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Via Electronic Submission

March 20, 2013

U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Request for Public Comments on SEC Regulatory Initiatives under the JOBS Act Title III - Crowdfunding

Ladies and Gentlemen:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "Committee") of the Business Law Section (the "Section") of the American Bar Association (the "ABA") with respect to the rules the Securities and Exchange Commission (the "Commission") is required to adopt pursuant to the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"). This letter is submitted in response to the Commission's request for public comments relating to the JOBS Act rulemaking.[1]

The comments expressed in this letter represent the views of the Committee, and have also been prepared in conjunction with, and reviewed and approved by, the Middle Market and Small Business Committee, the Private Equity and Venture Capital Committee, and the State Regulation of Securities Committee of the Section. The comments expressed in this letter have not been approved by the ABA's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, these comments do not represent the official position of the Section.

The Committee thanks the Commission for this opportunity to comment on the rulemaking the Commission is required or authorized to undertake in connection with the JOBS Act. In accordance with the Commission's efforts to organize the submission of comments relating to each major initiative under the JOBS Act, the Committee expects to submit a number of comment letters, each addressing one of the rulemaking categories identified by the Commission. This letter comments on the provisions set forth in Title III of the JOBS Act relating to crowdfunding (Title III). Because this letter is being submitted prior to the Commission's issuance of proposed rules, our comments are intended to highlight matters we believe the Commission should consider in formulating its proposed rules pursuant to Title III or in providing guidance pursuant with respect thereto.

[1] http://sec.gov/spotlight/jobsactcomments.shtml

Summary of Our Comments

Our comments with respect to Title III which, among other things, adds new Sections 4(6)[2] and 4A to the Securities Act of 1933 (the "Securities Act") and amends Sections 3 and 12(g) of the Securities Exchange Act of 1934 (the "Exchange Act"), are as follows:

1. The Commission is not required in its rulemaking to combine amounts raised by an issuer in crowdfunding transactions within any 12-month period with amounts raised by the issuer in transactions not involving crowdfunding during that period, and it should not do so.

2. The Commission should clarify the maximum amount permitted to be invested by each investor in a crowdfunding transaction.

3. The Commission should clarify the ability of an issuer to engage in crowdfunding transactions before, concurrently with or following certain other exempt transactions.

4. The Commission should consider the creation of standardized disclosure templates that can be used by crowdfunding issuers.

5. The Commission should work with FINRA to evaluate the benefits of creating a central database to facilitate compliance with investor maximum purchase limitations.

6. The Commission should develop a standard set of investor education materials that could be used to satisfy the investor education requirements of Title III.

7. The Commission should permit issuers and intermediaries in crowdfunding transactions to rely in good faith on investor representations as to the investor's net worth and annual income without requiring additional verification.

8. The Commission should consider increasing the target amounts that would require an issuer in a crowdfunding transaction to prepare audited financial statements.

9. The Commission should require an issuer that has engaged in a crowdfunding transaction to provide reviewed or audited financial statements in its annual report only if the total assets of the issuer at the last day of its fiscal year exceed specified amounts.

10. The Commission should permit issuers to raise funds in excess of the target offering amounts subject to specified conditions.

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[2] We note that Title III refers to Section 4(6) of the Securities Act. Although we assume that the intended reference was to Section 4(a)(6) in light of the other modifications to Section 4 of the Securities Act mandated by Title II of the JOBS Act, we will refer in this letter to Section 4(6) to be consistent with the statutory language.

11. The Section 4(6) disqualification provisions should be consistent with the disqualification provisions applicable to other Securities Act exemptive safe harbors.

12. The Commission should specify what compensation models would be acceptable for a crowdfunding intermediary that is not registered as a broker or dealer under the Exchange Act.

13. The Commission should provide guidance as to what activities may be undertaken by a crowdfunding intermediary that do not constitute "investment advice", as well as with respect to the activities in which a funding portal may engage or not engage without registration as a broker, dealer or investment adviser.

14. The Commission, together with FINRA, should consider which rules currently applicable to registered broker-dealers should also be applicable to funding portals and, correspondingly, which rules should not.

15. The Commission should clarify that a crowdfunding intermediary will not be required to register as an exchange or alternative trading system.

In addition to the foregoing comments, we expect to also submit comments to the Commission relating to its rulemaking to implement Section 303 of the JOBS Act to exempt securities acquired pursuant to crowdfunding offerings from the scope of Section 12(g) of the Exchange Act.

