

Regulatory Notice

13-34

Jumpstart Our Business Startups (JOBS) Act

FINRA Requests Comment on Proposed Funding Portal Rules and Related Forms

Comment Period Expires: February 3, 2014

Executive Summary

FINRA is soliciting public comment on a set of proposed rules—referred to as the Funding Portal Rules—and related forms for SEC-registered funding portals¹ that become FINRA members pursuant to the crowdfunding provisions of the JOBS Act.²

The text of the proposed rules is available in [Attachment A](#) and the related forms are available as [Attachments B through E](#).

Questions regarding this *Notice* should be directed to:

- ▶ Patricia Albrecht, Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8026; or
- ▶ Adam Arkel, Associate General Counsel, OGC, at (202) 728-6961.

Action Requested

FINRA encourages all interested parties to comment on the proposal. Comments must be received by February 3, 2014.

Comments must be submitted through one of 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

October 2013

Notice Type

- ▶ Request for Comment

Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Senior Management

Key Topics

- ▶ Crowdfunding
- ▶ Funding Portals
- ▶ JOBS Act

Referenced Rules & Notices

- ▶ FINRA By-Laws
- ▶ FINRA Rule 2010
- ▶ FINRA Rule 2020
- ▶ FINRA Rule 2210
- ▶ FINRA Rule 2268
- ▶ FINRA Rule 3310
- ▶ FINRA Rule 4360
- ▶ FINRA Rule 4530
- ▶ FINRA Rule 8000 Series
- ▶ FINRA Rule 8312
- ▶ FINRA Rule 9000 Series
- ▶ FINRA Rule 9520
- ▶ FINRA Rule 12000 Series
- ▶ FINRA Rule 13000 Series
- ▶ FINRA Rule 14000 Series
- ▶ NASD Rule 1010 Series
- ▶ NASD Rule 1160
- ▶ NASD Rule 3010
- ▶ NTM 03-73
- ▶ Regulatory Notice 12-34



Financial Industry Regulatory Authority

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

Important Notes: All comments received in response to this *Notice* will be made available to the public on the FINRA website. In general, 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 SEA Section 19(b).⁴

Background & Discussion

The JOBS Act, enacted in 2012 with the goal of increasing American job creation and economic growth, contains key provisions relating to securities offered or sold through “crowdfunding.”⁵ Funding portals that engage in crowdfunding on behalf of issuers relying on the JOBS Act’s “crowdfunding exemption”⁶ must register with the SEC and become a member of a national securities association.⁷ The JOBS Act prohibits funding portals from a variety of activities, including offering investment advice or recommendations, soliciting transactions for securities displayed on their websites, compensating employees for securities solicitations, and holding investor funds or securities.

FINRA is proposing rules and related forms for funding portals. This proposal, which reflects the rules recently proposed by the SEC, would implement in our rules the provisions of the JOBS Act. FINRA has streamlined the proposed rules to the extent possible to reflect the limited scope of activity permitted by funding portals while also maintaining investor protection.

In developing the proposed rules, FINRA has considered the comments that we received in response to [Regulatory Notice 12-34](#) (FINRA Requests Comment on Proposed Regulation of Crowdfunding Activities). In January, FINRA made available on its website the [Interim Form for Funding Portals](#) (IFFP), an online form for intermediaries that intend to apply for membership with FINRA as funding portals. Prospective funding portal members were invited, on a voluntary basis, to submit information to FINRA using the IFFP and thereby help to inform FINRA’s rulemaking process.⁸

The proposed Funding Portal Rules consist of a set of seven rules—Funding Portal Rules 100, 110, 200, 300, 800, 900 and 1200⁹—and related forms. Following are highlights of the proposed requirements.

General Standards (Funding Portal Rule 100)

Proposed Funding Portal Rule 100 provides that all funding portal members (*i.e.*, including both funding portals and their associated persons) shall be subject to the FINRA By-Laws, unless the context requires otherwise, and the Funding Portal Rules. The rule further sets forth basic definitions modified as appropriate to apply to funding portal members.

Funding Portal Application (Funding Portal Rule 110, Form FP-NMA, Form FP-CMA and FP-SD Schedule)

Proposed Funding Portal Rule 110(a) sets forth the membership application process (MAP) for funding portals. The membership application process will enable FINRA to assess whether funding portals are capable of complying with applicable regulations. The rule is based on the current NASD Rule 1010 Series membership rules that apply to broker-dealers. However, the process for funding portals is simplified to reflect the limited nature of their business.

