21F-10(f) thereunder, 17 C.F.R. § 240.21F-10(f), the Preliminary Determination became the Proposed Final Determination of the Claims Review Staff.

Upon due consideration under Rule 21F-10(f) and (h), 17 C.F.R. § 240.21F-10(f) and (h), and for the reasons set forth in the Proposed Final Determination, it is hereby ORDERED that Claimant #1 shall receive an award of thirty percent (30%) of the monetary sanctions collected in this Covered Action, including any monetary sanctions collected after the date of this Order.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70772 / October 30, 2013

WHISTLEBLOWER AWARD PROCEEDING
File No. 2014-1

In the Matter of the Claim for Award

in connection with

SEC v. Advanced Technologies Group LTD, Alexander Stelmak, and Abelis Raskas, LLC, 10-cv-4868 (S.D.N.Y. 2011)
Notice of Covered Action 2011-4

ORDER DENYING WHISTLEBLOWER AWARD CLAIM

Claimant timely filed a whistleblower award claim pursuant to Section 21F of the Securities Exchange Act of 1934 (the "Exchange Act"),[1] in connection with Notice of Covered Action 2011-4. The Claims Review Staff ("CRS") issued a Preliminary Determination recommending that Claimant 's claim be denied. Claimant filed a response contesting the Preliminary Determination. For the reasons set forth below, Claimant 's claim is denied.

I. Background

Beginning in Redacted and continuing through July 2009, Claimant submitted information to the Division of Enforcement ("Enforcement") staff regarding wrongdoing purportedly being engaged in by Alexander Stelmak ("Stelmak"), among others, in connection with the solicitation of securities by Advanced Technologies Group LTD ("ATG") and its predecessor entity.[2] In addition to calling and emailing the staff and sending it certain documents, Claimant also met with

[1] 15 U.S.C. § 78u-6.

[2] Claimant Redacted Redacted

the staff in April 2009.

The staff opened an investigation of ATG, Stelmak and Stelmak's partner, Abelis Raskas ("Raskas")[3] on or about March 5, 2009 (the "ATG Investigation"). On June 23, 2010, the Commission filed an enforcement action in *SEC v. Advanced Technologies Group LTD, Alexander Stelmak, and Abelis Raskas, LLC,* 10-cv-4868 (the "ATG Action"). The Commission alleged in its complaint that ATG, Stelmak, and Raskas, engaged in a series of offerings of unregistered non-exempt securities of ATG and ATG's predecessor entities between 1997 and 2006 in violation of Section 5 of the Securities Act of 1933. The unlawful offerings occurred through nationwide cold-calling campaigns supervised by Stelmak.

Effective July 21, 2010, Congress enacted Section 21F of the Exchange Act, "Securities Whistleblower Incentives and Protection," as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").[4] Section 21F directs the Commission to pay whistleblower awards, subject to certain statutory criteria and "under regulations prescribed by the Commission,"[5] to individuals who provide information that leads to successful enforcement actions. One of the statutory requirements found in Section 21F is that the information provided by a whistleblower be "original information."[6]

On September 14, 2010, Claimant sent a brief email to an Enforcement attorney whom -- had previously communicated with, as well as certain other SEC officials, in which -- identified two allegedly inaccurate statements that Stelmak made in his deposition taken during discovery in the ATG Action (the "September 2010 Email"). The first was Stelmak's statement that Redacted Redacted (Claimant Redacted Redacted). The second was Stelmak's statement that Redacted Redacted , Redacted , Claimant Redacted , Redacted " Redacted ."

On October 5, 2010, Commission staff notified the district court that they and the defendants had negotiated the agreed to terms of a proposed settlement that would soon be submitted to the Commission for its consideration; thereafter, in mid-November 2010, following the Commission's acceptance of those settlement terms, ATG, Stelmak and Raskas signed consent agreements that formally settled the ATG Action.[7] On January 12, 2011, the court

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[3] ATG was owned and operated by Stelmak and Raskas.

[4] Pub. L. No. 111-203, § 922, 124 Stat. 1376, 1841 (July 21, 2010).

[5] 15 U.S.C. 78u-6(b)(1).

[6] 15 U.S.C. 78u-6(a)(3).

[7] See, e.g., Order of Oct. 6, 2010 (S.D.N.Y. 10-civ-4868) (Dkt. #37); Raskas Consent Agreement (attached to Final

entered final judgments against the defendants in which, among other remedies, ATG and Stelmak were ordered jointly and severally liable for disgorgement in the amount of $14,741,760.76, together with prejudgment interest in the amount of $4,444,775.56, and ordered to pay civil penalties of $65,000 and $6,500, respectively. Of this disgorgement amount, defendant Raskas was jointly and severally liable for $3,639,920, together with prejudgment interest in the amount of $1,110,028.03.

On January 11, 2011, Claimant 's counsel submitted a claim for a whistleblower award along with a letter and exhibits in support of -- claim. In this submission, Claimant s counsel restated information -- client had provided to the staff between Redacted and 2009, as well as the September 2010 Email. By letter dated February 11, 2011, Claimant resubmitted this package to the Commission.

Effective August 12, 2011, we adopted Rules 21F-1 through 21F-17 under the Exchange Act to implement our whistleblower program.[8] Rule 21F-4(b)(1) defines "original information" in the same manner as that term is defined in Section 21F(a)(3) of the Exchange Act, but adds that the information must be "[p]rovided to the Commission for the first time after July 21, 2010 (the date of enactment of [Dodd-Frank])."[9]

On August 12, 2011, the Office of the Whistleblower ("OWB") posted a Notice of Covered Action (the "NoCA") for the ATG Action. As noted, Claimant had previously submitted a claim application setting forth the information and assistance -- had provided to the Commission.[10] In -- application, -- claimed that -- was entitled to an award because both the Commission and the general public "benefitted from [--] persistent efforts to bring Stelmak's and ATG's, as well as related individuals' and entities', wrongful conduct to light . . . [and that] -- efforts substantially assisted the SEC in its enforcement action."

In support of -- application for an award, Claimant identifies information that -- communicated to Enforcement staff between Redacted and September 2010 concerning possible securities law violations committed by Stelmak, ATG, and other related individuals and entities.

Judgment as to Defendant Abelis Raskas (S.D.N.Y. 10-civ-4868) (Dkt. #41)); Stelmak and ATG Consent Agreement (attached to Judgment (S.D.N.Y. 10-civ-4868) (Dkt. #42)).

[8] 17 C.F.R. §§ 240.21F-1 to -17.

[9] 17 C.F.R. § 240.21F-4(b)(1); 15 U.S.C. § 78u-6(a)(3).

[10] On August 17, 2011, following the effective date of the final rules implementing the whistleblower program, Claimant sent a letter to the OWB asking for confirmation that -- did not need to resubmit -- claim application and that -- earlier submissions were sufficient to satisfy the requirements for submitting a claim under the rules. In an email dated August 23, 2011, the OWB confirmed that it was not necessary for Claimant to resubmit.

However, with the exception of the September 2010 Email, all of Claimant 's information was submitted to the staff between Redacted and 2009, well before the enactment of Section 21F. As described above, in an apparent effort to overcome this obstacle, Claimant repackaged - information and provided it again in written submissions to the Commission in January and February 2011 – after Section 21F was enacted (collectively, Claimant 's "2011 Submissions").

II. Preliminary Determination (November 5, 2012)

In its Preliminary Determination, the CRS found that the information provided by Claimant prior to July 21, 2010, including information that Claimant re-submitted after July 21, 2010, was not "original information" within the meaning Section 21F(a)(1) of the Exchange Act and Rule 21F-4(b)(1)(iv) because it was not provided to the Commission for the first time after July 21, 2010 as required by the rule. The CRS further determined that the September 2010 Email did not lead to the successful enforcement of a covered judicial or administrative action as required by Section 21F(b)(1) of the Exchange Act and Rules 21F-3(a) and 21F-4(c) because it did not cause the Commission to open the ATG Investigation (or inquire into different conduct as part of the investigation) nor did it significantly contribute to the success of the ATG Action. Accordingly, the CRS recommended denying Claimant 's award application.

III. Claimant 's Response to the Preliminary Determination

Pursuant to Rule 21F-10(e)(1)(i), the OWB permitted Claimant to review the materials from among those set forth in Rule 21F-12(a) that formed the basis of the CRS's Preliminary Determination. However, Claimant sought extensive discovery, not permitted by the Commission's rules, of other documents and information relating to the ATG Investigation. Because the OWB denied these discovery requests, Claimant contests not only the CRS's Preliminary Determination to deny - a whistleblower award, but also the procedural rights that - has been afforded under our rules.

A. Claimant 's motions and requests following the Preliminary Determination

On November 16, 2012, Claimant 's attorneys requested that they be permitted to review the materials that formed the basis of the Preliminary Determination,[11] and that the OWB meet with them to discuss the Preliminary Determination.[12] On December 4, 2012, the OWB mailed the requested materials to Claimant 's attorneys; however, the packet inadvertently excluded the

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[11] Rule 21F-10(e)(1)(i) permits a claimant, before deciding whether to contest a Preliminary Determination, to request that OWB make available for the claimant's review "the materials . . . that formed the basis of the Claims Review Staff's Preliminary Determination."

[12] Rule 21F-10(e)(1)(ii) permits a claimant, before deciding whether to contest a Preliminary Determination to "request a meeting with the Office of the Whistleblower; however, such meetings are not required and the office may in its sole discretion decline the request."

second of two sworn staff declarations that the CRS had relied upon.[13]

On December 19, 2012, senior staff of the OWB, as well as staff of the Commission's Office of General Counsel, met with Claimant 's attorneys. Claimant 's counsel primarily used the meeting as an opportunity to present their views on the retroactivity issue, explaining why in their view the legislative history and case law require the Commission to make awards for information provided for the first time before Dodd-Frank's enactment.

On December 21, 2012, Claimant 's attorneys submitted various requests for documents relating to the April 2009 meeting between Enforcement staff and Claimant ; specifically, (1) any transcript of the April 2009 meeting; (2) a copy of the documentary evidence provided by Claimant to Enforcement staff in connection with the April 2009 meeting; and (3) any formal order of investigation which would have been available or in effect at that time.

On December 26, 2012, the OWB discovered that it had omitted the second staff declaration from the packet it had sent to Claimant 's attorneys on December 4, 2012. On that same day, December 26, the OWB emailed the second declaration to Claimant 's attorneys, advising them that this declaration had been inadvertently omitted from the December 4 package. The OWB further advised Claimant 's attorneys that, as a result of this error, the OWB would re-start the 60-day period for Claimant to contest the Preliminary Determination, such that the new date for Claimant to file a response would be February 25, 2013.[14]

By letter dated December 28, 2012, Claimant 's counsel made five demands regarding the second staff declaration: (1) that both staff declarations be stricken from the record; (2) that Claimant 's counsel be permitted to take the Enforcement staff attorney's deposition to discover, among other matters, the extent of the information Claimant provided to the Enforcement staff, the degree to which this information assisted the staff in the underlying investigation and enforcement action, and the circumstances surrounding the preparation of the two staff declarations; (3) that counsel be permitted to obtain all documents from the Enforcement staff pertaining to Claimant 's April 2009 meeting with the staff and, more broadly, the underlying

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[13] At a meeting held on September 14, 2012 to consider the Claimant award application, the CRS deferred issuing a preliminary determination and directed the OWB to request that the Enforcement staff supplement the record with additional detail concerning the ATG investigation, the ATG Action, and the information provided by Claimant . At a meeting held on November 5, 2012, the CRS considered a second staff declaration, dated October 26, 2012. In compiling the documents to send to Claimant 's attorneys, OWB included all the documents from the binder it had assembled in advance of the September 14 meeting but inadvertently omitted the October 26 staff declaration.