Background

Title III of the JOBS Act added Section 4(6) to the Securities Act to provide an exemption from the registration provisions of the Securities Act for crowdfunding transactions involving the offering of securities, and added Section 4A to the Securities Act to set forth the requirements for issuers and intermediaries, liability provisions, and certain other matters relating to crowdfunding. In addition, Title III amended various provisions of the Exchange Act in connection with the crowdfunding provisions. The JOBS Act requires the Commission to adopt a number of rules implementing crowdfunding, including the following:

1. Rules to carry out Section 4(6) and Section 4A of the Securities Act, pursuant to Section 302(c) of the JOBS Act;

2. Rules to provide for disqualifications of issuers, brokers or funding portals pursuant to Section 302(d) of the JOBS Act;

3. Rules to exempt, conditionally or unconditionally, the requirement for a registered funding portal to register as a broker or dealer under Section 15(a)(1) of the Exchange Act, pursuant to Section 304(a) of the JOBS Act; and

4. Rules to exempt, conditionally or unconditionally, securities acquired in crowdfunding transactions from the scope of Section 12(g) of the Exchange Act, pursuant to Section 303 (b) of the JOBS Act.

In addition, Title III authorizes the Commission to adopt such additional rules as may be appropriate to implement the crowdfunding provisions.

The purpose of this comment letter is to present the views of the Committee to the Commission in order to assist the Commission in connection with the formulation of its proposed rulemaking under Title III.

Discussion

1. The Commission is not required in its rulemaking to combine amounts raised by an issuer in crowdfunding transactions within any 12-month period with amounts raised by the issuer in transactions not involving crowdfunding during that period, and it should not do so.

   Section 4(6) provides a transactional exemption from registration under the Securities Act for crowdfunding, subject to certain limitations. Section 4(6)(A) provides that "the aggregate amount sold to all investors by the issuer, *including* any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction, is not more than $1,000,000" (emphasis added).

   Although the statutory language is not entirely clear, and could be read to provide for the aggregation of amounts raised in Section 4-exempt transactions that do not involve crowdfunding, we believe it is properly read to include as the limitation on the amount that can be raised in a crowdfunding transaction only those amounts raised by the issuer in other crowdfunding transactions during the preceding 12-month period. This reading is consistent with the language describing the aggregate limits on the amounts that can be invested by an individual investor under Section 4(6)(B), which provides in pertinent part that "the aggregate amount sold to any investor by an issuer, *including any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction*, does not exceed…." (italics added). It is also consistent with the issuer disclosure requirement in Section 4A(b)(1)(D) of the Securities Act, which requires an issuer to describe "the financial condition of the issuer, including, for offerings that, *together with all other offerings of the issuer under section 4(6) within the preceding 12-month period…*" (italics added). This reading is also consistent with the statutory approach, and the Commission's rulemaking, taken for other exempt offerings with dollar limitations, and it is reasonable to assume that Congress had these precedents in mind. Moreover, the specific aggregation identified in the statutory provision is limited to any crowdfunding offering within the preceding 12

months, further supporting the statutory reading that amounts raised in offerings that do not rely on the crowdfunding exemption are not required to be aggregated with amounts raised in crowdfunding transactions.

In addition, the policy considerations underlying the crowdfunding exemption support this reading of Congress' intent. Were any different interpretation applied to this section (that is, to read the statutory language limiting the "aggregate amount sold to all investors by the issuer" to refer to all sales pursuant to Section 4 of the Securities Act, the benefits of the crowdfunding exemption could be significantly undermined, as illustrated by the following examples:

a. Initial or follow-on investments in the issuer by the founder or founders of the issuer in exchange for securities of the issuer pursuant to the exemption under Section 4(a)(2) of the Securities Act would need to be subtracted from the maximum amount that could be raised in crowdfunding transactions within a given 12-month period. In the event the founders' investments were significant, the issuer may be limited or even precluded from raising capital by means of crowdfunding.

b. Capital raised in Section 4(a)(2)-exempt transactions from persons or entities other than founders also would decrease the amount an issuer could raise through crowdfunding. To illustrate, a start-up issuer may have capital needs in excess of $1,000,000 in a 12-month period. If such an issuer raised $1,000,000 or more in prior Section 4(a)(2)-exempt transactions during this period - for example, via early-stage venture capital investments - and later were to determine that it needs to raise additional capital in order to pay its employees or to maintain or expand its business operations, such an interpretation would prevent the issuer from raising any additional funds by means of crowdfunding.

We believe that the above results would be inconsistent with the basic premise of crowdfunding: to facilitate small business capital formation, especially early-stage capital, and thereby to promote job creation. Accordingly, we recommend that the Commission, in its proposed rules, clarify that the $1,000,000 calculation refers solely to the aggregation of amounts raised in transactions pursuant to Section 4(6).[3]

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[3] We believe that the need for this clarification is also important because Section 4(6) includes, within the scope of offers or sales by an issuer, offers or sales by all entities controlled by or under common control with an issuer. If the controlling person of an issuer seeking to raise funds in a crowdfunding transaction also controls an entity that had sold securities pursuant to Section 4(a)(2) within the prior 12 months (even if the only purchaser of such securities was the controlling person), then the sales by the other entity could - absent this clarification - decrease the amount that the issuer could sell in a crowdfunding transaction, because both entities would be under common control. It seems to us that this result is not what the statute intended.

