



NASAA

---

**NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, INC.**

750 First Street N.E., Suite 1140

Washington, D.C. 20002

202/737-0900

Fax: 202/783-3571

www.nasaa.org

February 3, 2014

**Via electronic submission to [pubcom@finra.org](mailto:pubcom@finra.org)**

Ms. Marcia E. Asquith  
Senior Vice President and Corporate Secretary  
FINRA  
1735 K Street, NW  
Washington DC 20006-1506

RE: Comments in Response to Regulatory Notice 13-34 Regarding Proposed Funding Portal Rules and Related Forms.

Dear Ms. Asquith:

The North American Securities Administrators Association, Inc. (NASAA) appreciates this opportunity to provide comment in response to your Regulatory Notice 13-34 regarding the proposed regulation of funding portals. Each member of NASAA has a keen interest in the FINRA rules that will govern funding portals because Section 305 of the Jumpstart Our Business Startups Act (“JOBS Act”) preserves the authority of a state securities regulator to conduct examinations and bring enforcement actions with respect to a funding portal whose principal place of business is located within that state. However, the state rules cannot exceed federal requirements, so state regulators are put in the position of enforcing regulations that are essentially promulgated by a third party. Accordingly, we would appreciate your fullest consideration of our comments as you undertake the rulemaking process.

***1. Funding Portals Should be Required to Use the Central Registration Depository.***

The Central Registration Depository (“CRD”) was designed to provide an efficient process for firms and individuals to apply for federal and state licenses in one coordinated filing system. To maximize the effectiveness of the system, FINRA Rule 1010(a) requires a broker-dealer to file all forms through the CRD.

A funding portal may be subject to registration with its home state as well as the Securities and Exchange Commission. To make the registration process as efficient as possible, we urge you to mandate the use of the CRD for the filing of the SEC’s proposed Form Funding Portal and related forms.

---

President: Andrea Seidt (Ohio)  
President-Elect: William Beatty (Washington)  
Past-President: A. Heath Abshire (Arkansas)  
Executive Director: Russel Iuculano

Secretary: Judith Shaw (Maine)  
Treasurer: Melanie Senter Lubin (Maryland)  
Ombudsman: Fred Joseph (Colorado)

Directors: Joe Borg (Alabama)  
Douglas R. Brown (Manitoba)  
Michael Rothman (Minnesota)  
Daphne D. Smith (Tennessee)

## ***2. An Associated Person of a Funding Portal Should be Required to Obtain a License.***

Your request for comment states that the proposed rules do not include licensing requirements for associated persons because “they do not appear necessary in light of the limited activities of funding portals.” On the contrary, funding portals are engaging in the most fundamental aspect of the securities business – being paid to help people buy and sell securities. Any person who represents a funding portal in effecting or attempting to effect the purchase or sale of securities is undertaking essentially the same role as an associated person of a broker-dealer and should, therefore, be subject to similar licensing requirements.

Licensure provides a layer of protection that is important for the customers of a funding portal. Those customers include not only the investors, but also the small issuers who rely upon the services of the funding portal. Licensure ensures that individuals operate in a professional manner and are individually accountable for misconduct.

Even if an associated person may be subject to sanctions under the proposed rules, it appears that complaints, terminations, and other pertinent information about associated persons would not be publicly disclosed. By subjecting associated persons of funding portals to licensure and disclosure obligations similar to those of registered representatives, regulators would be better equipped to police the migration of bad actors from funding portal to funding portal or to other segments of the financial markets.

Under the proposed rules, certain associated persons of a funding portal are given specific responsibilities. For example, proposed Rule 300(a)(1)(B) requires “the designation of a person with authority to carry out the supervisory responsibilities of the funding portal members,” and Rule 300(b)(1)(D) requires the designation of an anti-money laundering compliance person. At a minimum, FINRA should require licensure for any person who is in a position with specific responsibilities under the funding portal rules and should give further consideration to requiring passage of qualification examinations that demonstrate a minimum level of competency to perform the assigned tasks.

## ***3. The Funding Portal Conduct Rule Should be Enhanced to More Closely Align with the Conduct Rules for Broker-Dealers.***

We recognize that not all of the existing conduct rules for broker-dealers are appropriate for the more limited business model of a funding portal. However, your proposal pares back many rules that seem applicable in the crowdfunding context. We urge you to adopt the following rules or their substantial equivalents for funding portals:

- a. Rule 2150: Improper Use of Customers’ Securities or Funds; Prohibition Against Guarantees and Sharing in Accounts. This rule prohibits guaranteeing a customer against losses or sharing in the profits or losses in a customer’s account.
- b. Rule 2210(d)(1): Communications with the Public – Content Standards. This rule requires communications with the public to be truthful. The proposed rule would apply

much of existing Rule 2210(d)(1) to funding portals, but it is not apparent why the proposal fails to include rules that are similar in nature to 2210(d)(1)(C) through (E).

- c. Rule 3220: Influencing or Rewarding Employees of Others. This rule prohibits a FINRA member from paying “gratuities” to non-employees, including persons affiliated with an issuer.
- d. Rule 3240: Borrowing From or Lending To Customers. This rule prohibits borrowing money from or lending to a customer.
- e. Rule 5230: Payments Involving Publications that Influence the Market Price of a Security. This rule prohibits the paid touting of a security to influence its price.
- f. Rule 5110: Corporate Financing Rule – Underwriting Terms and Arrangements. Subsection (c)(1) of this rule prohibits unreasonable underwriting expenses or other terms. Subsection (f)(1) prohibits participation in an offering that is unfair or unreasonable in other respects.