[14] Rule 21F-10(e)(2) provides that a claimant who wishes to contest a Preliminary Determination must submit his written request and supporting materials within 60 days of the later of the date of the Preliminary Determination or the date OWB makes the CRS's review materials available to the claimant.

investigation and enforcement action so that Claimant 's counsel could determine the extent to which Claimant assisted in the investigation and the enforcement action; (4) that the OWB disclose all intra-agency communications with the staff attorney regarding the creation and purpose of the two declarations; and (5) that the OWB delay the start of the 60-day period for responding to the Preliminary Determination until 60 days after counsel has completed the discovery sought in its letter.

On January 4, 2013, the OWB responded that the whistleblower rules did not authorize the OWB to amend the record or to grant claimants discovery of materials not considered by the CRS.[15] With regard to counsel's request that the OWB delay the start of the 60-day period for responding to the Preliminary Determination until 60 days after counsel had completed the discovery sought in its letter, the OWB pointed out that Rule 21F-10(e)(2) provided that the 60-day period to contest the Preliminary Determination began when the OWB made available the materials that formed the basis of the Claims Review Staff's preliminary determination. Further, the OWB explained that it had provided the last of those materials (*i.e.*, the second staff declaration dated October 26, 2012) to counsel on December 26, 2012, and thus the 60-day period commenced on that date.

On January 22, 2013, Claimant 's attorneys requested that the OWB advise them when any and all Matters Under Inquiry ("MUIs") commenced with respect to the ATG Investigation.[16] On January 23, 2013, the OWB responded that, as such information was not included in the record that formed the basis of the CRS's Preliminary Determination, the OWB was not authorized to provide it to counsel.[17]

On January 28, 2013, Claimant 's counsel requested copies of the entire deposition

[15] The OWB specifically directed counsel's attention to Rule 21F-12(b) which states, in relevant part, that claimants are not entitled to obtain any materials from the Commission other than the materials delineated in Rule 21F-12(a) that the Commission and the CRS may rely upon in making an award determination. The OWB did inform counsel, however, that pursuant to Rules 6 and 7(a) of the SEC's Rules Relating to Investigations, 17 C.F.R. §§ 203.6 and 203.7(a), it was working with Enforcement staff to respond to counsel's requests for the transcript of Claimant's meeting with Enforcement staff attorneys in April 2009 and the formal order of investigation that led to the covered action. On January 11, 2013, OWB provided Claimant's counsel with copies of the documents produced by Claimant at the April 2009 meeting and the formal order of investigation for the ATG Investigation. With regard to counsel's request for a transcript of the April 2009 meeting, OWB advised counsel that the meeting had not been recorded or transcribed.

[16] Enforcement opens a MUI if it determines that "the facts underlying the MUI show that there is potential to address conduct that violates the federal securities laws; and [that]. . . the assignment of a MUI to a particular office will be the best use of resources for the Division as a whole." SEC Enforcement Manual, ¶ 2.3.1.

[17] Because the CRS determined that the information provided by Claimant , other than the September 2010 Email, was not original information within the meaning of Rule 21F-4(b)(1), the CRS did not need to consider the relationship between Claimant 's information and the opening of either the MUI or the formal ATG Investigation.

transcripts of Stelmak and Raskas, portions of which had been attached as exhibits to the Commission's Declaration in Support of Plaintiff's Application for Asset Freeze and Other Relief in the ATG Action. On January 31, 2013, the OWB again responded that it was not authorized to provide these items since they were not included in the materials that formed the basis of the CRS's Preliminary Determination.[18]

B. Claimant 's response contesting the Preliminary Determination

On February 25, 2013, Claimant submitted a response contesting the Preliminary Determination. Claimant raised three central contentions:

- The requirement of Rule 21F-4(b)(1)(iv) that information be submitted to the Commission for the first time after the enactment of Dodd-Frank "was neither included nor required in the Dodd-Frank Act . . . [and] cannot be applied retroactively to the Claimant who provided information to the Commission before July 21, 2010, and then timely submitted that information in writing after the passage of the Act but before the Final Rules became effective."

- At a minimum, the information Claimant has provided to the Commission since Redacted either caused the Commission to commence the ATG investigation or, to the extent the investigation was already underway, significantly contributed to the success of the enforcement action.

- The OWB "committed a variety of procedural errors" in reviewing and processing -- claim that "deprive[d] the Claimant of due process of law," including denying -- a "fair opportunity to take discovery" in order to contest "the wrongfulness of [] the assertions" made in the two staff attorney declarations.

Additionally, Claimant requested that, if the Preliminary Determination is upheld, then -- should be permitted to conduct a "*de novo* review" with the "opportunity to take reasonable discovery from the Commission (including, without limitation, deposition(s) of any and all individuals who executed declarations) on issues pertaining to [--] claim for award."

[18] In its response, the OWB also noted that the Commission's Rules Relating to Investigations do not authorize Claimant 's access to the requested transcripts, citing specifically to Rule 203.6, 17 C.F.R § 203.6, which provides that "[a] person who has submitted . . . testimony in a formal investigative proceeding shall be entitled . . . to procure a copy of . . . a transcript of his testimony." The OWB pointed out that counsel's request for these deposition transcripts fell outside of this rule since counsel was not requesting the transcripts on Stelmak's and Raskas's behalf.

IV. Analysis

A. Claimant 's argument about "retroactive" application of Rule 21F-4(b)(1)(iv) has no merit.

Claimant 's first contention is that the CRS should not have denied - claim based on the information that - originally submitted to the Commission before the effective date of Dodd-Frank and later re-packaged and submitted to the Commission in 2011. Claimant does not dispute that this denial followed from Rule 21F-4(b)(1)(iv), which requires that a whistleblower submission have been "[p]rovided to the Commission for the first time after July 21, 2010 (the date of enactment of [Dodd-Frank])" in order for it to be considered "original information." Rather, - argues that Rule 21F-4(b)(1)(iv) constitutes impermissible retroactive rulemaking by the Commission.

While Claimant 's argument is not entirely clear, - appears to be framing it in two different ways. First, - claims that Rule 21F-4(b)(1)(iv) is contrary to the statute insofar as it requires that information be submitted to the Commission for the first time after Dodd-Frank's effective date. Second, - claims that the rule is impermissibly retroactive because it deprives - of - "vested right" to an award based on - 2011 Submissions. As we explain below, each of these contentions is incorrect.

The first variant of Claimant 's argument, in our view, is not really about impermissible retroactivity of the Commission's rule. It is simply an argument that the Commission rule should be considered invalid because it conflicts with the statute. In fact, it is Claimant whose position relies on a retroactive application of law; in - view, Dodd-Frank *requires* that - be paid for information - provided before the whistleblower statute even existed. While - appears to accept that - cannot literally base - award claim on the submissions of information - made from Redacted to 2009 – *i.e.*, before Dodd-Frank was the law – - argues that by resubmitting the same information in written form in 2011, - made Claimant eligible for an award arising from the ATG action, even though that action had already been filed in June 2010 and was then on the verge of final settlement.

Claimant argues that - 2011 Submissions entitle - to an award because they satisfy the statutory definition of "original information." - further claims that - argument is supported by Section 924(b) of Dodd-Frank, which states that "[i]nformation provided to the Commission in writing by a whistleblower shall not lose the status of original information . . . solely because the whistleblower provided the information prior to the effective date of the regulations, if the information is provided by the whistleblower after the date of enactment of this subtitle."[19] In essence, Claimant contends that Section 924(b) *requires* the Commission to treat information

[19] Pub. L. No. 111-203, § 924(b), 124 Stat. 1376, 1850 (July 21, 2010).

submitted before the enactment of Dodd-Frank as eligible for an award as long as the information is re-submitted in writing after the date of enactment.

We disagree. Neither the statutory language, the legislative history, nor sound policy considerations suggest that Congress's adoption of a new whistleblower reward program in July 2010 was intended to pay awards to people like Claimant who gave the Commission original information years before the statute was enacted.

The starting point in any statutory analysis is the statutory language. Here, there is nothing in the statutory language that demonstrates Congressional direction to pay awards based on information submitted before Dodd-Frank was enacted. To the contrary, the few statutory provisions that specifically address timing issues do not mention payments for information provided before enactment.

Dodd-Frank includes a general effective date provision; one day after enactment "[e]xcept as otherwise specifically provided" in the statute.[20] No provision of Dodd-Frank establishes a different effective date for our whistleblower award program. Two provisions pertaining to whistleblower awards specifically address timing issues – Sections 924(b) and 924(c) – but each has its own very specific and limited focus, and neither suggests that Congress intended to pay awards for information submitted prior to enactment.

As noted, Section 924(b) requires that information that satisfies the statutory definition of "original information" be treated as such if it is submitted in writing after the effective date of the statute but before the promulgation of the Commission's regulations. This provision shows that Congress expressly considered, and provided for, the issue of how to treat information submitted *after* enactment of the statute but *before* adoption of the implementing Commission rules. Congress affirmatively directed that the Commission should treat as eligible for award payments all such information provided in writing, but *only if "the information [was] provided ... after the date of enactment...."* Congress did not similarly direct payment for information provided *before* the date of enactment, although it could have done so.[21]

Section 924(c) is to similar effect. That section provides that a whistleblower "may receive an award ... regardless of whether any violation ... underlying the judicial or administrative action upon which the award is based, occurred prior to the date of enactment" of Dodd-Frank.[22] Thus, Congress expressly provided that payments could be made even if the

[20] Pub. L. No. 111–203, §4, 124 Stat. 1376, 1390 (Jul. 21, 2010).

[21] Here we are particularly mindful of the well-established canon of statutory construction expression *unius est exclusion alterius*, or the expression of one thing implies the exclusion of others. *See, e.g., TRW Inc. v. Andrews*, 534 U.S. 19, 28-29 (2001); *United States v. Giordano*, 416 U.S. 505, 514 (1974).

[22] Pub. L. No. 111-203, § 924(c), 124 Stat. 1376, 1850 (July 21, 2010).

violation underlying the action on which the award is based occurred before enactment, but once again failed to include a similar express statement for *information* provided before enactment. It is clear from Sections 924(b) and 924(c) that Congress knew how to give specific directions for the pre-enactment application of the statute, yet plainly did not require the Commission to pay awards for information submitted before enactment.

The legislative history of Section 924(b) also supports our conclusion that Congress intended that the Commission only make awards for information provided for the first time after Dodd-Frank's enactment. In both the House and Senate bills, the provision that became Section 924(b) treated information submitted after the date of enactment, but before the adoption of our rules, as "original information" eligible for award consideration. However, the House bill also would have conferred "original information" status on information submitted pre-enactment if the information could have merited an award under the Commission's previous insider trading bounty program.[23] The Senate-passed substitute for the House bill would have permitted awards for information submitted by a whistleblower before enactment of the statute as long as the Commission collected monetary sanctions in the resulting enforcement action after the date of enactment.[24] Both of these provisions were omitted from the final version of Section 924(b) that emerged from the conference committee.[25] Thus, Congress considered alternatives that would have provided for varying degrees of retroactivity in the whistleblower award program, but ultimately failed to include them in the final version of Section 924(b). We take this as a strong indication that Congress made a conscious decision against authorizing whistleblower awards for information that was provided to the Commission prior to the Act's passage. At the very least, it provides no support for Claimant 's claim that Congress meant to *require* the Commission to consider pre-enactment submissions of information as eligible for awards.[26]

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[23] *Wall Street Reform and Consumer Protection Act of 2009*, H.R. 4173, 111th Cong. § 7205(b) (as passed by House, Dec. 11, 2009) (information deemed original information "provided such information was submitted after the date of enactment of this subtitle, *or related to insider trading violations for which a bounty could have been paid at the time such information was submitted.*") (emphasis added). Former Section 21A(e) of the Exchange Act authorized the Commission to award bounties to persons who provided information leading to the recovery of civil penalties for insider trading violations. Section 21A(e) was repealed by Section 923(b) of Dodd-Frank.

