



August 31, 2012

Ms. Marsha E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC, 20006-1506

VIA EMAIL TO pubcom@finra.org

Dear Ms. Asquith:

The National Crowdfunding Association (NLCFA) appreciates the opportunity to provide comments in response to FINRA Regulatory Notice 12-34 which seeks public comment on the appropriate scope of FINRA rules that should apply to funding portals and member firms engaging in crowdfunding activities, either as funding portals or as brokers.

The NLCFA is a trade organization that works for the betterment of crowdfunding as an industry and for the benefit of our members and other industry constituents. The NLCFA is currently working with regulators, operating funding portals, newly formed crowdfunding firms and existing FINRA members to find ways to assist in the further development of the crowdfunding industry.

The NLCFA understands the importance of a balanced regulatory approach and response to assuring the long term health of this industry, and we therefore value the ability to submit these comments. We have attempted to restrict our comments in this letter to issues related to crowdfunding that pertain to FINRA and FINRA members as you have requested in Regulatory Notice 12-34. We have also kept in mind the spirit of the JOBS Act which is to open the capital markets to the entrepreneurial business owner. While we are acutely attuned to the needs of crowdfunding portals you should also be aware that the NLCFA also has members that are registered with FINRA. Therefore the NLCFA offers the following comments:

Comments pertaining to the registration of Funding Portals

1. Registration: We believe that FINRA is the correct regulator to oversee crowdfunding business. Therefore, it is appropriate for FINRA to apply certain regulations to funding portals. In order to achieve this goal it will be important for FINRA to amend Article III of the FINRA Bylaws, Qualifications of Members and Associated Persons to include crowdfunding funding portals for crowdfunding purposes as an eligible firm for membership. We understand that crowdfunding has unique characteristics that are not prevalent in other businesses that FINRA regulates. We urge FINRA to create separate departments to deal with crowdfunding issues. These departments should be responsible for registrations, examinations, and should work hand-in-hand with the District offices of FINRA to make sure that the field personnel understand the nuances of the crowdfunding business. Without separate departments to handle crowdfunding issues specifically we would be concerned that the current regulatory and examination staff would be forced to handle matters that they would not be qualified to deal with.
 - a. Firm registration: A new category of firm registration should be created for crowdfunding portals. It will be important that in the future, investors be able to establish the difference between a crowdfunding portal and a crowdfunding portal that is also registered with FINRA. With the advent of new regulations investors must know that there will be a higher standard of accountability in a crowdfunding portal that is FINRA registered. We propose that a new line of business (Crowdfunding) be included on FORM BD in Item #12. We also suggest that new crowdfunding portals that become FINRA members and only operate as crowdfunding portals be identified as Crowdfunding Broker Dealers (CFBD). This will help to make a distinction between a crowdfunding member firm and all other FINRA member firms. We do not think that the current application fees that were recently put into effect by FINRA which covers all new FINRA applications is realistic. We urge FINRA to come up with a discounted membership rate for these new crowdfunding members.
 - b. Individual registration: Individuals that are employed by crowdfunding portals and employed by FINRA registered CFBDs will (by regulation) not be able to “sell” transactions, will not be able to give investment advice and cannot take in or handle cash or securities. The vast majority of transactions will occur online without any personal intervention. We do not believe that persons that are employed by a crowdfunding portal and

have no customer interaction should be required to be registered. However, we believe that persons that manage and run the day-to-day operations of a CFBD should have some sort of principal registration. We recommend that principals and managers of CFBDs be licensed as registered representatives and as principals. Certainly anyone that has a Series 7 and a Series 24 would meet these requirements. We suggest that FINRA develop a registration and qualification examination that is crowdfunding specific. Alternatively and in the near term we suggest that in lieu of a Series 7 FINRA also accept the Series 22 (Direct Participation Program), Series 62 (Corporate Securities Limited), Series 79 (Limited Representative, Investment Banking), or the Series 82 (Limited Representative Private Securities Offerings). Any person that has one of the previously mentioned licenses prior to the establishment of the crowdfunding license should then be grandfathered in and therefore not have to take any additional qualifying examinations. Likewise, any person that will supervise crowdfunding business at a CFBD should also be a registered principal. The reason to have a registered principal at a CFBD is to make sure that the managers of the CFBDs understand their supervisory and regulatory obligations as principals. Certainly anyone who has the Series 24 would qualify as a principal. We suggest that FINRA develop a registration and qualification examination for principals that are crowdfunding specific. Until that time then we urge FINRA to also accept as principal licenses the Series 10 (General Sales Supervisor), Series 14 (NYSE – CO) and the Series 23 (General Securities Principal Sales Module). Any person that has one of the previously mentioned principal licenses prior to the establishment of the crowdfunding principal license should then be grandfathered in and therefore not have to take any additional qualifying examinations.