Proposed Funding Portal Rule 110(a) thus would tailor the NASD Rule 1010 Series by:

- ▶ shortening the time frames for key events. For instance, the time frame for the Department of Member Regulation (Department) to provide a decision on a funding portal MAP application is 60 days after the application is filed (as opposed to 180 days in the broker-dealer MAP rules);
- ▶ streamlining and consolidating, from 14 to five, the NASD Rule 1010 Series standards for granting or denying an application. These five consolidated standards address a funding portal's: (1) ability to comply with applicable federal securities laws, rules and regulations and FINRA's Funding Portal Rules; (2) contractual or other arrangements and business relationships necessary to initiate operations; (3) supervisory system; (4) direct and indirect funding sources; and (5) recordkeeping system;
- ▶ providing that the membership interview may be conducted by video conference (or such other means as FINRA may specify);
- ▶ streamlining the process for appealing the Department's decision by reducing applicable filing and response time frames from 25 days for broker-dealers to 14 days and eliminating provisions providing for an appellate hearing; and
- ▶ narrowing the changes in ownership or control for which a funding portal member would be required to apply for approval.

Funding portals will apply for membership using proposed Form FP-NMA¹⁰ and for changes in ownership and control using Form FP-CMA.¹¹ They will submit statutory disqualification information using the FP-SD Schedule.¹² The Form FP-NMA and Form FP-CMA require significantly less information than the broker-dealer counterpart forms, consistent with the limited scope of business to be conducted by funding portals.¹³

Proposed Funding Portal Rule 110(b) sets forth a streamlined version of FINRA Rule 4360 (Fidelity Bonds) and requires funding portal members to maintain fidelity bond coverage. The rule addresses among other things the minimum required coverage, deductible provision and notification of cancellation, termination or substantial modification of coverage.

Funding Portal Conduct (Funding Portal Rule 200)

Based in large part on FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade), proposed Funding Portal Rule 200(a) requires a funding portal member, in the conduct of its business, to observe high standards of commercial honor and just and equitable principles of trade.

Proposed Funding Portal Rule 200(b), based in large part on FINRA Rule 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices), prohibits a funding portal member from effecting any transaction in, or inducing the purchase or sale of, any security by means of, or by aiding or abetting,¹⁴ any manipulative, deceptive or other fraudulent device or contrivance.

Proposed Funding Portal Rule 200(c) is an abbreviated version of FINRA Rule 2210 (Communications with the Public), essentially prohibiting false and misleading statements.

Funding Portal Compliance (Funding Portal Rule 300)

A funding portal member is required under proposed Funding Portal Rule 300(a) to establish and maintain a system to supervise the activities of each associated person of the funding portal member that is reasonably designed to achieve compliance with applicable securities laws and regulations and with the Funding Portal Rules. The rule is a streamlined version of current NASD Rule 3010 (Supervision) and is designed to permit funding portal members flexibility to tailor their supervisory systems to their business models.

Proposed Funding Portal Rule 300(b) requires each funding portal member to implement a written anti-money laundering (AML) program. This is consistent with the SEC's proposed requirements and Chapter X of Title 31 of the Code of Federal Regulations.¹⁵ Accordingly, the proposed rule is similar to current FINRA Rule 3310 (Anti-Money Laundering Compliance Program); however, the proposed rule contemplates that all funding portals will be eligible to conduct the required independent testing for compliance every two years.

Proposed Funding Portal Rule 300(c) requires funding portal members to report to FINRA (and the obligations of such members' associated persons to report to the member) regulatory proceedings, disciplinary and other events. The rule is largely based on current FINRA Rule 4530 (Reporting Requirements). Funding portal members would use the Funding Portal Rule 300(c) Form for their reporting requirements pursuant to the rule.¹⁶

Based in large part on current NASD Rule 1160 (Contact Information Requirements), proposed Funding Portal Rule 300(d) requires funding portal members to report to FINRA all contact information required by FINRA through such means as FINRA may specify and to promptly update their required contact information.

Investigations and Sanctions (Funding Portal Rule 800)

Under proposed Funding Portal Rule 800(a), funding portal members will be subject to the FINRA Rule 8000 Series (Investigations and Sanctions), unless the context requires otherwise. Paragraph (b) of the proposed rule includes a streamlined version of FINRA Rule 8312 (FINRA BrokerCheck Disclosure). The rule provides that FINRA shall make available to the public information filed by a funding portal member that is currently or was previously registered with FINRA, and that, except as otherwise provided by the rule, FINRA shall make available any information reported on the funding portal's most recently filed SEC registration forms. Further, under the rule, FINRA shall make available information filed by a funding portal member indicating whether the funding portal member or any associated person of the funding portal member is subject to a statutory disqualification.