[24] *Restoring American Financial Stability Act of 2010*, H.R. 4173, 111th Cong. § 924(b) (as passed by Senate, May 20, 2010) (information deemed original information "provided that the information is— (1) provided by the whistleblower after the date of enactment of this subtitle, *or monetary sanctions are collected after the date of enactment of this subtitle*; ....") (emphasis added).

[25] The Senate language providing for award eligibility where monetary sanctions were collected after enactment of the statute was used in the base text that went to the conference committee, but was deleted by the conferees.

[26] The Senate-passed version of Section 924(b) also would have treated as "original information" any information provided by a whistleblower that was "related to a violation for which an award under section 21F of the Securities Exchange Act of 1934, as added by this subtitle, could have been paid at the time the information was provided by the whistleblower." *Id.* § 924(b)(2). While this language is not entirely clear, it arguably would have supported

We believe that the Congressional purpose in creating the new whistleblower program also supports the conclusion that Congress did not intend the program to cover information provided to the Commission for the first time before the enactment of Dodd-Frank. The principal purpose of Section 21F was "to motivate those with inside knowledge to come forward and assist the Government to identify and prosecute persons who have violated securities laws…."[27] As further explained in the adopting release accompanying the final rules:

> Congress enacted Section 21F in order to provide new incentives for individuals with knowledge of securities violations to report those violations to the Commission. We believe that applying Section 21F prospectively—for new information provided to the Commission after the statute's enactment and not to information previously submitted—is most consistent with Congressional intent and with the language of the statute.[28]

In our view Congress did not intend for Section 21F to reward individuals who came forward before Dodd-Frank's enactment; rather, Congress intended for the award program to create powerful new incentives for the public to assist the Commission in its fight against securities law violations. Leveraging the limited assets of the Investor Protection Fund established by Section 21F(g) of the Exchange Act to pay those individuals who respond to the new incentive by coming forward after Dodd-Frank's enactment is consistent with that Congressional purpose.[29]

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blanket retroactivity, permitting whistleblower awards for any information submitted to the Commission pre-Dodd-Frank that satisfied the criteria set forth under Section 21F. This language was also deleted from the final version of Section 924(b).

[27] S. Rep. No. 111-176 at 110 (2010).

[28] *Securities Whistleblower Incentives and Protections,* Release No. 34-64545, 76 Fed. Reg. 34300, 34310 (June 13, 2011). The Commission further observed that "[t]he statute incentivizes whistleblowers to report possible securities law violations to the Commission by offering them financial awards, reducing the risks from employment retaliation, and lowering the barriers through user-friendly procedures and appellate redress." 76 Fed. Reg. at 34326, n.228.

[29] Section 21F(g) of the Exchange Act, 15 U.S.C. § 78u-6(g), established the "Securities and Exchange Commission Investor Protection Fund" (the "Fund") to fund the payment of whistleblower awards. In general, this section provides that the money to be paid into the Fund will come from "monetary sanction[s] collected by the Commission in any judicial or administrative action brought by the Commission under the securities laws that is not . . . otherwise distributed to victims of a violation of the securities laws." The method for funding award payments thus operates prospectively only. If, as Claimant argues, Dodd-Frank requires that awards must be paid for information provided before its enactment and simply resubmitted in writing afterwards, whistleblower claims based on such repackaged information could threaten to exhaust the fund in short order. If that had been its intention, we believe Congress would have established additional and more robust funding mechanisms to satisfy the possible flood of claims from individuals who provided information to the Commission in the past.

For all of the above reasons, we believe that the whistleblower statutory provisions do not authorize awards for information originally provided prior to Dodd-Frank's enactment. It is, in any event, clear that the statute does not *require* the Commission to pay awards based on pre-enactment submissions of information. Moreover, to the extent there is any ambiguity based on the lack of express direction in the statutory language, we believe, as set forth in Rule 21F-4(b)(iv), and based on our experience and expert judgment, that the better approach here is to allow whistleblower awards only for information provided to the Commission for the first time after July 21, 2010. As we observed, "overly broad definitions and unduly permissive provisions could result in inefficient use of the Investor Protection Fund."[30] Simply put, our interpretation of "original information" ensures that the Fund is used to reward those who provide new, high quality tips, not to pay for information that was already in the Commission's possession on July 21, 2010.

As noted above, Claimant presents a second variation of -- retroactivity argument: -- argues that our rule represents improper retroactive rulemaking because it takes away -- "vested right" to have -- 2011 Submissions considered as "original information." In this version of -- argument, -- seeks to rely on principles of retroactivity law by noting that a rule is retroactive when it "takes away or impairs vested rights acquired under existing law, or creates a new obligation, imposes a new duty, or attaches a new disability in respect to transactions or considerations already past."[31] Claimant asserts, in essence, that Dodd-Frank unambiguously created a vested right to have -- re-submission of previously submitted information treated as "original information," and that Rule 21F-4(b)(1)(iv) upset that vested right. As explained above, however, the statute creates no such right, as it nowhere indicates that the Commission is required to consider re-submissions of pre-enactment information as eligible for awards. Accordingly, this version of Claimant 's retroactivity argument also must fail.[32]

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[30] 76 Fed. Reg. at 34356 (June 13, 2011).

[31] Quoting *Hughes Aircraft Co. v. U.S. ex rel Shumer*, 520 U.S 939, 947 (1997) (internal quotation omitted). For a more recent enunciation of this principle, *see Coalition for Common Sense in Government Procurement v. United States Department of Defense*, 707 F.3d 311, 317 (D.C. Cir. 2013) (citing *National Mining Association v. Department of Labor*, 292 F.3d 849, 859 (D.C. Cir. 2002)). *See also Landgraf v. USI Film Products*, 511 U.S. 244, 280 (1994) (a statute has retroactive effect if it "would impair rights a party possessed when he acted, increase a party's liability for past conduct, or impose new duties with respect to transactions already completed."); *Enterprise Mortg. Acceptance Co., LLC, Securities Litigation v. Enterprise Mortg. Acceptance Co.*, 391 F.3d 401, 406 (2d Cir. 2004) (same).

[32] We note that Section 21F(b) of the Exchange Act expressly provides that whistleblower awards shall be paid "under regulations prescribed by the Commission." Therefore, until the Commission issued its final regulations spelling out the procedures for whistleblower awards and the Commission's interpretations of relevant statutory provisions, Claimant could have not had any "vested right" to a particular interpretation of the statute that would require that -- award application be granted. As noted above, in adopting the definition of original information found in Rule 21F-4(b)(1), we relied on our understanding of Congressional intent, as well as our expertise as to

In sum, we reject Claimant s contention that Rule 21F-4(b)(1)(iv) is impermissibly retroactive.

B. Claimant 's information did not lead to the ATG Action.

Claimant 's response to the Preliminary Determination further contends that the information - provided to the Commission after Dodd-Frank led to the successful enforcement of the ATG Action. Specifically, Claimant claims that, in the second declaration, the Enforcement attorney "wrongfully attempt[ed] to discredit Claimant as the original source of the information contained in Claimant's September 2010 Email." Claimant argues that the second declaration erroneously states that none of the information in the September 2010 Email about Redacted Redacted, was new to the staff. Claimant bases this argument on - belief that, if the Commission had previously known that information, it "would surely have led Enforcement to open the Investigation and commence the Enforcement Action" years before the investigation was actually opened.

We credit the staff's representation that the staff had long been aware of Redacted Redacted from a separate investigation into a Redacted Redacted Redacted In any event, there is no evidence that this information led to the success of the action, either in causing the staff to open a new avenue of its investigation or by significantly contributing to the success of the ATG Action.

Original information "leads to" a successful enforcement action if either: (i) the information caused the staff to open an investigation, commence an examination, or to inquire into different conduct as part of an existing investigation or examination, and we bring a successful action based in whole or in part on conduct that was the subject of the original information; or (ii) the conduct was already under investigation or examination, and the original information significantly contributes to the success of the action.[33] We find no evidence that the

how the whistleblower program could best assist in the Commission's efforts to enforce the securities laws. *Cf. Ohio Head Start Association, Inc. v. HHS*, 873 F. Supp. 2d 335, 348 (D.D.C. 2012), *aff'd*, 510 Fed. App'x 1 (D.C. Cir. 2013 (where Congress directed HHS to develop a system for ensuring that renewals of Head Start grants were only given to high-quality service providers, regulation that required grantees with a single deficiency finding to re-compete for grants did not operate retroactively against grantees who received deficiency findings between date of statutory authorization and date of regulation because regulation merely "codified the authority Congress granted to the Secretary…."); *Coalition for Common Sense in Government Procurement v. United States Department of Defense*, 671 F. Supp. 2d 48, 58 (D.D.C. 2009), *aff'd*, 703 F.3d 311 (D.C. Cir. 2013) (retroactivity not a concern where statute clearly subjected prescriptions to federal price ceilings as of a certain date, and all parties understood that their transactions could be governed by subsequent rule; "…the rule only identifies how that statutory requirement is implemented.").

[33] Rule 21F-4(c)(1)-(2).

September 2010 Email was used in either the ATG Investigation or in the ATG Action. The Enforcement staff states in its sworn declaration that it did not use the information from Claimant 's September 2010 Email in any way and that the information had no impact on the terms of the October 2010 settlement of the ATG Action. The staff further states in its declaration that the September 2010 Email did not cause the staff to correct any of Stelmak's purported false testimony or to ask Stelmak for any clarification of his testimony. Claimant 's contentions to the contrary are based on pure conjecture and we do not find them credible.

Because we have already determined that Claimant 's 2011 Submissions did not constitute "original information," we do not need to consider their impact on the ATG Investigation or the ATG Action. Moreover, the court entered final judgments in the ATG Action on January 12, 2011 – one day after Claimant submitted -- award claim, including - re-submitted information. It is manifest that a submission made a mere one day before an action is concluded cannot have led to the success of the action.

C. Claimant has been given a fair proceeding in accordance with the Commission's rules and due process requirements.

Claimant asserts that the Commission through the OWB committed numerous procedural errors that denied -- a fair proceeding. Specifically, - objects to the denial of - requests to depose the Enforcement attorney who signed the staff declarations and to obtain certain documents that were not relied upon by the CRS.[34] Claimant also contends that - should be permitted discovery "from the Commission (including, without limitation, deposition(s) of any and all individuals who executed declarations) on issues pertaining to [-] claim for award."

Rule 21F-10(e)(1)(i) provides that before deciding whether to contest a Preliminary Determination, a claimant may request "that the Office of the Whistleblower make available for [the claimant's] review the materials from among those set forth in § 240.21F-12(a) of this chapter that formed the basis of the Claims Review Staff's Preliminary Determination." Claimant received all of the materials permitted to - by Rule 21F-12(a). These materials included publicly available materials from the ATG Action, such as the complaint, the October 2010 settlement order and the final judgments, Claimant 's 2011 Submissions, additional correspondence between Claimant 's attorneys and the OWB, and the two sworn declarations provided by Enforcement staff with direct knowledge of the case. While the second of these declarations was received by Claimant approximately three weeks after the rest of the materials, the OWB advised Claimant 's counsel in its accompanying email that they would have the full 60 days authorized under Rule 21F-10(e)(2) from their receipt of the second declaration to submit a written response

[34] Among the denied requests was Claimant 's motion to obtain all documents pertaining to - April 2009 meeting with the staff and to require that the OWB disclose all intra-agency communications regarding the creation and purpose of the two declarations.

contesting the Preliminary Determination. We therefore find that Claimant received all of the materials -- was entitled to receive under our rules and that -- was accorded the complete time period set out in the rules to review these materials before submitting -- written response to the Preliminary Determination.

While a claimant has a right to request and to review these materials before contesting the Preliminary Determination, the rules "do not entitle claimants to obtain from the Commission any materials (including any pre-decisional or internal deliberative process materials that are prepared exclusively to assist the Commission in deciding the claim) other than those listed in [Rule 21F-12(a)]."[35] Claimant nonetheless claims that, notwithstanding that the rules do not authorize additional discovery, the OWB's decision not to grant -- requests denied -- a fair review of -- claim.