2. Responsibilities of FINRA: We believe that FINRA should have (at a minimum) the following responsibilities;
 - a. Be the primary SRO for all crowdfunding portals that intends to offer any type of security using crowdfunding methods.
 - b. Perform the examination functions on FINRA member CFBD firms.
 - c. Hire and train the needed staff to administer the regulatory duties of a new CFBD department.

- d. Review of FOCUS reports (as amended for CFBD use).
 - e. Since a new member classification is suggested then we also suggest that the Bylaws of FINRA be amended to allow a crowdfunding member a place on the FINRA Board (this should be a new seat and not a reallocation of an existing Small Firm seat) and a spot on the National Adjudication Board.
3. The New Member Application Process:
- a. FINRA should design a New Member Application Process (NMA) that is relevant to the crowdfunding business. This should be a scaled down version of the current NMA process. We believe that new crowdfunding members should be required to qualify for membership by conforming to the 14 standards of membership as delineated in NASD Rule 1014.
 - b. We believe that the Membership Application Program Department (MAP) in New York should create a separate department specifically to deal with new crowdfunding members and other related issues. Assigning crowdfunding related issues to a department that is specially trained to deal with crowdfunding members is a move that will make FINRA more efficient and will (hopefully) prevent a potential bottleneck from forming as an inevitable surge for membership is realized.
4. Other relevant issues:
- a. Written Supervisory Procedures (WSP) – We believe that each CFBD should be required to have a WSP that is crowdfunding specific. This WSP should detail (at a minimum) how transactions are posted to the firm’s website, define the due diligence process, describe how customers make investments and clearly define the fact that a CFBD cannot take in funds or securities, define which employees at the CFBD would need registration with FINRA, define the supervisory roles at the CFBD, define the process of handling customer complaints, define the use and review of advertising, define how customer information will be protected, and define an annual review process to be taken by the CFBD to measure how compliant the firm is with current regulations and try to identify inherent operational, compliance, and management risks at the firm. Having a separate WSP in place will prevent a new CFBD from having to review hundreds of existing FINRA rules and regulations to try to determine what

might be applicable to them. We suggest that FINRA create a template for the initial WSP to be used by new potential CFBD members. Additionally we also suggest that existing FINRA BDs that want to be active in crowdfunding also use the same template as a separate chapter of their existing WSP. It is important that all FINRA members, new and old, follow the same rules and regulations. Having a WSP that is crowdfunding specific will assure that this goal is met.

- b. Recordkeeping Requirements – We suggest that all CFBDs be required to keep all relevant records that relate to issuers, customers, investors, transactions, and employees as delineated in FINRA Rules 4511 through to 4515. We also suggest that CFBDs be required to adhere to the record keeping requirements of SEA Rules 17a-3 and 17a-4 specifically regarding the retention of electronic communications.
- c. Net Capital Requirements – The NLCFA urges FINRA to consider a minimum net capital requirement pursuant to SEA Rule 15c3-1 of \$5,000. We also urge FINRA to work with the SEC to expand SEA Rule 15c2-4(b) (2) which covers the use of escrow accounts by member firms. This is important since all crowdfunding transactions will have a contingency to be met prior to closing. But the NLCFA urges a relaxation of the definition of an escrow agent for crowdfunding purposes. We believe that the use of escrow agents that are not necessarily members of the Federal Reserve be approved specifically for crowdfunding transactions.
- d. SIPC membership – Since CFBDs will not hold assets, we do not believe that investors will benefit from SIPC coverage. Therefore we do not believe that CFBDs should be required to become members of SIPC.
- e. Customer disclosures – Because investors will be investing in a newly created security we suggest that FINRA come up with guidance that can be distributed to new clients of CFBDs. The purposes of these disclosures are to alert customers to the risks associated with a crowdfunding type of security. Hopefully these disclosures will assist in the prevention of fraud. These disclosures should include items such as;
 - i. An investment in company that is funded by crowdfunding may have little or no operating history to pass judgment on.

