FINKELSTEIN THOMPSON LLP

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Reply to Washington, D.C. office

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VIA EMAIL

Ms. Elizabeth A. Murphy
Secretary
Securities and Exchange Commission
100 F Street NW
Washington, DC 20549-1090
rule-comments@sec.gov

Re: File Number S7-09-13

Dear Ms. Murphy:

Finkelstein Thompson LLP respectfully submits the following comments in response to the Security and Exchange Commission's ("SEC" or "Agency") Request for comments in its proposed rules implementing the requirements of Title III of the Jumpstart Our Business Startups ("JOBS") Act and Section 4(a)(6) to the Securities Act of 1933 to create an exemption to permit securities-based crowdfunding.

We are a ten-lawyer boutique litigation firm, with offices in Washington, D.C. and San Francisco, CA, focusing on complex financial litigation involving antitrust violations, fraud and crime in the banking, securities and commodities industries, and consumer fraud. Our practice includes the representation of investors, financial professionals, and business entities. In light of this background, we are well situated to respond to the SEC's request and discuss the impact of the crowdfunding regulations on issuers and investors.

The comments below are in response to the Federal Register notice of November 5, 2013.

I. INTRODUCTION

The Agency has clearly been diligent in its rulemaking process, asking for comments on nearly 300 different issues. However, we believe the issues addressed in the following paragraphs are the most important and are those that we are best equipped to speak to as advocates for potential investors, issuers, and intermediaries. Our comment focuses on costs to issuers, verification of investor eligibility, verification of issuer eligibility, and income and investment limits. We believe these issues will have the largest impact on creating a fair and accessible market while minimizing fraud.

II. COMMENTS

A. Accounting Costs Preventing the Entry into the Sphere by Most Small Businesses

The proposed rules attempt to lower the cost of entry for an issuer below that which is typical in a standard offering by not requiring that the intermediaries register as brokers with the SEC. However, there are costs aside from registration associated with creating an infrastructure on an electronic platform to present offerings to buyers. The electronic capabilities necessary are immense. Intermediaries must create platforms that can accommodate information in various forms easily input into their systems. They must create a platform that can withstand access by an unknown amount of users. And, most importantly, the platforms must be highly secure against data breaches if they are to collect sensitive investor data. As a result of these requirements, it is unlikely that there will be a particularly large number of intermediaries that enter the market, leaving less room for competition in fee pricing and resulting in higher fees passed on to the issuers.

The SEC's cost-benefit analyses included in the proposed rulemaking indicate that it will cost between $39,810 and $69,810 to raise funds amounting between $100,000 and $500,000. The $100,000 to

$500,000 funding range is one in which many small businesses wishing to raise funds will fall. For example, it is within this range that construction costs to expand a business could easily fall. It is clear that raising money in this range will be impossible for most small business owners who lack the initial funds to pay the fees associated with the offering. While the fees charged by the intermediaries are beyond the control of the Agency, the costs associated with compliance are within the control of the rulemaking body. The largest cost component in the compliance equation is the cost of the requisite review of the company's financials by an accountant. Congress set a funding maximum of $1 million and such an amount is far below what any Initial Public Offering would ever produce. By implementing audit requirements, the rules imitate a traditional offering and exclude a large number of potential issuers from the market. The rules do not go far enough in limiting regulatory costs to make crowdfunding a viable option for most businesses.

B. Standards for Verification of Income and Net Worth

In the SEC rules lifting the ban on general solicitation and advertising in Rule 506 offerings to accredited investors, the Agency gave the following guidance:

> "if the terms of the offering require a high minimum investment amount and a purchaser is able to meet those terms, then the likelihood of that purchaser satisfying the definition of accredited investor may be sufficiently high such that, absent any facts that indicate that the purchaser is not an accredited investor, it may be reasonable for the issuer to take fewer steps to verify or, in certain cases, no additional steps to verify accredited investor status other than to confirm that the purchaser's cash investment is not being financed by a third party."

The proposed crowdfunding rules defy this logic and apply the opposite and contradictory standard of not requiring verification of net worth or income where the minimum investment amounts will by design be low to produce investment from lower income individuals. Further, crowdfunding is a marketplace created to specifically bring together unsophisticated investors with inexperienced issuers.

The SEC went on to suggest disclosure to a third party to verify assets or income to ensure that an accredited investor to whom solicitation is being made meets the income and net worth standards while still preventing disclosure of the investor's personal information to the issuer. The crowdfunding rules require a third party to be involved in the transaction in its very design by including the intermediary. Thus, requiring the intermediaries to verify income or net worth would be a relatively simple task and verification could be performed electronically by scanning and uploading financial documents.

We anticipate that the net worth requirement will prove confusing for laypersons registering on the platforms and issues like failure to understand the non-inclusion of the primary residence or failure to calculate liabilities in addition to assets will create numerous instances in which investors misreport their net worth. Requiring intermediary verification provides additional protection to investors who lack sophistication and may self-verify inaccurately due to a lack of understanding of the affirmation required in the registration. Finally, the electronic forum in which the verifications occur lend themselves to a lack of diligence by a potential investor. All of these issues combined suffer the necessary conclusion that verification requirements must be heightened and laid at the feet of the intermediaries.