2. <u>The Commission should clarify the maximum amount permitted to be invested by each investor in a crowdfunding transaction.</u>

Section 4(6)(B) also sets forth limits with respect to the aggregate amount of securities that may be sold to any investor in reliance on the exemption within a 12-month period. There are two tests, one with a lower limit and the other with a higher limit. The lower-limit test provides that the investment by any investor may not exceed 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. The higher-limit test provides that the investment by any investor may not exceed the greater of 10 percent of the annual income or net worth of such investor, as applicable, not to exceed a maximum aggregate amount of $100,000, if either the annual income or net worth of the investor is equal to or more than $100,000. Simply stated, these tests are logically inconsistent. For example, an investor with an annual income of less than $100,000, and with a net worth greater than $100,000, would fall within both categories. As a result, it is unclear from the statute how Congress intended such an investor to be treated.

We recommend that the Commission address this inconsistency in its proposed rules to implement Section 4(6). The Commission could do so most easily by including in its proposed rules either the lower-limit test or the higher-limit test, and by providing that the alternative test applies to investors who do not fall within the scope of the category of investors covered by the specified test. Should it believe that it has the statutory authority to do so, the Commission could also fashion a test along the lines of the statutory provision, by proposing standards that address what appears to be the Congressional intent to limit the maximum investment for all investors, and to impose lesser limits for less affluent investors. For example, the lower-limit test might apply only if an investor's annual income and net worth were both below a specified amount (*i.e.*, either annual income or net worth were below $100,000, and neither the investor's annual income nor the investor's net worth exceeded the specified amount). This formulation would, therefore, enable a retired investor who may have little current annual income, but a significantly higher net worth, to invest at the higher level. However the Commission chooses to address this matter in its proposed rulemaking, it is important that the Commission resolve the inconsistencies inherent in the two standards set forth in the statute.

Finally, on a separate but related point, it is unclear to us which measure (annual income or net worth) serves as the basis for the statutory investment limits. For example, if an investor has an annual income of $40,000 and net worth of $80,000, does the 5% test apply to the annual income or the net worth? Both with respect to the lower-limit test and the higher-limit test, the statute is unclear. We believe that the Commission should seek to eliminate this ambiguity in its proposed rules. It can do this by proposing within each category that either the

lower or the higher of annual income or net worth would serve as the benchmark for the application of the 5% or 10% test (as applicable).

3. The Commission should clarify the ability of an issuer to engage in crowdfunding transactions before, concurrently with or following certain other exempt transactions.

One of the concerns we have with respect to crowdfunding offerings is that individual investors may have neither the financial sophistication nor (in view of the limitations on the amount of individual investments) a sufficient economic incentive to conduct their own due diligence with respect to an issuer, or to negotiate or influence the terms of a crowdfunding offering and ancillary arrangements designed to protect investor rights. As a consequence, we believe that the investor protections available in crowdfunding transactions may be substantially less than those that may be demanded by accredited investors in proposed Rule 506(c) transactions. For example, we believe it would be more likely that accredited investors in Rule 506(c) transactions (assuming this rule is adopted substantially as proposed) will recognize the need for, and engage in, some degree of due diligence and would insist on certain protections. These protections may take various forms, including (but not necessarily limited to) the terms of the securities being offered to investors, the rights of the investors reflected in those terms, the ancillary agreements that may be entered into with investors (such as investors' rights agreements, voting agreements, and right of first refusal and co-sale agreements), and also in the conditions precedent to the consummation of the offering. Accredited investors are more likely, in our experience, to require that an issuer's management (or at least key personnel), as a condition to the investment, enter into employment agreements containing noncompetition and other provisions, to protect those investors from the risk that key personnel will resign and thus leave the issuer without suitable management expertise or management structure.

Although it is unlikely that investors in crowdfunding transactions will insist on receiving the full range of protections that larger and more sophisticated investors might require as a condition to investment, there could, in our view, be a significant benefit to crowdfunding investors were the Commission to permit crowdfunding transactions to occur concurrently with Rule 506(c) transactions utilizing general solicitation. Crowdfunding transactions conducted concurrently (or shortly after) Rule 506(c) transactions may provide greater assurance to the crowdfunding investors as to the corporate and organizational integrity of the issuer, based on the due diligence we believe normally would be performed by accredited investors in connection with the Rule 506(c) transaction. In addition, crowdfunding investors may indirectly benefit from the involvement of another investor group in monitoring the development of the business and the effectiveness of management performance, and the protections that may result from the ability of the other investor group to intercede if the business or management fails to perform as contemplated. Although, as we have noted,

crowdfunding investors are not likely to receive directly all of the protections accredited investors may obtain from the issuer in a private offering context, they may be able to benefit, if even indirectly, from the conditions and procedures that accredited investors may impose or undertake with respect to their investments.

