

Jumpstart Our Business Startups Act

FINRA Requests Comment on Proposed Regulation of Crowdfunding Activities

Comment Period Expires: August 31, 2012

Executive Summary

The Jumpstart Our Business Startups Act (JOBS Act)¹—a new law aimed at increasing American job creation and economic growth—contains key provisions relating to securities offered or sold through “crowdfunding.”² Under the new law, intermediaries performing crowdfunding on behalf of issuers must register with the Securities and Exchange Commission (SEC) as a “funding portal” or broker and must register with an applicable self-regulatory organization (SRO). FINRA is soliciting public comment on the appropriate scope of FINRA rules that should apply to member firms engaging in crowdfunding activities, either as funding portals or as brokers.

Questions regarding this *Notice* should be directed to:

- ▶ Gary L. Goldsholle, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8104; or
- ▶ Adam H. Arkel, Associate General Counsel, OGC, at (202) 728-6961.

July 2012

Notice Type

- ▶ Request for Comment

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Senior Management

Key Topics

- ▶ Crowdfunding
- ▶ Funding Portals
- ▶ JOBS Act

Referenced Rules & Notices

- ▶ NTM 03-73

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by August 31, 2012.

Member firms and other interested parties can submit their comments using the following methods:

- ▶ Emailing comments to pubcom@finra.org; or
- ▶ Mailing comments in hard copy to:
Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

To help FINRA process and review comments more efficiently, persons should use only one method to comment on the proposal.

Important Notes: The only comments that FINRA will consider are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the FINRA website. Generally, FINRA will post comments as they are received.³

Before becoming effective, a proposed rule change must be authorized for filing with the SEC by the FINRA Board of Governors, and then must be filed with the SEC pursuant to Section 19(b) of the Securities Exchange Act of 1934 (SEA).⁴

Background & Discussion

The crowdfunding provisions of the JOBS Act provide an exemption from registration under the Securities Act of 1933 (Securities Act) for securities offered by issuers in amounts of up to \$1 million over a 12-month period provided that the amount raised from any single investor adheres to strict limits (ranging from \$2,000 to \$100,000) based on the investor's annual income or net worth.⁵ The crowdfunding exemption establishes specific eligibility and sales practice standards for issuers and intermediaries that engage in crowdfunding.⁶ Intermediaries that seek to engage in crowdfunding must be registered as a broker or a funding portal, a newly created entity.

The regulatory scheme established by Congress expressly contemplates a role for an organization such as FINRA by mandating that each registered funding portal be a member of an applicable SRO.⁷ However, Congress limited a national securities association's examination and enforcement authority over such registered funding portals to its rules "written specifically for registered funding portals."⁸

Registered Funding Portal Rules

While the scope of any FINRA rules written specifically for registered funding portals will be influenced by, and should not be duplicative of, any crowdfunding rules adopted by the SEC, we have had conversations with SEC staff suggesting that FINRA should consider adopting its own crowdfunding rules. To assist in developing its crowdfunding rules, FINRA solicits comment on the specific rules that FINRA should adopt for registered funding portals that become FINRA members.

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 encouraged 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.⁹ Comments are particularly requested about possible rules concerning supervision, advertising, anti-money laundering, fraud and manipulation, and just and equitable principles of trade.

Application of FINRA Rules to Crowdfunding Activities by Broker-Dealers

FINRA also solicits comment on the application of existing FINRA rules to crowdfunding activities of *broker-dealers*. Unlike the rules applicable to *registered funding portals*, the JOBS Act does not limit the FINRA rules applicable to registered broker-dealers engaging in crowdfunding activities. Nevertheless, FINRA invites comments from broker-dealers regarding the application of existing FINRA rules to broker-dealers' crowdfunding activities and whether such rules should be relaxed to address a broker-dealer's crowdfunding activities, taking into account, among other things, the extent to which a broker-dealer may be able to isolate its crowdfunding business, or otherwise places limitations on its activities akin to those for registered funding portals. FINRA requests information from broker-dealers that may engage in crowdfunding concerning the organizational structure through which this activity would occur within the firm (*e.g.*, through the broker-dealer entity or a separately identified department). FINRA also requests comment on whether engaging in crowdfunding might present special conflicts or concerns for a broker-dealer, such as might arise if a registered representative were to recommend that a customer visit the firm's crowdfunding site.

Endnotes

1. Pub. L. No. 112-106, 126 Stat. 306 (2012).
2. See Title III of the JOBS Act. Crowdfunding generally refers to the use of the Internet by small businesses to raise capital through limited investments from a large number of investors.
3. FINRA will not edit personal identifying information, such as names or email addresses, from submissions. Persons should submit only information that they wish to make publicly available. See [NTM 03-73](#) (November 2003) (NASD Announces Online Availability of Comments) for more information.
4. See SEA Section 19 and rules thereunder. After a proposed rule change is filed with the SEC, the proposed rule change generally is published for public comment in the *Federal Register*. Certain limited types of proposed rule changes, however, take effect upon filing with the SEC. See SEA Section 19(b)(3) and SEA Rule 19b-4.
5. Specifically, an issuer relying on the crowdfunding exemption created by the JOBS Act may not raise from an investor an aggregate amount that exceeds: (i) the greater of \$2,000 or 5 percent of the investor's annual income or net worth (for investors whose annual income or net worth is less than \$100,000); or (ii) 10 percent of the investor's annual income or net worth, not to exceed \$100,000 (for investors whose annual income or net worth is \$100,000 or more). See Securities Act Section 4(6). These aggregate amounts limit an investor's total crowdfunding purchases from all issuers in a 12-month period.
6. See generally Securities Act Section 4A and SEA Section 3(a)(80).
7. See SEA Section 4A(a)(2). The term "self-regulatory organization" is defined under SEA Section 3(a)(26) to include a registered securities association (e.g., FINRA). SEA Section 3(h)(2) provides in part that for purposes of SEA Section 15(b)(8) the term "broker or dealer" includes a funding portal and the term "registered broker or dealer" includes a registered funding portal. SEA Section 15(b)(8) generally requires a broker or dealer to be a member of a registered securities association.
8. See SEA Section 3(h)(2).
9. For example, among other things, a funding portal may not: offer investment advice or recommendations; solicit purchases, sales, or offers to buy the securities offered or displayed on its website or portal; compensate employees, agents or other persons for such solicitation or sales; or hold, manage, possess or otherwise handle customer funds or securities. See SEA Section 3(a)(80).