Claimant 's argument has no merit. In enacting the whistleblower program, Congress expressly provided in Section 21F(j) that "[t]he Commission shall have the authority to issue such rules and regulations as may be necessary or appropriate to implement the provisions of this section consistent with the purposes of this section."[36] "Absent constitutional constraints or extremely compelling circumstances" an administrative agency "should be free to fashion [its] own rules of procedure and to pursue methods of inquiry capable of permitting [it] to discharge [its] multitudinous duties."[37] Indeed, it is "the very basic tenet of administrative law that agencies should be free to fashion their own rules of procedure."[38]

Here, the Commission Rules 21F-10(e) and 12 give claimants the right to review all the materials that formed the basis of the CRS's Preliminary Determination, other than pre-decisional or internal deliberative process materials. Importantly, the materials made available to claimants include declarations from knowledgeable Commission staff, sworn to under penalty of perjury, "regarding any matters relevant to the award determination."[39] In this case the CRS requested that the record be supplemented with additional information relevant to the ATG Investigation from the staff declarant, and Claimant was given access to this declaration as well as to the rest of the material upon which the CRS relied. To go further and permit claimants free-wheeling discovery on issues such as the staff's internal deliberations in evaluating and utilizing

[35] Rule 21F-12(b).

[36] Similarly, Section 21F(b)(1) states that the Commission shall pay awards "under regulations prescribed by the Commission."

[37] *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council*, 435 U.S. 519, 543 (1978).

[38] *Id.* at 544. *See, e.g., Katzon Bros., Inc. v. E.P.A.*, 839 F.2d 1396, 1399 (10th Cir. 1988).

[39] Rule 21F-12(a)(4).

a whistleblower's information or in considering the merits of a claimant's application, would constitute an unwarranted and a potentially damaging intrusion into our investigative processes, including the frank discussion of legal and policy decisions concerning whether an enforcement action should be brought, the specific causes of action that should be charged, and the parties that should be named as defendants.[40] The disclosure of this sort of information would, as we explained when it adopted the whistleblower rules, "have a chilling effect on our decision- making process."[41]

Finally, even were it appropriate in extraordinary circumstances to permit discovery beyond the information provided for in Rule 21F-12(a), this would surely not be the proper case in which to do so. This is because much, if not all, of the information Claimant seeks has no bearing on -- claim for an award since it concerns how Enforcement handled the information -- provided *before the enactment of Dodd-Frank.*

Claimant asserts that due process requires that we permit -- to take sweeping discovery in order to bolster -- claim for an award, citing *Mathews v. Eldridge*, 424 U.S 319 (1976). We do not decide whether Section 21F created any protected property interest subject to due process requirements[42] because, even assuming that the statute did so, our whistleblower rules provide all

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[40] 76 Fed. Reg. at 34347 and n.360 (citing to *United States v. Farley*, 11 F.3d 1385, 1389 (7th Cir. 1993), which held that "frank discussion of legal and policy matters is essential to the decision-making process of a governmental agency"). In this regard, we note that Rules 21F-10(e)(1) and 21F-12 are consistent with the long-recognized privilege of government agencies to protect against disclosure of information that would tend to reveal law enforcement investigative techniques or sources. *See e.g., Black v. Sheraton Corp. of America*, 564 F.2d 531, 545 (D.C. Cir. 1977). The purpose of this privilege is "to prevent disclosure of law enforcement techniques and procedures, to preserve the confidentiality of sources, to protect witness and law enforcement personnel, [and] to safeguard the privacy of individuals involved in an investigation . . . . ." *In re Department of Investigation of City of New York*, 856 F.2d 481, 484 (2d Cir. 1988). Further, the public interest in nondisclosure does not terminate simply because the subject investigation has concluded. *Black* at 546, quoting *Aspin v. Department of Defense*, 491 F.2d 24, 30 (D.C. Cir. 1973)("[I]f investigatory files were made public subsequent to the termination of enforcement proceedings, the ability of any investigatory body to conduct future investigations would be seriously impaired."); *Frankel v. SEC*, 460 F.2d 813, 817 (2d Cir. 1972) (noting that, if disclosure of an agency's investigative files were required as soon as an investigation concluded, "it would soon become a matter of common knowledge with the result that few individuals, if any, would come forth to embroil themselves in controversy or possible recrimination by notifying the [agency] of something which might justify investigation," quoting *Evans v. Dept. of Transportation*, 446 F.2d 821, 824 (5th Cir. 1971)); *In re City of New York*, 607 F.3d 923, 944 (2d Cir. 2010) (holding that an investigation need not be ongoing for the law enforcement privilege to apply as "the ability of a law enforcement agency to conduct future investigations may be seriously impaired if certain information" is revealed to the public); *Dorsett v. County of Nassau*, 762 F. Supp. 2d 500, 520 (E.D.N.Y. 2011) (same).

[41] 76 Fed. Reg. at 34347 and n.361 (citing to *Dep't of Interior v. Klamath Water Users Protective Ass'n*, 532 U.S. 1, 8–9 (2001) which stated that the "deliberative process privilege rests on the obvious realization that officials will not communicate candidly among themselves if each remark is a potential item of discovery and front page news").

[42] "Whether a given statutory scheme gives rise to a protected interest depends on whether the authority promulgating the statute or regulation has placed *substantive* limits on official discretion." *Tarpeh-Doe v. United*

the discovery and other procedural opportunities that due process could possibly require in a proceeding of this kind.

In *Mathews v. Eldridge*, the Supreme Court held that the Social Security Administration ("SSA") was not required to hold an evidentiary hearing prior to terminating disability benefits and that the administrative procedures for such termination fully comported with due process. In assessing whether an agency has provided sufficient procedural protections, the Court stated that the reviewing court must weigh three distinct factors:

> [F]irst, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and, finally, the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail.[43]

Here, all three factors support our view that Claimant was accorded all the procedural protections required under the Due Process Clause.

First, the private interest that will be affected by our action is the denial of Claimant 's claim for a monetary award. While the receipt of an award would no doubt benefit Claimant , its denial would not rise to the level of economic impact that might result, for example, from the termination of disability or welfare benefits where a recipient's very well-being could be at risk.[44]

Second, the procedures established under our whistleblower rules provide substantial safeguards against erroneous decisions. In *Mathews*, the Supreme Court pointed to SSA's policy of:

States, 904 F.2d 719, 722 (D.C. Cir. 1990), citing *Olim v. Wakinekona*, 461 U.S. 238, 249 (1983) (emphasis in original). Although Section 21F directs the Commission to pay whistleblower awards to individuals who voluntarily provide the Commission with original information that leads to the successful enforcement of covered judicial or administrative actions, Congress left it entirely to our discretion to determine, by rule, when we consider a claimant's information to have "led to" a successful enforcement action. *See Ohio Head Start Association, Inc. v. Department of Health and Human Services*, 873 F. Supp. 2d 335, 349-50 (D.D.C. 2012), *aff'd*, 2013 U.S. App. LEXIS 11540 (D.C. Cir. 2013) (no protected property interest in renewal of Head Start grants where statute directed agency to award grants to providers of "high-quality and comprehensive" services but left agency discretion to decide which providers met that standard).

[43] 424 U.S. at 335.

[44] *See id.* at 342 (finding that "significant" hardship imposed upon erroneously terminated disability recipient not sufficient to require an evidentiary hearing).

> allowing the disability recipient's representative full access to all information relied upon by the state agency. In addition, prior to the cutoff of benefits the agency informs the recipient of its tentative assessment, the reasons therefor, and provides a summary of the evidence that it considers most relevant. Opportunity is then afforded the recipient to submit additional evidence or arguments, enabling him to challenge directly the accuracy of information in his file as well as the correctness of the agency's tentative conclusions. These procedures . . . enable the recipient to "mold" his argument to respond to the precise issues which the decisionmaker regards as crucial.[45]

Our whistleblower award procedures are directly analogous. Specifically, our rules allowed Claimant and -- counsel access to all information relied upon by the CRS other than deliberative process materials. In addition, the Preliminary Determination informed Claimant of the bases upon which the CRS determined to deny -- claim. OWB staff then granted the request of Claimant 's counsel for a meeting at which Claimant was able to present any additional information concerning the merits of -- claim. Claimant has also been afforded the opportunity to submit additional evidence and arguments in writing, enabling -- to challenge directly the information in the record, and the Preliminary Determination of the CRS. Finally, under our rules, once Claimant challenged the Preliminary Determination, -- award claim was elevated from the CRS directly to the Commission. As in *Mathews v. Eldridge*, these procedures were fully in accordance with the strictures of due process, enabling Claimant to "mold" -- argument to respond to the precise issues which the CRS regarded as crucial in its Preliminary Determination.

Finally, in weighing the Government's interest, we note that "the Commission's primary goal, consistent with the congressional intent behind Section 21F, is to encourage the submission of high-quality information to facilitate the effectiveness and efficiency of the Commission's enforcement program."[46] If claimants were granted the extensive discovery rights that Claimant seeks, this would not only cause the "chilling effect on our decision-making process," as discussed above,[47] it would also inevitably lengthen the claims resolution process, delay the Commission's ability to pay awards to eligible whistleblowers, and, thereby, potentially discourage prospective whistleblowers from submitting information to the Commission.[48]

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[45] *Mathews v. Eldridge,* 424 U.S. at 345-6.

[46] 76 Fed. Reg. at 34323.

[47] *See supra* n.41 and text therein.

[48] *See* 424 U.S. at 347 (1976) (in determining the appropriate process an agency owes to a claimant, a court must weigh in assessing the appropriate due process balance "the administrative burden and other societal costs that would be associated with requiring, as a matter of constitutional right, an evidentiary hearing upon demand in all cases . . . .").

Accordingly, we find that Claimant received all of the discovery and other process that the rules provide and due process requires.

* * *

Finally, we take this opportunity to remind counsel that the Commission has a substantial interest in granting awards to whistleblower applicants who satisfy the statutory and regulatory criteria for an award. In furtherance of that interest, our goal is to work with whistleblowers and their counsel in a collaborative, non-adversarial manner to determine whether the whistleblowers satisfy the award criteria. We firmly believe that this approach best serves the interests of whistleblowers and the Commission, and thus should help maximize the award program's overall effectiveness in the enforcement of the federal securities laws and the protection of investors.

V. Conclusion

It is ORDERED that Claimant 's whistleblower award claim be, and hereby is, denied.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

October 30, 2013

In The Matter Of	:	
	:	
Press Ventures, Inc.	:	**ORDER OF SUSPENSION OF TRADING**
	:	
File No. 500-1	:	

It appears to the Securities and Exchange Commission that the public interest and the protection of investors require a suspension of trading in the securities of Press Ventures, Inc. ("PVEN") because of concerns regarding potentially manipulative transactions in PVEN's common stock. PVEN is a Nevada corporation based in Warsaw, Poland. It is quoted on OTCBB and OTC Link under the symbol PVEN.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed company.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed company is suspended for the period from 9:30 a.m. EDT on October 30, 2013 through 11:59 p.m. EST on November 12, 2013.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70777 / October 30, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3708 / October 30, 2013

INVESTMENT COMPANY ACT OF 1940
Release No. 30772 / October 30, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15235

In the Matter of

FRY HENSLEY AND COMPANY, AND NICHOLAS L. FRY, II

Respondents.

ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940

I.

On March 8, 2013, the Securities and Exchange Commission ("Commission") instituted proceedings against Fry Hensley and Company ("FHC") and Nicholas L. Fry, II ("Fry") (collectively "Respondents") pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act) and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act").

II.