Code of Procedure (Funding Portal Rule 900)

Under proposed Funding Portal Rule 900(a), funding portal members will be subject to the FINRA Rule 9000 Series (Code of Procedure), unless the context requires otherwise. Paragraph (b) of the proposed rule includes a streamlined version of the current FINRA Rule 9520 Series (Eligibility Proceedings) and sets forth the procedures for a person to become or remain associated with a funding portal member notwithstanding the existence of a statutory disqualification, and for a funding portal member or person associated with a funding portal member to obtain relief from the eligibility or qualification requirements of the FINRA By-Laws or Funding Portal Rules.

Arbitration and Mediation (Funding Portal Rule 1200)

Under proposed Funding Portal Rule 1200(a), funding portal members will be subject to the FINRA Rule 12000 Series (Code of Arbitration Procedure for Customer Disputes), FINRA Rule 13000 Series (Code of Arbitration Procedure for Industry Disputes) and FINRA Rule 14000 Series (Code of Mediation Procedure), unless the context requires otherwise. Paragraph (b) of the proposed rule addresses the use by funding portal members of predispute arbitration agreements for investor accounts. The rule is a streamlined version of current FINRA Rule 2268 (Requirements When Using Predispute Arbitration Agreements for Customer Agreements).

Request for Comment

FINRA requests comment on all aspects of the proposed rules and related forms, including any potential costs and burdens that the proposal could impose on funding portals. FINRA particularly requests comment concerning the following issues:

- ▶ Do the proposed rules appropriately accommodate the scope of funding portal business as provided by the JOBS Act? If not, what other accommodations are appropriate and why?
- ▶ Do the proposed rules provide sufficient protections to investors who might use funding portals? If not, what additional protections are warranted and why?
- ▶ Is there any segment of the funding portal industry for which the rules will be more burdensome? Are these additional burdens justified by the business engaged in by these funding portals?
- ▶ The proposed rules do not impose licensing requirements on associated persons of funding portal members, as they do not appear necessary in light of the limited activities of funding portals. Should there be licensing requirements for associated persons of funding portals? Why or why not?
- ▶ What costs will be associated with the fidelity bond coverage required by proposed Funding Portal Rule 110(b)? Are there financial responsibility or net capital requirements that FINRA should adopt in addition to or in lieu of a fidelity bond requirement? Why or why not?
- ▶ As discussed earlier, proposed Funding Portal Rule 300(a) requires funding portal members to establish and maintain supervisory systems. Are there specific supervisory requirements that FINRA should adopt? Why or why not? What potential costs do prospective funding portal members expect in developing and implementing supervisory systems? Similarly, what costs do prospective funding portal members expect would be imposed by compliance with the proposed requirements to:
 - ▶ develop and implement a written anti-money laundering program as specified under proposed Funding Portal Rule 300(b); and
 - ▶ promptly report to FINRA the regulatory proceedings, disciplinary and other events as set forth under proposed Funding Portal Rule 300(c)?

FINRA requests that commenters provide empirical data or other factual support for their comments wherever possible.

Endnotes

1. The term “funding portal” is defined under Section 3(a)(80) of the Securities Exchange Act of 1934 (SEA), as revised by the JOBS Act. See Pub. L. No. 112-106, 126 Stat. 306 (2012). The SEC has separately proposed rules to implement the provisions of the JOBS Act governing funding portals. Exchange Act Release No. 70741 (October 23, 2013).
2. See Title III of the JOBS Act.
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. Crowdfunding generally refers to the use of the Internet by small businesses to raise capital through limited investments from a large number of investors.
6. See Section 4(a)(6) of the Securities Act of 1933, as amended by the JOBS Act.
7. The SEC’s proposed Rule 400(a) under Regulation Crowdfunding requires in part that a funding portal must register with the Commission and become a member of FINRA or any other applicable national securities association registered under SEA Section 15A. FINRA is the only registered national securities association.
8. See Exchange Act Release No. 68633 (January 11, 2013), 78 FR 4186 (January 18, 2013) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change; File No. SR-FINRA-2013-005).
9. The text of the proposed rules is set forth in [Attachment A](#).
10. See [Attachment B](#).
11. See [Attachment C](#).
12. See [Attachment D](#). Funding portals are required to keep statutory disqualification information current and to update the information promptly, but in any event not later than 10 days following any change in such information. Proposed Funding Portal Rule 110(a)(3)(B) sets forth this update requirement as to funding portal *applicants*; proposed Funding Portal Rule 800(b)(2) sets forth the requirement as to intermediaries once they become funding portal *members*.
13. FINRA will separately address the specific membership application and other fees that apply to funding portals.
14. FINRA notes that current FINRA Rule 2020 does not expressly include the term “aiding and abetting.”
15. See Exchange Act Release No. 70741 (October 23, 2013).
16. See [Attachment E](#).