Currently (that is, until the Commission adopts rules implementing the elimination of the current prohibition on general solicitation and general advertising in connection with certain Rule 506 transactions), an issuer's ability to conduct a side-by-side Rule 506 offering with an offering that is publicized (such as registered public offerings) requires an analysis of how investors in the private offering were solicited.[4] The elimination of the general solicitation and general advertising restrictions in connection with a proposed Rule 506(c) transaction should to a large extent obviate the need for this analysis in the context of Rule 506(c) offerings. However, unlike a Rule 506(c) offering, which will not be subject to any significant limitations on the offering process other than the issuer's obligation to take reasonable steps to verify an investor's status as an accredited investor, Title III imposes significantly more conditions on the conduct of crowdfunding offerings. In order that an issuer's Rule 506(c) offering shortly prior to or concurrently with a proposed crowdfunding transaction not be integrated with the crowdfunding transaction or viewed as being inconsistent with the statutory requirements applicable to the crowdfunding transaction, we recommend that the Commission's proposed rules reflect the following considerations:

a. A Rule 506(c) transaction may be conducted by an issuer without any limitations beyond those set forth in Rule 506(c), provided that the Rule 506(c) transaction is completed not less than 30 days prior to the commencement of a crowdfunding transaction by that issuer.

b. A Rule 506(c) transaction by an issuer may be conducted less than 30 days prior to the commencement of a crowdfunding transaction by that issuer, or concurrently with a crowdfunding transaction by that issuer, provided that the manner in which the Rule 506(c) offering is conducted is consistent with the manner in which the crowdfunding transaction is required to be conducted. We believe that this requirement could, for example, provide that advertising with respect to the Rule 506(c) transaction state explicitly that the Rule 506(c) offering is being made only to accredited investors. In addition, the Commission should require that any Rule 506(c) advertising following the commencement of the crowdfunding offering direct persons who are not accredited investors to the funding portal or broker in accordance with the provisions of Section 4A(b)(2) of the Securities Act and the Commission's rules thereunder.

[4] See, for example, the interpretive positions outlined in Section II.C. of the Commission's proposing release entitled "Revisions of Limited Offering Exemptions in Regulation D", Release No. 33-8828 (August 3, 2007), available at http://www.sec.gov/rules/proposed/2007/33-8828.pdf.

Beyond the scope of crowdfunding transactions conducted prior to or concurrently with Rule 506(c) transactions, we suggest that the Commission explicitly state that a securities offering by an issuer pursuant to an exemption from registration under the Securities Act that has been completed prior to the commencement of a crowdfunding transaction will not be affected by any subsequent crowdfunding transaction.[5] In its proposed rulemaking (or the Commission's release with respect thereto), it may be helpful for the Commission to address whether an issuer's ability to engage in a crowdfunding transaction will be affected by any prior exempt offering.[6]

4. The Commission should consider the creation of standardized disclosure templates that could be used by crowdfunding issuers.

It is clear that, in enacting Section 4(6), Congress intended to provide a simplified means for small issuers to raise limited amounts of capital. However, many small private companies are unfamiliar with the capital-raising process, and the issuer disclosure requirements set forth in Section 4A(b)(1) may appear to them to be intimidating and overly complex. We believe it would be very helpful to such issuers, and entirely consistent with the Congressional intent, if the Commission were to create a disclosure template that would allow issuers to complete certain fields by inserting the required information. Such a template could also provide drop-down screens or other methods to explain to issuers what is meant by certain terms or intended to be included in certain fields, especially the fields providing for a description of the ownership and capital structure of the issuer.[7] For example, not all issuers would necessarily know what information is contemplated to be provided in discussing the terms of the securities being offered, 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. Explanations of such concepts would be useful, and a series of simple questions to which the issuer could respond would help to avoid unnecessary confusion. Were the template to ask an issuer whether the issuer has any class of security other than a single class of common stock, and the issuer were to answer "no", then the template might direct the issuer to sections other than the class-by-class comparisons.[8]

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5 See, by analogy, Securities Act Rule 152 relating to a completed private offering followed by a registered public offering.

6 Under any circumstances, in our view, securities offerings that are distinct from each other based upon the five-factor test referred to in the Note to Securities Act Rule 502(a) should not be integrated under any circumstances.

7 We note that the North American Securities Administrators Association (NASAA), in conjunction with the American Bar Association, has developed the Small Company Offering Registration ("SCOR") program, which includes a simplified "question and answer" registration form that companies can use as the disclosure document for investors in connection with a Rule 504 offering.

8 As part of the standardized form, the Commission may want to consider, though, whether issuers should (assuming this to be the case) be required to disclose as a risk factor that the issuer may in the future issue securities having terms that may materially limit, dilute or qualify the rights of the holders of the securities

Whether or not the Commission is able to create such templates by the time the Commission's crowdfunding rules become effective, the Commission should state in its rulemaking that the disclosures required to be made by issuers should be clear and concise and need not, except to the extent material to investors, include any information beyond the scope of the disclosures mandated by the Commission's rules.

5. The Commission should work with FINRA to evaluate the benefits of creating a central database to facilitate compliance with investor maximum purchase limitations.