Respondents have submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, Sections 203(e), 203(f) and

203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940 ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds[1] that:

Summary

1. This matter concerns an investment adviser's failure to disclose to its clients significant conflicts of interest from which it profited at its clients' expense. From at least January 1, 2007 to October 2011, registered investment adviser FHC and its president Fry obtained undisclosed compensation in the form of payments from inflated commissions, markups and markdowns ("transaction charges") charged to their clients by the broker-dealer that FHC and Fry recommend that their clients use. FHC's agreement with clients provided that they gave Fry discretionary authority to trade in their accounts at their broker-dealer. During the relevant period, Fry typically conducted his equity trading for clients through one of the broker-dealer's principal trading accounts, first instructing the broker-dealer to buy or sell securities with the market and then instructing it how to allocate the trades to his clients. For equity securities, Fry set the amount of the transaction charges clients paid for these trades, and he typically set them much higher than he could have. Fry's wife, who was a registered representative at the broker-dealer, received credit for 50% of the transaction charges paid by FHC's advisory clients, and between January 1, 2007 and October 2011, the broker-dealer credited Fry's wife with more than $775,669.09 from inflated transaction charges. During this time, FHC was otherwise insolvent, and Fry used hundreds of thousands of dollars from the above inflated transaction charges to support FHC, which would have otherwise gone out of business. In addition, FHC received undisclosed services from the broker-dealer partly in exchange for the inflated transaction charges. Also during this time, FHC and Fry failed to tell their clients the essential facts about the arrangement described above, and made false and misleading disclosures to them in documents given to clients and filed with the Commission.

2. Specifically, FHC and its clients signed written Portfolio Management Agreements ("PMAs") that specified the compensation the client would pay for FHC's advisory services. However, neither FHC nor Fry informed the clients that Fry also directed their broker-dealer to charge them additional, disguised compensation in the form of inflated transaction charges. In addition, FHC's Forms ADV and firm brochures (Forms ADV Part II) made false and misleading statements to clients about these issues and omitted certain facts that were required to be disclosed. While FHC's disclosure evolved over time, for most of the relevant period, FHC told clients that it and Fry did not have the authority to set client commission rates, while Fry exercised this authority. And FHC misrepresented to clients that it would comply with its duty to seek to obtain best execution for them, when in fact, Fry was not seeking best execution at their broker-dealer because he directed it to charge his clients much higher transaction charges than he could. Throughout, FHC and Fry failed to tell clients that FHC was insolvent, that Fry was benefiting himself, his wife and FHC at the expense of his clients and that Fry was setting their

[1] The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

transaction charges much higher than he could in an attempt to prop up his failing advisory business.

Respondents

3. FHC is an Ohio corporation with its principal place of business in Cincinnati, Ohio. FHC is an investment advisory firm that was registered with the Commission as an investment adviser from 1994 until August 2012. In August 2012, FHC withdrew its registration with the Commission. FHC is now registered as an investment adviser with the State of Ohio. According to FHC's August 2012 Form ADV filed with the Commission, FHC had $32,942,809 in assets under management for 52 client accounts.

4. Fry, age 73, is a resident of Covington, Kentucky. From at least 2004 to the present, Fry has been FHC's sole owner, president and chief compliance officer. From 1993 through June 2008, Fry was associated with Ross, Sinclaire and Associates, LLC ("the Broker-Dealer"), as an investment company and variable contracts products representative with a Series 6 securities license only.

Other Relevant Entity and Person

5. The Broker-Dealer is an Ohio limited liability company with its principal place of business in Cincinnati, Ohio. From 2005 through the present, the Broker-Dealer has been registered with the Commission as a broker-dealer.

6. Jane Fry was Fry's wife. Jane Fry was associated with the Broker-Dealer as a registered representative from about 1990 until her death in October 2011.

Facts

Background

7. From January 1, 2007 to October 2011 ("relevant period"), FHC was an investment advisory firm that Fry operated with just one or two employees. FHC had written contracts with its clients, called PMAs, which specified the advisory fee that the client would pay for FHC's discretionary advisory services. Fry was responsible for these advisory services, which included that Fry would trade securities in the clients' accounts at their broker-dealer.

8. FHC and the Broker-Dealer had a close relationship for many years. Fry and the Broker-Dealer's president were old friends. From approximately 1994 to October 2010, FHC maintained its office within the Broker-Dealer's Cincinnati office. Also, FHC and Fry recommended that their advisory clients maintain their brokerage accounts at the Broker-Dealer, and the vast majority of FHC's clients did so.

9. Fry's wife, Jane Fry, was listed as the Broker-Dealer registered representative assigned to the accounts of FHC's clients. However, Jane Fry was only nominally the representative for FHC's clients and she did not work on their accounts. In fact, a number of

FHC's clients were unaware that Jane Fry had any association with the Broker-Dealer or their brokerage accounts. The Broker-Dealer credited Jane Fry with 50% of the transaction charges that it charged to FHC's clients for their equity trades. The Broker-Dealer kept the other 50% of such charges.

10. By no later than 2004, FHC was not collecting sufficient advisory fees to cover its expenses.

11. In early 2004, FHC and Fry changed the way they conducted securities trading on behalf of their clients. Prior to March 2004, FHC and Fry conducted equity trading for clients on an agency basis. In this arrangement, when Fry purchased or sold a particular security for a number of clients, he sent an order to the Broker-Dealer for each client.

12. In March 2004, FHC and Fry switched to trading securities in bulk through at least one principal trading account at the Broker-Dealer. In this arrangement, Fry first sent one order to the Broker-Dealer to purchase or sell the total amount of securities with the market in a Broker-Dealer principal trading account. After that trade was completed, and the price that the Broker-Dealer had paid or received for the securities was known, Fry gave the Broker-Dealer the information needed to allocate the securities purchased or sold to FHC's client accounts, specifying which clients would participate and the number of securities each client would purchase or sell. In addition, on equity trades, Fry set the price his clients paid or received, which was different than the price the Broker-Dealer obtained from the market (i.e., Fry set the amount of the markup or markdown).

13. In early 2005, FHC and the Broker-Dealer entered into a contract that provided that the Broker-Dealer would provide office space and certain office services to FHC. In exchange, FHC paid the Broker-Dealer 50% of the advisory fees it collected from its clients. In addition, the Broker-Dealer took FHC's two employees onto its books as employees. However, Fry set their salaries, and the employees continued to work at Fry's direction on FHC's work. FHC and the Broker-Dealer agreed that the Broker-Dealer would deduct from Jane Fry's share of client transaction charges the salary costs that the Broker-Dealer incurred from the employment of FHC's two employees and for FHC's use of the Broker-Dealer's computer trading system. This agreement was amended in 2009 so that FHC was to pay the Broker-Dealer a fixed fee of $70,000 per year for office space and services, and FHC continued to pay for its former employees' salaries though an offset against the transaction charges credited to Jane Fry. However, over time, FHC's financial condition grew worse, and it could not pay the full amounts it owed to the Broker-Dealer under the contract and began to accrue a growing debt to the Broker-Dealer.

FHC and Fry Obtained Undisclosed Compensation and Failed to Seek Best Execution

14. From at least January 1, 2007 to October 2011, Fry submitted equity security orders directly to the Broker-Dealer. For these trades, Fry set the amount of the transaction charges paid by clients to the Broker-Dealer. During this time, the Broker-Dealer had a $50 minimum commission which Fry could have and sometimes did instruct the Broker-Dealer to charge his clients. However, Fry typically set his clients' transaction charges at much higher

rates. By failing to seek to obtain the best price or the lowest commission reasonably available for their clients, FHC and Fry breached their obligation to seek best execution for their clients.

15. Between January 1, 2007 and October 2011, Fry caused FHC's advisory clients to pay inflated transaction charges (i.e., more than the minimum) to the Broker-Dealer on more than 10,800 occasions (or on approximately 72% of the total equity trade allocations to clients for which Fry set the amount of the transaction charge) without making adequate disclosure to clients that he was doing so. In these instances, FHC's clients paid an average transaction charge of approximately $195.40 per trade to the Broker-Dealer.

16. During this time, FHC and Fry caused FHC's clients to pay more than $1.58 million in inflated transaction charges to the Broker-Dealer, and they secured for themselves and for Jane Fry $775,669.09 from the undisclosed inflated transaction charges.

17. Each month, the Broker-Dealer credited Jane Fry with 50% of the transaction charges it received from Fry's equity trading for clients. Against these amounts, the Broker-Dealer offset certain amounts owed by FHC to the Broker-Dealer, including the salaries of the two former FHC employees who were then on the Broker-Dealer's books. The Broker-Dealer also offset a monthly salary advance that it paid to Jane Fry in the amount of $12,500. In addition, the Broker-Dealer paid to Jane Fry any amount of her 50% share of the transaction charges that exceeded the above offsets. These payments were deposited into a joint bank account that Jane Fry shared with Fry.

18. In total, from January 1, 2007 to October 2011, the Broker-Dealer credited Jane Fry with $775,669.09 in inflated equity transaction charges (i.e., Jane Fry's share of the amount of each client's transaction charges exceeding $50). During this time, FHC paid the Broker-Dealer for its employees' salaries out of client transaction charges, Fry personally benefited from the deposits into the bank account he shared jointly with Jane Fry, and Fry transferred hundreds of thousands of dollars from that bank account to FHC to pay its other expenses, thus enabling it to stay in business.

False and Misleading Disclosures to Clients in Forms ADV Filed with the Commission

19. During the relevant period, FHC filed a number of Forms ADV with the Commission, and FHC's disclosure about the issues discussed above evolved over time. Fry was the person with ultimate authority over FHC's Form ADV, and he signed each of them as FHC's president, certifying that the statements and information in them were true and correct.

20. From at least 2007 through April 2010, FHC and Fry answered "no" in response to a question on Part 1 of Form ADV, under the heading "Item 8, Investment or Brokerage Discretion," which asked:

"C. Do you or any *related person* have *discretionary authority* to determine the:

* * *

(4) commission rates to be paid to a broker or dealer for a *client's* transactions?"

Fry electronically signed these Forms ADV. During this time, for equity security transactions, Fry set the amount of the transaction charges paid by clients to the Broker-Dealer.

False and Misleading Disclosures in Forms ADV Part II (Firm Brochure)

21. FHC and Fry made similar false and misleading disclosures in its Forms ADV Part II (i.e. its firm brochure) and their disclosure evolved over time. Fry was the person with ultimate authority over FHC's ADV Part II firm brochures. As its disclosure changed, FHC did not provide each new version of their firm brochures to clients, but instead, only advised clients by letter that it was available on request. As a result, a number of clients did not get each new firm brochure.

22. From at least 2007 to May 21, 2010, under the heading "12. Investment or Brokerage Discretion," FHC and Fry checked "no" in response to question 12.A:

"A. Does applicant or any related person have authority to determine, without obtaining specific client consent, the:

* * *

(4) commission rates paid? . . . . ."

During this time, for equity security transactions, Fry set the amount of transaction charges paid by clients to the Broker-Dealer.

23. In its Form ADV Part II in effect from September 15, 2007 to May 20, 2010, also under heading 12, FHC and Fry checked "yes" in response to question 12B:

"B. Does applicant or a related person suggest brokers to clients?"

Because FHC and Fry checked "yes," the instructions required them to "describe on Schedule F the factors considered in selecting brokers and determining the reasonableness of their commissions." FHC and Fry made no disclosure of the factors they considered, and omitted to disclose their financial incentive to direct brokerage to the Broker-Dealer, including that the Broker-Dealer was carrying two of FHC's employees on its books, that the Broker-Dealer was providing FHC with use of its computerized trading system, and that these benefits were being paid for by inflated transaction charges.

24. In addition, from at least 2007 to May 21, 2010, FHC's firm brochure stated that Fry was a registered representative at the Broker-Dealer, and that he would earn "normal

commissions" on client trades made through it. However, the disclosure that Fry would earn "normal" commissions is misleading, because, FHC and Fry failed to state that Fry was setting the clients' transaction charges, and at much higher rates than he could have set. And FHC and Fry still did not disclose to clients that Jane Fry, FHC and Fry were benefiting from 50% of the inflated charges.