- ii. Securities purchased via crowdfunding must be held for a minimum of 12 months before they can be transferred or sold.
 - iii. The securities issued through the crowdfunding process are normally illiquid and normally do not have a secondary market.
 - iv. Once purchased you and your broker may not be able to determine the value of the security (with this in mind we seek guidance on whether or how crowdfunding transactions could be held in self directed ERISA accounts such as IRA, SEP, or other similar accounts).
- 5. Review of Websites – We believe that a supervisory review of crowdfunding websites should be established. This review should take place at the principal level of the CFBD and should ultimately be reviewed on a periodic basis by FINRA to look for inflammatory statements and other items that could be considered violations of advertising regulations that will be in place under the new FINRA Rule 2210.
- 6. Principal approval of crowdfunding transactions – We suggest that each issuer originated transaction be approved by a Principal of the CFBD prior to being offered to the public. The principal should review each transaction for compliance with appropriate SEC and FINRA rules and regulations and review for economic feasibility, completeness of due diligence, a review of background investigation of the principals and officers of the company, and a review of the sales materials to be used. The purpose of this principal review will be to assure investors and regulators that each transaction has been reviewed by senior officers at the CFBD prior to being offered. This is no different than what current FINRA members must adhere to today.
- 7. Continuing Education –
 - a. Regulatory Element – We believe that CE is an important aspect of training and gaining industry knowledge. We believe that all registered employees of a CFBD should be required to partake in regulatory element training. The regulatory element program should focus on the new rules and regulations that each CFBD will be required to follow. Overtime, a training program for principals of CFBDs should also be developed to make sure that each principal understands his role within his CFBD and his relationship with FINRA. These training programs should be

developed with current crowdfunding trade organizations (including but not limited to the NLCFA) and the The Securities Industry/Regulatory Council on Continuing Education. We do not, however, believe that registered persons employed by CFBD should be required to take the current Series 101 or Series 201 Continuing Education program currently required by FINRA.

- b. Firm Element – A requirement for firm element continuing education should be required for each CFBD and should be offered to all non-registered employees. This program could be designed and developed internally by each firm or an outside vendor could be used to provide a computer based program as so many FINRA member firms do today.
8. Anti-money Laundering – CFBDs will have a different relationship with their customers as compared to other BDs. Their role is clearly defined in the JOBS Act: They will be intermediaries between the issuer and the investor, they will not be able to hold funds or securities, they will not actually have a traditional established account that most self clearing or fully disclosed FINRA members have today. A CFBD will have the same relationship with its customer that a non-custodial RIA has with its customers (except for the fiduciary role that the RIA plays). Therefore, it may not be equitable to hold a CFBD to the same AML standards that other BDs are required to adhere to. We do, however, advocate that at a minimum an OFAC check be done on each client account. We also believe that each CFBD will have to perform a more complete AML check on issuers which will include more than a minimum verification with OFAC.
9. Customer Information Program (CIP) – We understand the importance of collecting personal non-public information to allow any FINRA member to be able to perform background due diligence on customers and assess suitability of investments for purchase. In the case of crowdfunding suitability is primarily based upon income, and then the statute dictates the customer’s maximum annual investment level. Suitability is primarily in the customers hands and takes on the role of “do your own homework.” Therefore we urge FINRA to amend its CIP requirement for CFBDs to reflect this requirement.
 - a. Measuring Income versus total crowdfunding investment – The JOBS Act puts a requirement on CFBDs to take a measure of a customer’s annual income of non-accredited investors versus the total amount of crowdfunding investment made within a year. This measure of annual crowdfunding investment also includes looking at investments made at

other crowdfunding portals. We are concerned that customers may fraudulently not list all previous crowdfunding investments made in order to be able to invest in a transaction that is appealing to them when they may have already invested their legal annual amount. We are also concerned that unsavory crowdfunding sales employees may omit such information just to be able to close a sale. To combat this potential for fraud we urge the formation of a database that would collect information on what specific dollar amounts of crowdfunding investments may have been made by that customer. There have been many discussions over the past months regarding the use of a centralized database to meet this requirement, and we believe that the use of a database makes the most sense of this time. At the NLCFA we have discussed several proposed structures that we would be glad to discuss with FINRA in detail in order to come up with a viable solution to meet this requirement of the statute.

10. Due Diligence – Most previous commenters are concerned about fraud as it relates to due diligence of issuers. We urge FINRA to work with the industry to design and enforce the use of a standard template that all firms would (at a minimum) be required to use. Additional due diligence could then be collected if the CFBD believes that additional information is required. A standard formatted due diligence form would also make it easier for any investor to make comparisons between issuers. We believe that maintaining a minimum due diligence standard makes sense and will help to reduce the potential for fraud. Therefore we suggest that a minimum due diligence standard be defined by FINRA. As long as these minimum due diligence requirements are met then the CFBD would be released from any liability that may arise because of due diligence issues. Likewise, if a CFBD were to discover fraudulent or deceptive due diligence we believe that this should be reported to FINRA. We urge FINRA to create a designated list of firms that presented fraudulent due diligence to any CFBD member. This list should be made available to, and required use by all CFBDs. In an effort to make sure that scheming issuers cannot go to other CFBDs to try to get their transaction done we also suggest that each crowdfunding transaction be mutually exclusive to the originating CFBD. We do not agree with other commenter's opinions that each CFBD be required to obtain a fairness opinion from a FINRA member to pass judgment on the due diligence and the structure of the transaction. We believe that, as previously suggested, if each transaction is approved by a principal of a CFBD, then that principal actually has an obligation to review issuer information to make sure that the due diligence is complete and that the transaction has been constructed with economic viability in mind. We are concerned that requiring a fairness opinion of

some sort would 1) increase the overall cost of the transaction to the issuer, and 2) create the potential for unqualified FINRA members issuing fairness opinions just to earn a fee.