   Pursuant to Section 4A(a)(8), intermediaries are required to make such efforts as the Commission determines appropriate, by rule, to ensure that no investor in a 12-month period has purchased securities offered pursuant to Section 4(6) in excess of the limit set forth in Section 4(6)(B).[9] In order to facilitate compliance with this requirement, the Commission should consider, in collaboration with FINRA, creating a central database that intermediaries can use to report 4(6) offerings, including the names of issuers, a description of the securities sold in the offering, the names of investors and the amounts such investors have invested in each such offering. Because investors will likely not want the specifics of their investments to be publicly available, we recommend that this information only be made available to intermediaries, and subject to such further controls as the Commission deems appropriate. Were the Commission and FINRA to develop such a database, we believe that it would facilitate greatly compliance by covered intermediaries regarding the monitoring of individual investments, and could also assist the Commission (as well as FINRA) in connection with its data-gathering and enforcement programs.[10]

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being offered. The Commission also may want to suggest certain standardized risk factors, which issuers would be able to include, exclude or modify to the extent appropriate.

[9] Section 4(6)(B) sets forth the aggregate amount that may be sold to any investor *by an issuer* – we note that the such section does not specify the aggregate amount of securities that may be sold to any investor by all issuers within the relevant 12-month period. Accordingly, we read the reference in Section 4A(a)(8) as requiring intermediaries to take steps to confirm that an investor in a specific crowdfunding transaction has not, in the preceding 12-month period, purchased securities in other crowdfunding transactions that exceeded the investor limitations applicable to purchases of securities from each issuer in such other transactions. We do not read the provision as imposing a substantive limitation on investments extending beyond the scope of the limitation set forth in Section 4(6)(B).

[10] The Commission may also determine that intermediaries are entitled to rely on self-certification from investors as to their compliance with the investor maximum purchase limitations, as discussed in Item 7 of this comment letter.

6. The Commission should develop a standard set of investor education materials that could be used to satisfy the investor education requirements of Title III.

   One of the principal benefits of the crowdfunding rules may be the opportunity they provide to disseminate investor education materials widely to retail investors. Section 4A(a)(3) requires intermediaries to provide investors with disclosure relating to risks and other investor education materials, as the Commission determines appropriate. We believe it would be very helpful if the Commission were to create a standardized set of basic investor education materials that could be used by intermediaries to satisfy this requirement. Among other things, the use of a standardized set of materials would help to assure that investors are provided with information regarding their rights as investors and their remedies should the investors believe that an issuer has acted fraudulently or otherwise in violations of the securities laws, a matter that many issuers may not be willing to highlight. Issuers and intermediaries should be free to supplement this information as appropriate (assuming issuers otherwise fulfill the mandatory disclosure obligations established by the Commission in implementing Section 4A(b)), but a standardized set of investor education disclosures would assure that investors receive straightforward, clear and helpful information that will assist them in formulating investment decisions. The information could also provide a link (www.investor.gov) and contact information to the Commission's Office of Investor Education and Advocacy, as well as information regarding possible enforcement recourse in the event that fraud or irregularity are suspected. We see this as accretive: the more investors learn about intelligent investing, the more likely they are to be informed investors going forward, and to share their information with others.

7. The Commission should permit issuers and intermediaries in crowdfunding transactions to rely in good faith on investor representations as to the investor's net worth and annual income without requiring additional verification.

   Pursuant to Title III, all investors will be able to invest up to the greater of $2,000 or 5% of the investor's annual income or net worth in crowdfunding transactions during a 12-month period. In order to invest at higher levels, however, investors in crowdfunding transactions will be required to represent that they have annual income or net worth in excess of $100,000. We are aware that the investment limitations that Congress imposed on purchases by investors in crowdfunding transactions could be evaded were investors to misrepresent their net worth or annual income to issuers or intermediaries. However, we are concerned that any requirement that issuers or intermediaries undertake a verification process would be both costly and burdensome, especially because a single crowdfunding transaction may attract hundreds or even thousands of potential investors. Verification with respect to income may require a review of tax records, and verification of net worth may require analysis of the value of particular assets

owned by investors, as well as a review of the investor's liabilities, which may be very complicated.[11] In many cases, the costs of verification may be disproportionate relative to the amount of funds being raised. Finally, requiring investors in crowdfunding transactions to provide personal financial information may create privacy concerns and dissuade investors from participation in crowdfunding transactions.

Based upon the above considerations, we believe the Commission should permit issuers and intermediaries in crowdfunding transactions to rely in good faith on investor representations as to the investor's net worth and annual income without requiring additional verification (unless otherwise on notice that a particular potential investor may not be eligible). We also suggest that the Commission consider proposing that issuers include a statement in any offering circular or related document (such as an investor questionnaire or subscription agreement) advising investors that any misrepresentation by an investor with respect to the investor's annual income or net worth could cause the issuer to sell securities in excess of the individual limits established by statute. This statement could also note that the Commission has the authority to initiate administrative proceedings or seek other remedies against investors who fraudulently misrepresent their annual income or net worth.