25. FHC and Fry prepared a new Form ADV Part II that was in effect from May 21, 2010 to March 30, 2011. In this Brochure, FHC and Fry changed their answer to Question 12A, "Investment or Brokerage Discretion," now answering "yes," indicating that that they now had authority to determine the commission rates paid by its clients, disclosing for the first time that they were determining the client transaction charges. But they still did not disclose to clients Fry set client transaction charges much higher than he could have.

26. Also in this version of FHC's brochure, FHC and Fry stated: "Although the commission and/or transaction fees paid by Registrant's clients shall comply with the Registrant's duty to obtain best execution, a client may pay a commission that is higher than another qualified broker-dealer might charge to effect the same transaction where the Registrant determines, in good faith, that the commission/transaction fee is reasonable in relation to the value of the brokerage and research services received." This statement was also false and misleading, as FHC and Fry were not seeking to obtain best execution at the Broker-Dealer, but instead, were setting client transaction charges at much higher rates than they could have.

27. In this version, FHC and Fry also answered "yes" to Item 12B: "Does applicant or a related person suggest brokers to clients?" Because FHC and Fry checked "yes," the instructions required them to "describe on Schedule F the factors considered in selecting brokers and determining the reasonableness of their commissions." In explaining, FHC and Fry for the first time included a discussion of the conflict of interest that arose from Jane Fry's position with the Broker-Dealer and that the Broker-Dealer provided FHC with services that were paid for "through commission sharing . . . ." In addition, in a different part of Schedule F, FHC and Fry stated that "the brokerage commissions or transaction fees charged by the designed broker-dealer/custodian are exclusive of, and in addition to, Registrants investment management fee." However, FHC and Fry still did not disclose that Fry was setting client transaction charges at much higher rates than he could have.

28. FHC prepared a new Form ADV Part 2 dated March 31, 2011. The instructions for Item 12, as now amended, required FHC and Fry to disclose the factors they considered in selecting or recommending brokers and in determining the reasonableness of the broker's compensation, and required them to disclose, among other things, the research, products or services they received from the Broker-Dealer. Under "Item 12 – Brokerage Practices," FHC and Fry now stated that "we do not solicit or accept soft dollar benefits from any brokerage firm, including [the Broker-Dealer]." In another part of this brochure, under the heading "Additional Fee and Expenses," FHC and Fry stated that "we recommend [the Broker-Dealer] based on the full range and quality of its services, including the value of the research provided, execution capability, financial responsibility, and responsiveness to our clients, and not merely comparative trading costs." FHC and Fry also stated that they were authorized to determine the commission rates paid by their clients at the Broker-Dealer, and that Fry's wife would earn commissions on securities

trades. However, FHC and Fry failed to disclose that they were directing the Broker-Dealer to charge their clients more than necessary in order to benefit Fry, his wife, and to compensate the Broker-Dealer for providing certain services to FHC.

False and Misleading Disclosures to Clients in FHC's Portfolio Management Agreements

29. FHC and its clients signed PMAs that spelled out the agreement between FHC and the clients. During the relevant period, the PMAs stated that "this management agreement represents our entire understanding with regard to the matters specified here and any changes must be in writing." The PMA specified the advisory services that FHC would provide and the compensation the clients would pay (typically as a percentage of assets in their account). The PMA also noted, in a section titled "Other Fees," that: "Our management fee is payment for management of your account by Fry Hensley & Company. Any transfer fees, transaction fees, redemption fees, sales loads, wiring fees, etc. charged against your account by any third parties are separate from our management fee and will be deducted from the account by the Custodian." But while stating that their Broker-Dealer would charge transaction fees to their accounts, FHC failed to tell clients that Fry (and not the Broker-Dealer) was setting the amount of these charges, and at much higher rates than he could.

Failure to Disclose FHC's Financial Condition

30. Throughout the relevant period, FHC failed to disclose to its clients that its financial condition was so seriously impaired that it was reasonably likely to impair its ability to provide services to its clients. FHC also did not disclose that it stayed in business only because Fry received additional compensation in the form of payments from inflated transaction charges, and because Fry transferred hundreds of thousands of dollars of those client funds to FHC. Without this infusion of client funds, FHC would not have been able to stay in business.

Violations

31. As a result of the conduct described above, FHC willfully violated Sections 206(1), 206(2), 206(4), Rule 206(4)-4 thereunder, and Section 207 of the Advisers Act.

32. As a result of the conduct described above, Fry willfully violated Sections 206(1), 206(2), and Section 207 of the Advisers Act. In addition, as a result of the conduct described above, Fry willfully aided and abetted and caused FHC's violations of Sections 206(1), 206(2), 206(4), Rule 206(4)-4 thereunder, and Section 207 of the Advisers Act.

Disgorgement and Civil Penalties

33. Respondent FHC has submitted a sworn Statement of Financial Information dated April 26, 2013 and other evidence, and has asserted its inability to pay disgorgement plus prejudgment interest and a civil penalty.

34. Respondent Fry has submitted a sworn Statement of Financial Condition dated April 29, 2013 and other evidence, and has asserted his inability to pay disgorgement plus prejudgment interest and a civil penalty.

IV.

In view of the foregoing, the Commission deems it appropriate in the public interest to impose the sanctions agreed to in Respondents' Offer.

Accordingly, pursuant to Section 15(b)(6) of the Exchange Act, Sections 203(e), 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent FHC shall cease and desist from committing or causing any violations and any future violations of Sections 206(1), 206(2) and Section 207 of the Advisers Act;

B. Respondent Fry shall cease and desist from committing or causing any violations and any future violations of Sections 206(1), 206(2) and Section 207 of the Advisers Act;

C. Respondent Fry be, and hereby is:

1. barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, provided however, that for a period of up to 30 days from the entry of this Order, Fry may, solely for the purpose of winding down FHC's investment advisory business, continue to be associated with FHC while FHC acts as an investment advisor; and

2. prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

D. Respondent FHC is censured.

E. Any reapplication for association by Respondent Fry will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

F. Respondents FHC and Fry shall pay, on a joint and several basis, disgorgement of $775,669.09 and prejudgment interest of $118,988.33, but that payment of such amount is waived based upon Respondent FHC's sworn representations in its Statement of Financial Information dated April 26, 2013, Respondent Fry's sworn representations in his Statement of Financial Condition dated April 29, 2013 and other evidence submitted to the Commission.

G. Based upon Respondent FHC's sworn representations in its Statement of Financial Information dated April 26, 2013, Respondent Fry's sworn representations in his Statement of Financial Condition dated April 29, 2013 and other evidence submitted to the Commission, the Commission is not imposing a penalty against Respondents.

H. The Division of Enforcement may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondents provided accurate and complete financial information at the time such representations were made; and (2) seek an order directing payment of disgorgement, pre-judgment interest and the maximum civil penalty allowable under the law. No other issue shall be considered in connection with this petition other than whether the financial information provided by Respondents was fraudulent, misleading, inaccurate, or incomplete in any material respect. Respondents may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of disgorgement, interest and a penalty should not be ordered; (3) contest the amount of disgorgement and interest to be ordered, or the imposition of the maximum penalty allowable under the law; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70778 / October 30, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15594

In the Matter of **WAYNE REED OGDEN,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Wayne Reed Ogden ("Ogden" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Ogden, age 49, is a Utah resident. Ogden is not registered as or associated with a broker or dealer registered with the Commission. However, Ogden acted as an unregistered broker or dealer by selling Paradigm Acceptance, LLC securities to investors for which he received transaction-based compensation.

2. On April 12, 2013, Ogden pled guilty to one count of wire fraud and one count of securities fraud in the United States District Court for the District of Utah for his role in Paradigm. In his statement to the Court in advance of his guilty plea, he admitted that he "devised and executed a plan to defraud and to obtain money from investors by means of pretenses, representations, and omissions which I knew were false and misleading." He also admitted that "rather than using investor funds as intended and promised . . . [he] diverted and used those funds to pay prior investors," to himself a salary, and to make other improper payments.

3. On August 15, 2013, Ogden was convicted of one count of securities fraud in violation of 15 USC §78(j)(b) and one count of wire fraud in violation of 18 USC § 1843 before the United States District Court for the District of Utah in U.S. v. Wayne Reed Ogden, 2:11-cr-00543-001-TS. He was sentenced to a prison term of 120 months followed by 36 months of supervised release and ordered to pay restitution in the amount of $5,454,323.04.

4. The counts of the indictment to which Ogden pled guilty alleged, inter alia, that Ogden, in connection with the offer or sale of securities to investors, directly or indirectly, made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or engaged in acts, practices, or course of business which operated or would operate as a fraud or deceit.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Ogden's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, PL-111-203, July 21, 2010, 124 Stat. 1376, that Respondent Ogden be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70779 / October 30, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15595

In the Matter of

TERRY PAUL OGDEN,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Terry Paul Ogden ("Ogden" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Ogden, age 46, is a Nevada resident. Ogden is not registered as or associated with a broker or dealer registered with the Commission. However, Ogden acted as an unregistered broker or dealer by holding himself out as a broker of Paradigm Acceptance, LLC ("Paradigm") promissory notes, actively soliciting investors to purchase the notes, handling investor funds, and accepting investor orders. He also paid himself from funds that were obtained through the sale of the Paradigm promissory notes and paid for personal expenses.

2. On May 17, 2013, Ogden pled guilty to misprision of a felony in the United States District Court for the District of Utah for his role in Paradigm. In his statement to the Court in advance of his guilty plea, Ogden admitted to concealing the fraudulent conduct of Wayne Ogden, his brother, in connection with the sale of Paradigm securities. Ogden admitted that, "[a]lthough I knew about Wayne's parole restrictions, I agreed to form Paradigm and act as a nominee under Wayne's control and direction." Ogden's conviction for misprision of a felony involves the sale of securities. He admitted to the Court that he "knew that Paradigm had run out of cash and was staying afloat by raising new investor funds to pay prior investors." He further admitted that instead of reporting his brother's fraudulent activities, he "took steps to conceal the crime by lulling investors into a false sense of security and by permitting Paradigm to accept Ponzi payments to pay prior investors to keep them from going to the authorities."

3. The counts of the indictment to which Ogden pled guilty alleged, inter alia, that Ogden concealed, "through misrepresentations to investors," a scheme by Wayne Reed Ogden "to defraud investors and to obtain money from investors under false and fraudulent pretenses for use in a sham mortgage rescue program, for which wire transmissions and securities were used." On September 16, 2013, Ogden's guilty plea was entered by the United States District Court for the District of Utah in U.S. v. Terry Paul Ogden, 2:11-cr-00543-002-TS and he was sentenced to a prison term of one year and one day followed by twelve months of supervised release and ordered to pay restitution in the amount of $1,345,745.59.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Ogden's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, PL-111-203, July 21, 2010, 124 Stat. 1376, that Respondent Ogden be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

October 31, 2013

In the Matter of **Acies Corporation,** **Immtech Pharmaceuticals, Inc.,** **MRU Holdings, Inc.,** **MSTI Holdings, Inc.,** **Nestor, Inc.,** **New Generation Holdings, Inc., and** **Nuevo Financial Center, Inc.,** **File No. 500-1**	**ORDER OF SUSPENSION OF TRADING**

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Acies Corporation because it has not filed any periodic reports since the period ended June 30, 2010.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Immtech Pharmaceuticals, Inc. because it has not filed any periodic reports since the period ended March 31, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of MRU Holdings, Inc. because it has not filed any periodic reports since the period ended September 30, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of MSTI Holdings, Inc. because it has not filed any periodic reports since the period ended September 30, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Nestor, Inc. because it has not filed any periodic reports since the period ended September 30, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of New Generation Holdings, Inc. because it has not filed any periodic reports since the period ended June 30, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Nuevo Financial Center, Inc. because it has not filed any periodic reports since the period ended September 30, 2007.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on October 31, 2013, through 11:59 p.m. EST on November 13, 2013.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70785 / October 31, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15597