These rules are designed to address conflicts of interest and other practices that have historically led to the abuse of investors by broker-dealers. In fact, FINRA recently published a Report on Conflicts of Interest noting that “conflicts are widespread across the financial services industry.”<sup>1</sup> Investors in crowdfunded securities are susceptible to the same conflict-related abuses, so relevant protections should be extended to the customers of funding portals. The rules described above are relatively clear, easy to follow, and not unduly burdensome, particularly when weighed against the benefits they provide for investors.

#### ***4. Funding Portals Should be Prohibited from Placing Mandatory Pre-dispute Arbitration Agreements in their Customer Agreements.***

While NASAA has no objection to the use of voluntary arbitration clauses in customer agreements, we strongly oppose the imposition of mandatory pre-dispute arbitration agreements (“PDAAs”). In the context of crowdfunding, these agreements are especially troubling because the small investment amounts may diminish an investor’s bargaining power. Moreover, a crowdfunding investor may wish to bring claims against both the funding portal and the issuer, and it appears the investor could be forced to bring the related claims in separate forums if the funding portal uses a PDAA requiring FINRA arbitration.

While NASAA has advocated for reforms to the dispute resolution process involving investors, the fundamental problem remains that individual investors should not be prohibited from choosing the forum in which they can pursue their claims against their investment professionals, even if their claims are small. Investors should be given the option to have the law applied to their claims, pursue full discovery, appeal the decision, have a written decision explaining the outcome, pursue claims in a public venue open to public review, allow the development of the law, and prevent corruption.

---

<sup>1</sup> See <http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p359971.pdf>.

The proposed rules acknowledge the need for streamlined oversight given the limited scope of activity of funding portals, but the proposed arbitration rules do not share that same approach. The very nature and purpose of funding portals and their anticipated customer base would require a greatly simplified and less expensive version of the traditional broker-dealer dispute resolution venue. Requiring these new members and their customers to be subject to the same process does not consider the limited nature of the transaction for either the purchaser or issuer, both of whom are clients of the proposed member.

Many investor claims may be appropriate for class actions, and we support your proposal to prohibit class action waivers because the court system is best suited for these claims. Similarly, though, the small claims process in civil court is well-suited for individual small dollar claims, and customers should have the option to use it instead of an arbitration forum.

For those parties who wish to pursue arbitration, NASAA recommends, the following additional accommodations:

- a. Hearing locations. The existing number of hearing locations may not be sufficient given the envisioned mass appeal of crowdfunding and the potential for investors to be located anywhere in the country, including remote rural areas of large land mass states. The best way to serve aggrieved clients is to enable them to file a complaint in their local county courthouse if they choose.
- b. Fees. The goal of crowdfunding is to attract numerous small dollar investments. The current FINRA Dispute Resolution fee structure is not practical for remedying grievances of such small amounts, and it will discourage investors from pursuing claims at all. Retaining the right to file a grievance in small claims court would be more affordable.
- c. Arbitrator Pool. NASAA supports the recently revised panel approach, which defaults to the All Public Panel, and we recommend the same for the funding portal rules. In addition, the current "industry non-public" arbitrator profile may not be appropriate for this audience. Efforts to recruit representation from the crowdfunding portal industry will be required to make this resource effective for its function on the panel. However, the list of "non-public" arbitrators for funding portals should be kept separate from the list for other types of FINRA arbitrations.

#### ***5. Funding Portals Should be Required to Maintain Books and Records to Demonstrate Compliance with FINRA Rules.***

The SEC has proposed a recordkeeping rule for funding portals in Rule 404 of Regulation Crowdfunding. Those rules will require funding portals to maintain a variety of records for five years, including communications with issuers and investors, records of transactions, and other "records required to demonstrate compliance" with the SEC rules governing funding portals.

We recognize that FINRA will have the ability to enforce the SEC's recordkeeping rules. However, FINRA should adopt its own recordkeeping rule to require, at a minimum, that

funding portals maintain any record that is required to demonstrate compliance with the FINRA Rules.

***6. The Grounds for a Fine Should Include the Failure to Maintain an Adequate Fidelity Bond.***

In existing Rule 9217, a broker-dealer is subject to a fine for failure to maintain adequate fidelity bond coverage. However, in the proposed corresponding rule for funding portals, Rule 900(a)(4), the failure to maintain a fidelity bond is not listed among the grounds for a fine. There is no apparent reason why a funding portal should be treated different than a broker-dealer in this respect. Given that FINRA has not articulated a reason for the omission of this important requirement, we would urge that it be included for funding portals.

**Conclusion**

NASAA supports FINRA's efforts to establish a rational regulatory framework that is workable for funding portals but provides an adequate level of protection for issuers and investors. We believe the comments we have noted above are representative of just such an approach.

If you would like further information or clarification, please contact me or NASAA's General Counsel, Joseph Brady, at (202) 737-0900.

Sincerely,

A handwritten signature in black ink that reads "Andrea Seidt". The signature is written in a cursive, flowing style.

Andrea Seidt  
NASAA President  
Ohio Securities Commissioner