C. Central Database Requirement to Safeguard Against Investors Pledging Excess Funds

The proposed rules prohibit investors from investing in crowdfunding annually in excess of certain limits; however, there is no mechanism by which to ensure these limitations are not exceeded. While an individual platform may implement appropriate safeguards to ensure that an investor does not exceed their investment limit, there is no mechanism by which the investor may be prevented from registering with multiple platforms and investing far in excess of the limit based on their income. This failure to monitor compliance with this key provision of the rules makes the rule itself futile.

The Agency could create and maintain a database in which intermediaries could check the amount of an investor's purchases for the year to date. Such a database would prevent the income limits in place from being ineffectual. The Financial Industry Regulatory Authority ("FINRA") has databases in place such as BrokerCheck® that indicate it would have the capacity to develop such a database if the SEC was unable or did not wish to do so. Such an arrangement may be desirable given that FINRA will also regulate those engaging in crowdfunding.

D. Income Limits

The Agency asked for various comments on questions related to income limits. In particular, the question of whether investment limitations should be calculated using a "greater of" analysis where if either net worth or income are greater than $100,000 the limitations are applied or whether the limitations should be applied if either net worth or income are less than $100,000. While there is ambiguity in the statutory language, income levels related to registration exemptions most commonly used are those applied when calculating accredited investor eligibility. Accredited investors are determined eligible using a "greater of" analysis. Thus, the "greater of" application keeps with current Agency practices and norms.

There are also practical considerations that must be considered. Failing to include a "greater of" analysis could exclude retired individuals who no longer have income at this level, but as a result of their savvy and financial understanding have amassed great wealth. Such a group is less vulnerable to falling victim to scams and other types of fraudulent transactions. The very design of the tiered system is to limit exposure to those who are likely to be less capable of high-level financial assessment. Thus, not only would adopting the "greater of" analysis keep with the standard used by the agency for years in determining income levels related to eligibility in regards to registration exemptions, but it will also fulfill the intent of including those who have accumulated enough assets that they no longer require high levels of income.

E. Background Checks

Rule 301(a) in the section titled "Measures to Reduce Fraud" of the proposed rules require an intermediary to have a reasonable basis to believe that an issuer complies with the requirements in Securities Act Section 4A(b), however, the rules fail to specify more than cursory steps an intermediary must take in order to form this reasonable belief. The Agency points out that the issuer will have an obligation to comply with these requirements, however, such an obligation will not act as a deterrent for the very type of issuer that the background checks are designed to exclude: an issuer intentionally perpetrating a fraudulent offering.

The argument contesting the recommendation that an intermediary take additional steps to uncover fraudulent histories of an issuer and its officers, directors (or any person occupying a similar status or performing a similar function) and 20 Percent Beneficial Owners stems from the argument that it would raise the cost of the offering and this cost will be passed on to the issuer. The Agency specifically lists the following types of investigatory functions that it is considering including: review of credit reports, verification of necessary business or professional licenses, evidence of corporate good standing, Uniform Commercial Code checks or a CRD snapshot report. The SEC estimates that fees charged by intermediaries for offerings will range from 5%-15%. Thus, the range of fees collected by intermediaries for a $500,000 offering (the median offering available) will range from $25,000 to $75,000. Given the large sums to be earned by intermediaries for each offering, requiring these additional steps will cost the intermediaries such a small fraction of the amount assessed to issuers it seems incredulous not to require them if the true purpose of this subsection of the rules is to reduce fraud. Each of the suggested additional steps either may be performed in a matter of minutes or relies on production of documents by the issuer that may be inspected in a matter of minutes. These types of checks are utilized by unsophisticated individuals and businesses when they do things such as purchase a car or hire a broker. To expect an intermediary standing to gain on average $50,000 per issuer to perform some of these checks represents a minimal level of due diligence. On the other hand, the investing community stands to gain enormous advantages in countering fraud. When the cost-benefit is weighed it is difficult to understand why such requirements would not be included in the rules. Without specification of these additional steps in the rules, they are unlikely to be performed because the companies owning the intermediaries will not be able to justify the expense if it is not required.

III. CONCLUSION

Of all of the rules the Agency is reviewing, we believe the SEC should pay particular attention to those items outlined in the preceding paragraphs. An appropriate balance must be struck between allowing easy entry into this new market, while also protecting investors from the schemes that will inevitably be perpetrated using this system. With limited government budgets for enforcement, verifications and checks done prior to actors on either side being permitted to act protects all involved. Lower costs of compliance will make the system truly accessible for small businesses. We applaud the SEC for its incredible diligence in preparing these proposed rules and appreciate the opportunity to provide our thoughts on these important issues.

Respectfully submitted,

BY: ______/s/__________________
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