In the Matter of Acies Corporation, Immtech Pharmaceuticals, Inc., MRU Holdings, Inc., MSTI Holdings, Inc., Nestor, Inc., New Generation Holdings, Inc., and Nuevo Financial Center, Inc. Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against the Respondents named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Acies Corporation ("ACIE")[1] (CIK No. 1138462) is a defaulted Nevada corporation located in North Miami Beach, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ACIE is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2010. As of October 28, 2013, the common stock of ACIE was quoted on OTC Link (formerly "Pink Sheets") operated by OTC Markets Group Inc. ("OTC Link"), had six

[1]The short form of each issuer's name is also its stock symbol.

market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Immtech Pharmaceuticals, Inc. ("IMMP") (CIK No. 882509) is a delinquent Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IMMP is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended March 31, 2009, which reported a net loss of $6,501,903 for the prior year. As of October 28, 2013, the common stock of IMMP was quoted on OTC Link, had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. MRU Holdings, Inc. ("UNCLQ") (CIK No. 1145202) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). UNCLQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2008, which reported a net loss of $18,570,000 for the prior three months. On February 6, 2009, UNCLQ filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Southern District of New York, which was still pending as of October 28, 2013. As of October 28, 2013, the common stock of UNCLQ was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. MSTI Holdings, Inc. ("MSHI") (CIK No. 1372305) is a void Delaware corporation located in Hawthorne, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MSHI is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2008, which reported a net loss of $5,416,914 for the prior nine months. As of October 28, 2013, the common stock of MSHI was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Nestor, Inc. ("NEST") (CIK No. 720851) is a void Delaware corporation located in Providence, Rhode Island with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). NEST is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2008, which reported a net loss of $7,252,000 for the prior nine months. As of October 28, 2013, the common stock of NEST was quoted on OTC Link, had thirteen market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. New Generation Holdings, Inc. ("NGHO") (CIK No. 1024605) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). NGHO is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2009, which reported a net loss of $30,978 for the prior six months. As of October 28, 2013, the common stock of NGHO was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. Nuevo Financial Center, Inc. ("NVFN") (CIK No. 1119689) is a void Delaware corporation located in Union City, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). NVFN is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2007, which reported a net loss of $898,957 for the prior nine months. On January 28, 2008, NVFN filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Southern District of New York, which was closed on October 29, 2008. As of October 28, 2013, the common stock of NVFN was quoted on OTC Link, had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

8. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

9. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires issuers to file quarterly reports.

10. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70786 / October 31, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15598

In the Matter of JEREMY S. FISHER, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Jeremy S. Fisher ("Fisher" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Jeremy Fisher, age 43, is currently a resident of La Crescent, Minnesota. At the time of the misconduct, he resided in LaCrosse, Wisconsin. He is the sole owner and president of The Good Life Financial Group, Inc. and The Good Life Global Enterprise, LLC. From August 2009 through December 2012, Fisher solicited investors to purchase securities offered by his two companies which would use the funds to invest in purported trading platforms. At the time of these securities sales, Fisher was not registered as a broker or dealer with the Commission and was not associated with a registered broker or dealer.

2. On October 16, 2013, a final judgment was entered by consent against Fisher, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act") and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Jeremy S. Fisher, et al., Civil Action Number 3:13-cv-00683, in the United States District Court for the Western District of Wisconsin.

3. The Commission's complaint alleged that, from August 2009 through December 2012, Fisher and his companies raised approximately $1.04 million from approximately 18 investors who invested in unregistered securities offerings conducted by Fisher through his companies. Fisher offered investors the opportunity to invest their money on a "special trading platform" that supposedly generated significant returns. He told investors that their money would be pooled with other investors' money and deposited in an overseas bank account where the funds would remain. The overseas bank would then use the monies in the account as collateral to trade in certain securities. Fisher also told investors that they would receive a guaranteed return of 1% of the amount invested per month or 50% of the trading profits, whichever was greater. Fisher, however, never invested the funds from investors as promised and spent most of the money on himself and his family. Fisher also sent out false account statements indicating that investor funds were fully invested and earning returns. The complaint also alleged that Fisher acted as an unregistered broker.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Fisher's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Fisher be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

October 31, 2013

In the Matter of Heritage Worldwide, Inc., Impala Mineral Exploration Corp., Klondike Star Mineral Corporation, MIV Therapeutics Inc., Most Home Corp., Moventis Capital, Inc., and OrganiTECH USA, Inc., File No. 500-1

ORDER OF SUSPENSION OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Heritage Worldwide, Inc. because it has not filed any periodic reports since the period ended December 31, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Impala Mineral Exploration Corp. because it has not filed any periodic reports since the period ended March 31, 2009.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Klondike Star Mineral Corporation because it has not filed any periodic reports since the period ended May 31, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of MIV Therapeutics Inc. because it has not filed any periodic reports since the period ended November 30, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Most Home Corp. because it has not filed any periodic reports since the period ended April 30, 2008.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Moventis Capital, Inc. because it has not filed any periodic reports since the period ended March 31, 2007.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of OrganiTECH USA, Inc. because it has not filed any periodic reports since the period ended September 30, 2008.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on October 31, 2013, through 11:59 p.m. EST on November 13, 2013.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70783 / October 31, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15596

In the Matter of **Heritage Worldwide, Inc.,** **Impala Mineral Exploration Corp.,** **Klondike Star Mineral Corporation,** **MIV Therapeutics Inc.,** **Most Home Corp.,** **Moventis Capital, Inc.,** and **OrganiTECH USA, Inc.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against the Respondents named in the caption.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Heritage Worldwide, Inc. ("HWWI") [1] (CIK No. 1034682) is a forfeited Delaware corporation located in La Seyne-Sur-Mer, France with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). HWWI is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2008, which reported a net loss of $1,247,167 for the prior six months. As of October 28, 2013, the common stock of HWWI was quoted on OTC Link

[1] The short form of each issuer's name is also its stock symbol.

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(formerly "Pink Sheets") operated by OTC Markets Group Inc. ("OTC Link"), had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Impala Mineral Exploration Corp. ("IMXC") (CIK No. 1413599) is a revoked Nevada corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IMXC is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2009, which reported a net loss of $20,322 for the prior three months. As of October 28, 2013, the common stock of IMXC was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Klondike Star Mineral Corporation ("KDSM") (CIK No. 1083321) is a void Delaware corporation located in Whitehorse, Yukon Territory, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). KDSM is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended May 31, 2008, which reported a net loss of $962,733 for the prior three months. As of October 28, 2013, the common stock of KDSM was quoted on OTC Link, had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. MIV Therapeutics Inc. ("MIVI") (CIK No. 1083011) is a Nevada corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MIVI is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended November 30, 2008, which reported a net loss of $7,182,496 for the prior six months. As of October 28, 2013, the common stock of MIVI was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. Most Home Corp. ("MHME") (CIK No. 1047965) is a defaulted Nevada corporation located in Maple Ridge, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MHME is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended April 30, 2008, which reported a net loss of $2,152,493 for the prior nine months. As of October 28, 2013, the common stock of MHME was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Moventis Capital, Inc. ("MVTS") (CIK No. 1104734) is a forfeited Delaware corporation located in White Rock, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MVTS is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2007, which reported a net loss of $1,630,961 for the prior nine months. As of October 28, 2013, the common stock of MVTS was quoted on OTC Link, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. OrganiTECH USA, Inc. ("ORGT") (CIK No. 832810) is a forfeited Delaware corporation located in Yoqneam, Israel with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ORGT is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2008, which reported a net loss of $996,202 for the prior nine months. As of October 28, 2013, the common stock of ORGT was quoted on OTC Link, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

8. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

9. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires issuers to file quarterly reports.

10. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for **October 2013**, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

MARY JO WHITE, CHAIR

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

(3 Documents)

Commissioner Gallagher not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70680 / October 11, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15568

In the Matter of THOMAS S. MULHOLLAND, Respondent.	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act) against Thomas S. Mulholland ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Respondent is 54 years old and resides in Saginaw, Michigan. In 2010, the State of Michigan Office of Financial and Insurance Regulation revoked Respondent's insurance license for offering and selling securities to his insurance clients.

2. On October 4, 2013, a final judgment was entered by consent against Respondent, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15(a)(1) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Thomas S. Mulholland, et al., Civil Action Number 1:12-cv-14663, in the United States District Court for the Eastern District of Michigan.

3. The Commission's complaint alleged that since the 1990's, Respondent and his twin brother, James C. Mulholland, Jr., (collectively, "the Mulhollands") operated a real estate business which involved buying, maintaining, and renting residential real estate in Michigan. To finance the real estate business, the Mulhollands raised money from individual investors through the offer and sale of securities in the form of demand notes ("Mulholland Notes"). The Commission also alleged that beginning in at least January 2009, the Mulhollands' real estate business experienced significant cash flow problems and had difficulty meeting financial obligations, including repaying investors. The complaint also alleged that despite the deteriorating financial condition of their real estate operation, the Mulhollands continued to solicit investors and to raise additional funds from them. From January 2009 through January 2010, the Mulhollands raised approximately $2 million from approximately 75 investors through the offer and sale of the Mulholland Notes. The Commission alleged that the Mulhollands defrauded these investors by, among other things, telling investors that the Mulhollands' real estate business was profitable, that investors would earn 7% per year on their investment and that the investors' returns would be generated by profits from the real estate business. The Commission also alleged that Respondent held himself out as a broker in connection with the offer and sale of Mulholland Notes. The complaint further alleged that the Mulhollands misrepresented to investors that investors' principal and interest were guaranteed and that they could get their money back upon 30 days' written notice. The Commission alleged that in reality the Mulhollands' real estate business was a failure and losing money. In fact, the business had experienced negative monthly cash flow from real estate operations during most of the relevant period, needed new investor funds to pay its bills and to pay interest to previous investors, and did not have the means to refund investors' principal within 30 days even if a small number of them requested to redeem their notes. The complaint alleged that despite their deteriorating financial condition, the Mulhollands continued to raise new investor funds throughout 2009 and into the beginning of 2010 – including within weeks of their bankruptcy filings – relying on the above misrepresentations and omissions to make the sales.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Mulholland's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Mulholland be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and
>
> barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70679 / October 11, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15567

In the Matter of

JAMES C. MULHOLLAND, JR.,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act) against James C. Mulholland, Jr. ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Respondent is 54 years old and resides in St. Pete Beach, Florida. In approximately 1981, Respondent became registered as a "securities agent" in Michigan, and between 1981and 1991 was associated with multiple registered broker-dealers. In 1991, the State of Michigan's Corporation and Securities Bureau entered a consent order revoking Respondent's securities agent registration and fining him $8,000 for engaging in the unregistered offer and sale of securities. In 2004, Respondent became associated with Invest Financial Corporation ("Invest"), a registered broker-dealer located in Tampa, Florida. Respondent resigned from Invest in July 2005 and, in 2006, FINRA suspended him and fined him $10,000 for offering and selling securities to customers without notice to or permission from Invest. Also in 2006, the State of Michigan Office of Financial and Insurance Regulation revoked Respondent's insurance license for offering and selling securities to his insurance clients.

2. On October 4, 2013, a final judgment was entered by consent against Respondent, permanently enjoining him from future violations of Sections 5 and 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15(a)(1) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. James C. Mulholland, Jr., et al., Civil Action Number 1:12-cv-14663, in the United States District Court for the Eastern District of Michigan.