Finally, we suggest that the Commission include in the proposed rule a provision to the effect that an issuer will not lose the Section 4(6) exemption with respect to a crowdfunding transaction if it reasonably believes that the aggregate amount sold to investors in the transaction does not exceed the maximum amounts set forth in clauses (A) and (B) of Section 4(6).[12] Because time will tell whether investor misrepresentation proves to be a significant problem, we recommend that, whatever standard the Commission may propose and may adopt, the Commission should monitor compliance with this requirement following the effectiveness of the final crowdfunding rules in order to determine whether there appear to be significant violations of the statutory investment limitations and, if appropriate, to consider additional rulemaking to reduce the risk of any such violations in future periods.

8. The Commission should consider increasing the target amounts that would require an issuer in a crowdfunding transaction to prepare audited financial statements.

[11] Consider, for example, how an issuer or intermediary would be able independently to determine whether an investor's estimate of the value of home furnishings or collectibles is accurate. Although we understand that third party companies may be able to provide verification services, we do not believe the Commission's proposed rulemaking should impose obligations in anticipation that such service companies will develop, or if they do, that they will be able to provide such services in a reliable, cost-efficient manner to crowdfunding issuers and/or intermediaries.

[12] A reasonable belief standard would be consistent with the determination of "accredited investor" status in Rule 506 offerings, and eligible "qualified institutional buyers" in Rule 144A transactions.

The JOBS Act provides that every issuer that offers or sells securities that (together with all other offerings of the issuer under Section 4(6) within the preceding 12-month period) have a target offering amounts of more than $500,000 is required to prepare, file with the Commission and provide to investors audited financial statements. The JOBS Act, however, specifically authorizes the Commission to change the threshold triggering an obligation to provide audited financial statements. Although we appreciate that an audit report would provide additional integrity to an issuer's financial statements, we are concerned that the additional costs associated with an audit may discourage some issuers from undertaking a crowdfunding offering at or above the $500,000 level. Because the Commission has the express authority to revise the $500,000 threshold, we recommend that the Commission consider a higher trigger level for the audited financial statement requirement amount (such as $750,000), or identify additional criteria (such as revenue levels) that would require an issuer to provide audited financial statements, and invite public comment as to the appropriateness of such levels or criteria.[13]

Because amounts raised in a crowdfunding transaction are required to be aggregated with amounts raised in crowdfunding transactions conducted by the same issuer within the preceding 12-month period for the purpose of calculating whether a review or audit of the issuer's financial statements is required, we are concerned that the audit requirement could be triggered by a small offering that follows prior offerings within the preceding 12-month period. For example, were the applicable audit trigger level set at $500,000, and an issuer were to seek to raise $100,000 after having raised $400,000, the issuer would be obligated to engage an auditor to conduct an audit of its financial statements in connection with the planned crowdfunding offering. We note that, in this example, the prior investors would have already made their investment decisions without the benefit of having audited financial statements. Moreover, the costs of the audit could represent a significant percentage of the additional amounts to be raised. Issuers in this situation would be required either to incur the cost of an audit or, in order to avoid the audit, to defer the offering until the passage of time would not require audited financial statements, or to seek capital by some other route.

In view of the Commission's express statutory authority with respect to the audit requirement, we recommend that an issuer not be required to provide audited financial statements in connection with a crowdfunding transaction if (i) the target offering amount in the crowdfunding transaction is not greater than $100,000 (notwithstanding any other crowdfunding transactions conducted by the issuer within the preceding 12-month period), and (ii) the issuer has not conducted a crowdfunding transaction within six months prior to the commencement of the proposed crowdfunding transaction. The latter requirement would minimize the

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[13] We note that this provision, as well as other provisions of Title III, refers to a "target offering amount." As discussed in Item 10 below, we believe that issuers should be permitted to raise amounts of capital in excess of the target offering amount, subject to their compliance with certain additional disclosure obligations.

risk that issuers will seek to avail themselves of the exemption in clause (i) by arranging a series of crowdfunding transactions. We note that if audited financial statements are not required, an issuer would nonetheless be required to provide reviewed financial statements for offerings that, together with all other crowdfunding transactions by the issuer within the preceding 12-month period, have, in the aggregate, target offering amounts of more than $100,000.

9. The Commission should require an issuer that has engaged in a crowdfunding transaction to provide reviewed or audited financial statements in its annual report only if the total assets of the issuer at the last day of its fiscal year exceed specified amounts.

   We believe that the Commission's rules regarding annual reporting by issuers that have engaged in crowdfunding transactions should require issuers to provide reviewed or audited financial statements only if the total assets of the issuer at the last day of its fiscal year exceed specified amounts. For example, financial statements reviewed by an independent accounting firm may be required only if total assets on such date exceed $300,000 and audited financial statements should be required only if total assets exceed $750,000. We suggest these tests based, in part, on the fact that public reporting pursuant to Section 12(g) of the Exchange Act is based on a total assets test, and the same Commission rules or staff guidance regarding Section 12(g) could apply equally to this situation.[14] We believe that a requirement based upon other standards, such as revenues or income, may result in developmental stage companies with considerable assets but limited or no revenues or income not being subject to the review or auditing requirements, and that a requirement based upon whether the issuer was required to provide reviewed or audited financial statements in connection with a prior crowdfunding transaction may subject the issuer to excessive costs in proportion to its current assets if its current asset levels have declined by reason of expenditures. In short, we believe that an asset test offers a reasonable predicate for balancing the relative costs to very small, early-stage issuers vs. informational benefits to crowdfunding investors (recognizing, of course, that equity securities issued in "crowdfunding" transactions are carved out of the Section 12(g) record holder calculation).[15]

[14] *See, e.g.,* Exchange Act Rule 12g5-2(defining "total assets").

[15] In addition, the Commission should also consider specifying criteria for determining when issuers that have conducted an offering exempt under the crowdfunding provisions will no longer be required to prepare an annual report. Similar to Section 15(d) of the Exchange Act, that obligation could terminate after a specified period of time if the securities of the class issued in the crowdfunding transaction are held by less than a specified number of holders of record as of the beginning of a fiscal year.

10. The Commission should permit issuers to raise funds in excess of the target offering amounts subject to specified conditions.

    In determining whether a review or an audit by an independent public accountant is required, and in connection with certain disclosures issuers are required to make in connection with crowdfunding transactions, Title III refers to target offering amounts. Although Title III suggests that the target offering amount is not an absolute cap on the amount an issuer can raise in a crowdfunding transaction[16], the statute does not provide clarity as to the obligations imposed on an issuer that seeks to accept investments in excess of the target offering amount. We suggest that the Commission's proposed rules permit issuers to raise funds in a crowdfunding offering in excess of the target offering amount, subject to the following conditions:

    a. An issuer seeking to raise amounts in excess of the target offering amount must disclose:

        i. The maximum amount that it will raise in the crowdfunding transaction.

        ii. The total amount of securities that will be issued should the target offering amount be raised and the total amount of securities that will be issued should the maximum amount be raised.

        iii. The anticipated use of proceeds should the target offering amount be raised and the anticipated use of proceeds should the maximum amount be raised.

    b. If the maximum amount exceeds the target offering amount, the issuer would be required to provide the financial statements (certified, reviewed or audited) that would have been required had the target offering amount been stated to be equal to the maximum amount.[17]

11. The Section 4(6) disqualification provisions should be consistent with the disqualification provisions applicable to other Securities Act exemptive safe harbors.

    Section 302(d) of the JOBS Act requires the Commission to adopt disqualification rules applicable to crowdfunding transactions that are "substantially similar" to

[16] Subsection (a)(7) of Section 4A provides 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…" (italics added)

[17] Also, in our view, the calculation of amounts raised in crowdfunding transactions during the preceding 12-month period should equal the aggregate of the amounts actually raised rather than the target offering amounts.

those set forth in Rule 262 under the Securities Act. Because the Commission is currently engaged in rulemaking required under the Dodd-Frank Act to implement disqualification provisions under Rule 506 of Regulation D, we believe it would be appropriate for the Commission to adopt a uniform disqualification standard applicable to Rule 506 transactions, Regulation A transactions and crowdfunding transactions pursuant to Section 4(6). Uniformity will avoid unnecessary complexity and therefore facilitate compliance by issuers and persons acting on their behalf. Because of the potential breadth of the disqualification provisions, the Commission may also want to create, or work with FINRA to create, a central database of persons and entities that are disqualified under these rules.

12. The Commission should specify what compensation models would be acceptable for a crowdfunding intermediary that is not registered as a broker or dealer under the Exchange Act.

New Section 4A(a) of the Securities Act requires that any person acting as an intermediary in a crowdfunding transaction register with the Commission, either as (i) a broker or (ii) a funding portal (as defined in Section 3(a)(80) of the Exchange Act). Pursuant to Section 3(a)(80), the term "funding portal" means any person acting as an intermediary in a crowdfunding transaction that does not "(A) offer investment advice or recommendations; (B) solicit purchases, sales, or offers to buy the securities offered or displayed on its website or portal; (C) compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal; (D) hold, manage, possess, or otherwise handle investor funds or securities; or (E) engage in such other activities as the Commission, by rule, determines appropriate.''

Although Title III clearly prohibits a funding portal from compensating its employees, agents or other persons for solicitation activities in respect of purchases or sales of the securities being offered in crowdfunding transactions based on "such solicitation or based on the sale of securities displayed or referenced on its website or portal", there is no provision relating to the means by which the funding portal itself may be compensated. We believe the Commission should seek public comment regarding the compensation of funding portals and provide appropriate guidance as to the types of compensation models that may be implemented by a funding portal without triggering a requirement that the funding portal also register as a broker or dealer under the Exchange Act.

In particular, we note that the staff of the Commission has maintained in other contexts that the receipt of so-called "transaction-based compensation" is the hallmark of broker-dealer activity, and that an entity receiving such compensation should normally be registered as a broker or dealer absent an available exemption. In view of this position, several important questions should, in our view, be addressed in the Commission's rulemaking. For example, if a funding portal

were to receive a fee from the issuer that is success-based or that represents a percentage of the amount raised by the issuer in a crowdfunding transaction, would the funding portal be required to register as a broker or dealer under Section 15(a) of the Exchange Act? Is a funding portal entitled to charge only a flat fee that is paid regardless of whether the crowdfunding transaction is ultimately consummated and regardless of the amount that is actually raised in the offering? If the latter limitation is imposed, the cost to the crowdfunding issuer may be too high to risk utilizing the funding portal's services and would appear to defeat the Congressional purpose in establishing this new category of intermediary.

13. The Commission should provide guidance as to what activities may be undertaken by a crowdfunding intermediary that do not constitute "investment advice", as well as with respect to the activities in which a funding portal may engage or not engage without registration as a broker, dealer or investment adviser.

    As noted above, there are significant limitations on the activities in which a crowdfunding intermediary may engage if it is registered solely as a funding portal. We believe the Commission should provide guidance as to those activities in which a funding portal is able to engage without registration as a broker, dealer or investment adviser. In this regard, the proposed rules should provide guidance as to which activities would not constitute "investment advice" as used in Exchange Act Section 3(a)(80), and clarify that the reference to "investment advice" refers to investment advice regarding the securities to be offered in the crowdfunding transaction. In addition, we are concerned that the limitation as to the provision of "investment advice" could be interpreted to prohibit a prospective crowdfunding intermediary that is registered as an investment adviser with the Commission or applicable state regulatory authority from registering as a funding portal under Section 4A, and we therefore request further clarification with respect to this issue as well.

    We also believe the Commission's proposed rules should permit a registered broker-dealer to establish a separate subsidiary or affiliate (including a separate unit, department or division within the broker-dealer itself) that may engage in crowdfunding activities on the same basis as funding portals that are not affiliated with a broker-dealer (*i.e.,* subject to the same requirements and limited obligations applicable to funding portals). The absence of such capability could put registered broker-dealers at a competitive disadvantage relative to funding portals.

14. The Commission, together with FINRA, should consider which rules currently applicable to registered broker-dealers should also be applicable to funding portals and, correspondingly, which rules should not.

    Funding portals exempted from the requirement to register as a broker or dealer pursuant to Section 304(a) of Title III are, among other things, required to become

members of a national securities association registered under Section 15A of the Exchange Act. We are aware that FINRA, as the only such national securities association so registered, is already in discussions with the Commission regarding the registration and regulation of funding portals and has been actively considering which of its rules would apply to registered funding portals as well as to broker-dealers that engage in crowdfunding activities.[18]

We expect to provide detailed comments regarding the application of FINRA's rules to crowdfunding intermediaries once FINRA is further along in its process. However, we note that, at a minimum, such proposed rulemaking should address the application of (or exemption from) rules regarding recordkeeping, privacy, suitability, capital, fidelity bond requirements, personnel licensing requirements, anti-money laundering, reporting, due diligence, continuing education requirements, arbitration and dispute resolution, "know your customer" requirements, the account opening process, standards for communications with the public and the use of material nonpublic information. We believe the provision of more specific comments on these and other rules is premature at the present time, but look forward to submitting them in the future once the Commission and/or FINRA solicits further input.

15. The Commission should clarify that a crowdfunding intermediary will not be required to register as an exchange or alternative trading system.

The activities of a crowdfunding intermediary may be deemed to bring together purchasers and sellers of securities within the meaning of Section 3(a)(1) of the Exchange Act, and, absent further clarification or exemption, could require such intermediary to register with the Commission as an exchange or alternative trading system.

Although Rule 3b-16 under the Exchange Act describes certain activities that fall outside the definition of "exchange", we believe further clarification regarding the parameters of a crowdfunding intermediary's permitted activities in this context is necessary. Without such clarification or exemptive relief, these requirements would likely thwart the intent of Title III.

The Committee appreciates the opportunity to submit these comments. Members of the Committee are available to meet and discuss these matters with the Commission and its staff and

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[18] See FINRA Regulatory Notice 12-34 (July 2012). FINRA's Board of Governors has also recently approved the issuance by FINRA of an interim form that would seek to elicit certain information from prospective funding portals intending to apply for membership with FINRA in accordance with the JOBS Act. See Letter from Richard Ketchum regarding the FINRA Board of Governors Meeting dated December 7, 2012 at http://www.finra.org/Industry/Regulation/Guidance/CommunicationstoFirms/P197425.

to respond to any questions.

Very truly yours,

/s/ Catherine T. Dixon
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