11. Use of CUSIP Numbers – We urge FINRA to require each crowdfunding transaction to obtain a CUSIP number. In doing this, the basic information regarding each issuer would then be made available to investors, FINRA members, and regulators alike. This will help create one point in the industry where information regarding crowdfunding transactions will be centered.
12. Solicitation – We urge a clearer definition of solicitation from FINRA. We do not believe that the mere posting of a transaction on a portal would constitute a solicitation. Nor do we believe that the curation process (or listing of crowdfunding transactions by most popular or widely funded) would also be considered a solicitation.

Within the discussion of solicitation we also need clarity from FINRA regarding when a solicitation occurs and when a transaction closes from the perspective of Blue Sky registrations. Even though there are discussions within the statute that discuss when state registration would be required (50% of domiciled investment) we are not sure if the implication is at the point of pledging or receiving an indication of interest for the transaction, or at the close of the transaction, or if it is meant to cover 50% of the dollars invested or 50% of the total subscribers in the transaction. We believe that additional clarification is needed from FINRA as to exactly when a CFBD would be required to meet the requirement of state registration.

Application of Crowdfunding activities to existing FINRA members

The NLCFA believes that existing FINRA members be allowed to participate in crowdfunding transactions. This needs to be clearly defined by FINRA. The following are comments that pertain to existing FINRA membership:

1. Crowdfunding business line needs to be approved – In the same fashion that FINRA will require a NMA from new CFBDs and show that they are able to supervise crowdfunding activities and have supervisory policies and procedures in place, so should existing member also meet that requirement. This means that each existing FINRA member that wants to participate in crowdfunding activities open a Continuing Membership Application (CMA) with the MAP. This will include checking the box for the new business line on FORM BD and

submitting the request supervisory procedures. We suggest that rather than having a separate WSP for crowdfunding that existing members create an additional chapter covering crowdfunding activities and supervision in their existing WSPs. We do not believe that the current proposed fee schedule that was recently published by FINRA apply to a CMA seeking crowdfunding approval. The NLCFA believes that a reduced fee be applied to crowdfunding CMAs.

If an existing BD seeks to be approved for crowdfunding as an approved business line then that BD should keep all books and records separate from its traditional business in a separate crowdfunding department. In doing this it will make it easier for firms and regulators to be able to identify which transactions and revenues are crowdfunding related.

2. Syndicate crowdfunding business – There may be certain instances when the customer of an existing BD would want to participate in a crowdfunding transaction and would direct his current BD to act as the broker for the transaction. In this case we believe that the CFBD should be able to share fees with the existing CFBD without having to apply for a CMA to allow crowdfunding as a line of business. We also believe that the existing BD should be able to rely on the due diligence performed by the CFBD that originated the transaction. This way, existing customers of FINRA member firms that may want to participate in a crowdfunding transaction will be able to do so without having to establish a new relationship with a CFBD. Furthermore, it should give comfort to FINRA that the crowdfunding transaction is being transacted by a firm that is familiar with the crowdfunding process and the requirements.
3. Recommendations from existing BDs – While current BDs are in the business of making investment recommendations and giving advice, they cannot extend that service to crowdfunding transactions in order to stay compliant with the JOBS Act. Therefore each existing FINRA member firm that seeks approval for crowdfunding as a business line will need to assure FINRA that they have provisions in place to supervise and assure that no advice or recommendations relating to the crowdfunding transaction(s) were given. FINRA needs to be clear as to if an existing FINRA member firm engages in crowdfunding activities what, if any, dilution exists in the current FINRA member's responsibility to its existing clients as compared to the relationship that would exist with new crowdfunding clients.

We would be glad to further discuss any of these issues. Please do not hesitate to contact Howard Landers directly at 786-375-5644 ext 101 if you have any questions regarding the items addressed in this letter.

Respectfully submitted,

THE NATIONAL CROWDFUNDING ASSOCIATION

/s/ Howard Landers, Director of Regulatory Affairs

/s/ David Marlett, Executive Director