3. The Commission's complaint alleged that since the 1990s, Respondent and his twin brother, Thomas S. Mulholland, (collectively, "the Mulhollands") operated a real estate business which involved buying, maintaining, and renting residential real estate in Michigan. To finance the real estate business, the Mulhollands raised money from individual investors through the offer and sale of securities in the form of demand notes ("Mulholland Notes"). The Commission also alleged that beginning in at least January 2009, the Mulhollands' real estate business experienced significant cash flow problems and had difficulty meeting financial obligations, including repaying investors. The complaint also alleged that despite the deteriorating financial condition of their real estate operation, the Mulhollands continued to solicit investors and to raise additional funds from them. From January 2009 through January 2010, the Mulhollands raised approximately $2 million from approximately 75 investors through the offer and sale of the Mulholland Notes. The Commission alleged that the Mulhollands defrauded these investors by, among other things, telling investors that the Mulhollands' real estate business was profitable, that investors would earn 7% per year on their investment and that the investors' returns would be generated by profits from the real estate business. The Commission also alleged that Respondent held himself out as a broker in connection with the offer and sale of Mulholland Notes. The complaint further alleged that the Mulhollands misrepresented to investors that investors' principal and interest were guaranteed and that they could get their money back upon 30 days' written notice. The Commission alleged that in reality the Mulhollands' real estate business was a failure and losing money. In fact, the business had experienced negative monthly cash flow from real estate operations during most of the relevant period, needed new investor funds to pay its bills and to pay interest to previous investors, and did not have the means to refund investors' principal within 30 days even if a small

number of them requested to redeem their notes. The complaint alleged that despite their deteriorating financial condition, the Mulhollands continued to raise new investor funds throughout 2009 and into the beginning of 2010 – including within weeks of their bankruptcy filings – relying on the above misrepresentations and omissions to make the sales.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Mulholland's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Mulholland be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and
>
> barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70678 / October 11, 2013

INVESTMENT ADVISERS ACT OF 1940
Release No. 3691 / October 11, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15566

In the Matter of **JONATHAN FRAIMAN,** *Respondent.*	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Jonathan Fraiman ("Fraiman" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. From January 2008 through June 2009, Fraiman was employed as a "Marketing and Investment Relations Executive" at Envit Capital LLC and Envit Capital Multi-Strategy Mixed Investment Fund I LP. During this time, he was also the Director and Chief Compliance Officer of Envit Capital Private Wealth Management, LLC, an unregistered investment adviser. Fraiman holds Series 7 and Series 66 securities licenses. Fraiman, 33 years old, is a resident of San Diego, California.

2. On October 8, 2013 a final judgment was entered by consent against Fraiman, permanently enjoining him from future violations of Section 17(a)(2) of the Securities Act of 1933; Sections 10(b) and 15(a)(1) of the Exchange Act and Rule 10b-5(b) thereunder; and Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, in the civil action entitled Securities and Exchange Commission v. Edward M. Laborio, et al., Civil Action Number 1:12-cv-11489-MBB, in the United States District Court for the District of Massachusetts. Fraiman was also barred from participating in an offering of penny stock, including engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of any penny stock.

3. The Commission's complaint alleged that Fraiman and others raised up to \$5.7 million from approximately 150 investors nationwide and overseas through five fraudulent and unregistered securities offerings involving a group of related entities (the "Envit Companies"). The complaint alleged that Fraiman made multiple misrepresentations and misleading statements about the Envit Companies' businesses, revenues, financial projections, uses of investor funds, and historical returns generated by a purported hedge fund that in reality never conducted any business. The complaint also alleged that Fraiman induced the purchase of securities without being registered in accordance with Section 15 of the Exchange Act.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Fraiman's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act that Respondent Fraiman be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, with the right to reapply for reentry after ten years to the appropriate self-regulatory organization, or if there is none, to the Commission.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for **October 2013**, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

ELISSE B. WALTER, CHAIRMAN

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

(2 Documents)

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70633 / October 8, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15553

In the Matter of

Arn Wilson,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Arn Wilson ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Wilson was a registered representative ("RR") at The Thornwater Company, L.P. ("Thornwater") from 1998 to 2002. Wilson next was an RR at Sky Capital LLC (now known as Granta Capital LLC) ("Sky Capital"), a New York-based broker-dealer, from 2002 to 2008. Wilson, 48 years old, is a resident of Dix Hills, New York.

2. On January 28, 2011, Wilson plead guilty to (1) conspiracy: to commit fraud in connection with the purchase or sale of securities, in violation of Title 15, United States Code, Sections 78j(b) and 78ff, and Title 17, Code of Federal Regulations, Section 240.10b-5; to commit wire fraud, in violation of Title 18 United States Code, Section 1343; and to commit mail fraud in violation of Title 18, United States Code, Section 1341; (2) securities fraud in violation of Title 15, United States Code, Sections 78j(b) and 78ff, and Title 17, Code of Federal Regulations, Section 240.10b-5; (3) wire fraud in violation of Title 18 United States Code, Section 1343 and 2; (4) mail fraud in violation of Title 18, United States Code, Section 1341 and 2, before the United States District Court for the Southern District of New York, in United States v. Ross Mandell, et al, 09-cr-662 (S.D.N.Y.). Wilson's sentencing hearing has not yet been scheduled.

3. The counts of the criminal indictment under which Wilson pleaded guilty alleged, inter alia, that from at least in or about 1998 through in or about 2006, Wilson and others participated in a securities fraud scheme through Thornwater and Sky Capital. Wilson and others carried out this scheme by soliciting millions of dollars from investors under false pretenses, manipulating the market for certain affiliated companies' stocks, failing to use investors' funds as promised, and misappropriating and converting investors' funds without their knowledge. In furtherance of this scheme, Wilson and others used material misrepresentations and omissions to cause individuals to invest in a series of purported investment opportunities, including private placements. Wilson and others raised a total of approximately $140 million from investors through their fraudulent scheme. Wilson and his co-defendants used those funds to enrich themselves, pay undisclosed commissions to brokers, and pay off earlier investors who had lost funds on prior purported investment opportunities.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Wilson's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Wilson be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the

issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70790 / October 31, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15599

In the Matter of **Robert Grabowski,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Robert Grabowski ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and the subject matter of these proceedings and to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

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1. Grabowski was a registered representative ("RR") at The Thornwater Company, L.P. ("Thornwater") from 1997 to 2003. Grabowski next was an RR at Sky Capital LLC (now known as Granta Capital LLC) ("Sky Capital"), a New York-based broker-dealer, from 2003 to 2008. Grabowski, 45 years old, is a resident of Staten Island, New York.

2. On January 25, 2011, Grabowski pled guilty to (1) conspiracy: to commit fraud in connection with the purchase or sale of securities, in violation of Title 15, United States Code, Sections 78j(b) and 78ff, and Title 17, Code of Federal Regulations, Section 240.10b-5; to commit wire fraud, in violation of Title 18 United States Code, Section 1343; and to commit mail fraud in violation of Title 18, United States Code, Section 1341; (2) securities fraud in violation of Title 15, United States Code, Sections 78j(b) and 78ff, and Title 17, Code of Federal Regulations, Section 240.10b-5; (3) wire fraud in violation of Title 18 United States Code, Section 1343 and 2; (4) mail fraud in violation of Title 18, United States Code, Section 1341 and 2, before the United States District Court for the Southern District of New York, in United States v. Ross Mandell, et al, 09-cr-662 (S.D.N.Y.). Grabowski's sentencing hearing has not yet been scheduled.

3. The counts of the criminal indictment under which Grabowski pled guilty alleged, inter alia, that from at least in or about 1998 through in or about 2006, Grabowski and others participated in a securities fraud scheme through Thornwater and Sky Capital. Grabowski and others carried out this scheme by soliciting millions of dollars from investors under false pretenses, manipulating the market for certain affiliated companies' stocks, failing to use investors' funds as promised, and misappropriating and converting investors' funds without their knowledge. In furtherance of this scheme, Grabowski and others used material misrepresentations and omissions to cause individuals to invest in a series of purported investment opportunities, including private placements. Grabowski and others raised a total of approximately $140 million from investors through their fraudulent scheme. Grabowski and his co-defendants used those funds to enrich themselves, pay undisclosed commissions to brokers, and pay off earlier investors who had lost funds on prior purported investment opportunities.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Grabowski's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Grabowski be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the

issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for **October 2013** with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

MARY L. SCHAPIRO, CHAIRMAN

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

(1 Document)

Commissioner Aguilar,
Commissioner Paredes
not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 70656 / October 10, 2013

ADMINISTRATIVE PROCEEDING
File No. 3-15562

In the Matter of **MARK GASARCH,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Mark Gasarch ("Respondent" or "Gasarch") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any attorney . . . who has been by name (A) [p]ermanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder; or (B) [f]ound by any court of competent jurisdiction in an action in which he or she is a party to have violated (unless the violation was found not to have been willful) or aided and abetted the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Gasarch, age 72, is a U.S. citizen who lives in New York, New York.

2. Gasarch is and has been an attorney licensed to practice law in the State of New York.

3. On September 26, 2013, a final judgment was entered against Gasarch, permanently enjoining him from aiding or abetting future violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Petro-Suisse Ltd., et al., Civil Action Number 12-CV-6221 (AJN), filed in the United States District Court for the Southern District of New York. The final judgment also ordered Gasarch jointly and severally liable with Petro-Suisse Ltd. ("Petro-Suisse") to pay $8,370,000 in disgorgement, deemed satisfied by the previous payments made by Petro-Suisse to Petro-Suisse limited partnership investors, and a $130,000 civil penalty.

4. The Commission's complaint alleged, among other things, that between 2003 and 2006, in connection with the purchase and sale of limited partnership interests offered by Petro-Suisse to finance the drilling of oil wells in Trinidad, Gasarch drafted 21 private placements memorandums ("PPMs") that contained materially false and misleading information. Specifically, the PPMs stated that Petro-Suisse or an affiliate, as general partner, would cause each of the 21 partnerships to enter into written agreements to finance the drilling of oil wells in Trinidad for which the partnerships would receive contractual rights to receive returns measured by the net revenues of the wells drilled and payable out of those revenues. The PPMs contained materially false and misleading information because the partnerships never entered into any such written agreements.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Gasarch's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Respondent is suspended from appearing or practicing before the Commission as an attorney for 5 years from the date of the Order.

B. After 5 years from the date of the Order, Respondent may request that the Commission consider his application to resume appearing and practicing before the Commission as an attorney. The application should be sent to the attention of the Office of the General Counsel.

C. In support of such an application, Respondent must provide a certificate of good standing from each state bar where Respondent is a member.

D. In support of such an application, Respondent must also submit an affidavit truthfully stating, under penalty of perjury:

1. that Respondent has complied with the Order;

2. that Respondent:

   a. is not currently suspended or disbarred as an attorney by a court of the United States (or any agency of the United States) or the bar or court of any state, territory, district, commonwealth, or possession; and

   b. since the entry of the Order, has not been suspended as an attorney for an offense involving moral turpitude by a court of the United States (or any agency of the United States) or the bar or court of any state, territory, district, commonwealth, or possession, except for any suspension concerning the conduct that was the basis for the Order;

3. that Respondent, since the entry of the Order, has not been convicted of a felony or misdemeanor involving moral turpitude as set forth in Rule 102(e)(2) of the Commission's Rules of Practice; and

4. that Respondent, since the entry of the Order:

   a. has not been found by the Commission or a court of the United States to have committed a violation of the federal securities laws, except for any finding concerning the conduct that was the basis for the Order;

b. has not been charged by the Commission or the United States with a violation of the federal securities laws, except for any charge concerning the conduct that was the basis for the Order;

c. has not been found by a court of the United States (or any agency of the United States) or any state, territory, district, commonwealth, or possession, or any bar thereof, to have committed an offense involving moral turpitude, except for any finding concerning the conduct that was the basis for the Order; and

d. has not been charged by the United States (or any agency of the United States) or any state, territory, district, commonwealth, or possession, or any bar thereof, with having committed an offense involving moral turpitude, except for any charge concerning the conduct that was the basis for the Order.

E. If Respondent provides the documentation required in Paragraphs C and D, and the Commission determines that he truthfully attested to each of the items required in his affidavit, he shall by Commission order be permitted to resume appearing and practicing before the Commission as an attorney.

F. If Respondent is not able to truthfully attest to the statements required in Subparagraphs D(2)(b) or D(4), Respondent shall provide an explanation as to the facts and circumstances pertaining to the matter and the Commission may hold a hearing to determine whether there is good cause to permit him to resume appearing and practicing before the Commission as an attorney.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary