SECURITIES AND EXCHANGE COMMISSION

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Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

MARY JO WHITE, CHAIR

LUIS A. AGUILAR, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

KARA M. STEIN, COMMISSIONER

MICHAEL S. PIWOWAR, COMMISSIONER

(41 DOCUMENTS)

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9958 / October 1, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76067 / October 1, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4214 / October 1, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31857 / October 1, 2015

ADMINISTRATIVE PROCEEDING
File Nos. 3-16311, 3-16312

In the Matter of

RELIANCE FINANCIAL ADVISORS, LLC,
TIMOTHY S. DEMBSKI, AND
WALTER F. GRENDA, JR.

SCOTT M. STEPHAN

ORDER GRANTING EXTENSION

Chief Administrative Law Judge Brenda P. Murray has moved, pursuant to Commission Rule of Practice 360(a)(3), for an extension to issue the initial decision as to Timothy B. Dembski in these proceedings.[1] The initial decision is currently due by October 19, 2015.

We adopted Rule of Practice 360(a) to enhance the timely and efficient adjudication and disposition of Commission administrative proceedings by setting deadlines for issuance of an

[1] On December 10, 2014, we issued an Order Instituting Proceedings against Reliance Financial Advisors, LLC, Timothy S. Dembski and Walter F. Grenda, Jr., and an Order Instituting Proceedings against Scott M. Stephan, which both provided for issuance of initial decisions within 300 days after service of the respective Orders Instituting Proceedings. *Reliance Fin. Advisors, LLC*, Securities Act Release No. 73801, 2014 WL 6967370 (Dec. 10, 2014); *Scott M. Stephan*, Securities Act Release No. 9687, 2014 WL 6967372 (Dec. 10, 2014). These two proceedings were consolidated on January 9, 2015. *Reliance Fin. Advisors, LLC*, Administrative Proceedings Rulings Release No. 2205 (Jan. 9, 2015).

initial decision.[2] That rule provides for extensions of those deadlines under certain circumstances if supported by a motion from the Chief Administrative Law Judge and if we determine that "additional time is necessary or appropriate in the public interest."[3] From our review of the present motion, it appears appropriate in the public interest to grant the Chief Administrative Law Judge's request and extend the time period for filing the initial decision.[4]

Accordingly, it is ORDERED that the deadline for filing the initial decision in these proceedings is extended to January 19, 2016.

By the Commission.

Brent J. Fields
Secretary

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2 17 C.F.R. § 201.360(a); *see Adopting Release*, Exchange Act Release No. 48018, 2003 WL 21354791, at *2 (June 11, 2003) ("[T]he Commission has determined that timely completion of proceedings can be achieved more successfully through the adoption of mandatory deadlines and procedures designed to meet these deadlines.").

3 17 C.F.R. § 201.360(a)(3).

4 *See Reliance Fin. Advisors, LLC*, Administrative Proceedings Rulings Release No. 3074 (Aug. 28, 2014) (motion to the Commission for an extension), available at http://www.sec.gov/alj/aljorders/2015/ap-3074.pdf (last visited Sept. 18, 2015).

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-76062; File No. SR-OCC-2015-803)

October 1, 2015

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Advance Notice of and No Objection to The Options Clearing Corporation's Proposal to Enter a New Credit Facility Agreement

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act")[1] and Rule 19b-4(n)(1)(i)[2] under the Securities Exchange Act of 1934 ("Exchange Act"), notice is hereby given that, on September 10, 2015, The Options Clearing Corporation ("OCC") filed an advance notice (SR-OCC-2015-803) with the Securities and Exchange Commission ("Commission"). The advance notice is described in Items I and II below, which Items have been prepared by OCC. The Commission is publishing this notice to solicit comments on the advance notice from interested persons, and to provide notice that the Commission does not object to the changes set forth in the advance notice and authorizes OCC to implement those changes earlier than 60 days after the filing of the advance notice.

I. Clearing Agency's Statement of the Terms of Substance of the Advance Notice

This advance notice is filed by OCC in connection with a proposed change to its operations to replace an existing credit facility OCC maintains for the purposes of meeting obligations arising out of the default or suspension of a clearing member, in anticipation of a potential default by a clearing member, or the failure of a bank or securities or commodities clearing organization to perform its obligations due to its bankruptcy, insolvency, receivership or suspension of operations.

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1 12 U.S.C. 5465(e)(1).

2 17 CFR 240.19b-4(n)(1)(i).

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. The text of these statements may be examined at the places specified in Item IV below. OCC has prepared summaries, set forth in sections A and B below, of the most significant aspects of these statements.

A. Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants or Others

Written comments were not and are not intended to be solicited with respect to the advance notice and none have been received.

B. Advance Notice Filed Pursuant to Section 806(e) of the Clearing Supervision Act

(i) Description of Change

This advance notice is being filed in connection with a proposed change in the form of the replacement of a revolving credit facility that OCC maintains for a 364-day term for the purpose of meeting obligations arising out of the default or suspension of a clearing member, in anticipation of a potential default by a clearing member, or the failure of a bank or securities or commodities clearing organization to perform its obligations due to its bankruptcy, insolvency, receivership or suspension of operations. OCC's existing credit facility (the "Existing Facility") was implemented on October 7, 2014 through the execution of a Credit Agreement among OCC, JPMorgan Chase Bank, N.A. ("JP Morgan"), as administrative agent, and the lenders that are parties to the agreement from time to time. The Existing Facility provides short-term secured borrowings in an aggregate principal amount of $2 billion but may be increased to $3 billion if OCC so requests and sufficient commitments from lenders are received and accepted. To obtain

a loan under the Existing Facility, OCC must pledge as collateral U.S. dollars or certain securities issued or guaranteed by the U.S. Government or the Government of Canada. Certain mandatory prepayments or deposits of additional collateral are required depending on changes in the collateral's market value. In connection with OCC's past implementation of the Existing Facility, OCC filed an advance notice with the Commission on September 11, 2014, and the Commission published a notice of no objection on September 30, 2014.[3]

The Existing Facility is set to expire on October 6, 2015, and OCC is therefore currently negotiating the terms of a new credit facility (the "New Facility") on substantially similar terms as the Existing Facility, except that a new administrative agent, Bank of America, N.A. ("Bank of America"), has been selected and OCC anticipates that U.S. Bank National Association ("U.S. Bank") will act as collateral agent, joint lead arranger and joint book runner. Under the Existing Facility, both of these roles are performed by JP Morgan. OCC also anticipates that The Bank of Tokyo-Mitsubishi UFJ, Ltd. ("Bank of Tokyo Mitsubishi") will act as a back-up administrative agent and collateral agent as well as joint lead arranger and joint book runner. On September 9, 2015, OCC, Bank of America, Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLPF&S"), a joint lead arranger and book runner, U.S Bank and Bank of Tokyo Mitsubishi executed a Commitment Letter with regard to the New Facility.

The terms and conditions applicable to the New Facility are set forth in the Summary of Terms and Conditions, which is not a public document.[4] OCC has separately submitted a request

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3 See Securities Exchange Act Release No. 73257 (September 30, 2014), 79 FR 60214 (October 6, 2014) (SR-OCC-2014-806).

4 The Summary of Terms and Conditions for the New Facility clarifies certain terms regarding mandatory prepayments or deposits of additional collateral, which, as described above, are also features of the Existing Facility.

for confidential treatment to the Commission regarding the Summary of Terms and Conditions, which is included in this filing as Exhibit 3. The conditions regarding the availability of the New Facility, which OCC anticipates will be satisfied on or before October 6, 2015, include the execution and delivery of (i) a credit agreement between OCC and the administrative agent, collateral agent and various lenders under the New Facility, (ii) a pledge agreement between OCC and the administrative agent or collateral agent, and (iii) such other documents as may be required by the parties. The definitive documentation concerning the New Facility is expected to be consistent with the Summary of Terms and Conditions and substantially similar to that concerning the Existing Facility, although it will include certain changes to accommodate the use of accounts at a new collateral agent and certain other changes as may be necessary regarding administrative and operational terms being finalized between the parties. Mainly, and in order to effect a borrowing under the New Facility, OCC would pledge collateral to the collateral agent for the benefit of the administrative agent.

The New Facility involves a variety of customary fees payable by OCC, including: (1) an arrangement fee payable to the joint lead arrangers; (2) administrative and collateral agent fees payable to the administrative agent and collateral agent if the New Facility closes; (3) upfront commitment fees payable to the lenders based on the amount of their commitments; and (4) an ongoing quarterly commitment fee based on the unused amount of the New Facility.

(ii) Anticipated Effect on and Management of Risk

Completing timely settlement is a key aspect of OCC's role as a clearing agency performing central counterparty services. Overall, the New Facility would continue to promote the reduction of risks to OCC, its clearing members and the options market in general because it would allow OCC to obtain short-term funds to address liquidity demands arising out of the

default or suspension of a clearing member, in anticipation of a potential default or suspension of clearing members or the insolvency of a bank or another securities or commodities clearing organization. The existence of the New Facility would therefore help OCC minimize losses in the event of such a default, suspension or insolvency, by allowing it to obtain funds on extremely short notice to ensure clearance and settlement of transactions in options and other contracts without interruption. OCC believes that the reduced settlement risk presented by OCC resulting from the New Facility would correspondingly reduce systemic risk and promote the safety and soundness of the clearing system. By drawing on the New Facility, OCC would also be able to avoid liquidating margin or clearing fund assets in what would likely be volatile market conditions, which would preserve funds available to cover any losses resulting from the failure of a clearing member, bank or other clearing organization. Because the New Facility preserves substantially the same terms and conditions as the Existing Facility, OCC believes that the change would not otherwise affect or alter the management of risk at OCC.

(iii) Consistency with the Clearing Supervision Act

OCC believes that the New Facility is consistent with Section 805(b) of the Clearing Supervision Act[5] because it promotes robust risk management by OCC of settlement and liquidity risk. The New Facility would promote robust risk management of these risks by providing OCC with timely access to a stable and reliable liquidity funding source to help it complete timely clearing and settlement.

(iv) Accelerated Commission Action Requested

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5 12 U.S.C. 5464(b).

Pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,[6] OCC requests that the Commission notify OCC that it has no objection to the New Facility not later than Friday, October 2, which is four days prior to the October 6, 2015 effective date of the New Facility. OCC requests Commission action four days in advance of the effective date in order to ensure that there is no period of time that OCC operates without this essential liquidity resource, given its importance to OCC's borrowing capacity in connection with its management of liquidity and settlement risk and timely completion of clearance and settlement.

III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The proposed change may be implemented if the Commission does not object to the proposed change within 60 days of the later of (i) the date that the proposed change was filed with the Commission or (ii) the date that any additional information requested by the Commission is received. OCC shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission providing the OCC with prompt written notice of the extension. A proposed change may be implemented in less than 60 days from the date the advance notice is filed, or the date further information requested by the Commission is received, if the Commission notifies OCC in writing that it does not object to the proposed change and authorizes OCC to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission.

OCC shall post notice on its website of proposed changes that are implemented.

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6 12 U.S.C. 5465(e)(1)(I).

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the advance notice is consistent with the Clearing Supervision Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-OCC-2015-803 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-OCC-2015-803. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method of submission. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed change that are filed with the Commission, and all written communications relating to the proposed change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Section, 100 F Street, N.E., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m.

Copies of such filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_15_803.pdf.

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-OCC-2015-803 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

V. Commission's Findings and Notice of No Objection

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, its stated purpose is instructive.[7] The stated purpose is to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities ("FMUs") and strengthening the liquidity of systemically important FMUs.[8] Section 805(a)(2) of the Clearing Supervision Act[9] authorizes the Commission to prescribe risk management standards for the payment, clearing, and settlement activities of designated clearing entities and financial institutions engaged in designated activities for which it is the Supervisory Agency or the appropriate financial regulator. Section 805(b) of the Clearing Supervision Act[10] states that

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7 See 12 U.S.C. 5461(b).

8 Id.

9 12 U.S.C. 5464(a)(2).

10 12 U.S.C. 5464(b).

the objectives and principles for the risk management standards prescribed under Section 805(a) shall be to:

- promote robust risk management;
- promote safety and soundness;
- reduce systemic risks; and
- support the stability of the broader financial system.

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act [11] and the Exchange Act ("Clearing Agency Standards").[12] The Clearing Agency Standards require registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.[13] Therefore, it is appropriate for the Commission to review advance notices against these Clearing Agency Standards and the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act.[14]

The Commission believes that the proposal in the advance notice is consistent with the Clearing Agency Standards, in particular, Exchange Act Rule 17Ad-22(d)(11) and Exchange Act Rule 17Ad-22(b)(3). Exchange Act Rule 17Ad-22(d)(11) requires that registered clearing agencies "establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable . . . establish default procedures that ensure that the clearing agency

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11 12 U.S.C. 5464(a)(2).

12 See Exchange Act Rule 17Ad-22. 17 CFR 240.17Ad-22. Securities Exchange Act Release No. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11).

13 Id.

14 12 U.S.C. 5464(b).

can take timely action to contain losses and liquidity pressures and to continue meeting its obligations in the event of a participant default." The Commission believes that the proposal is consistent with Exchange Act Rule 17Ad-22(d)(11) because the New Facility will allow OCC to obtain short-term funds to address liquidity demands arising out of the default or suspension of a clearing member, in anticipation of a potential default or suspension of clearing members or the insolvency of a bank or another securities or commodities clearing organization. Therefore, the New Facility should help OCC minimize losses in the event of such a default, suspension or insolvency, by allowing it to obtain funds on extremely short notice to ensure clearance and settlement of transactions in options and other contracts without interruption.

Exchange Act Rule 17Ad-22(b)(3) requires a central counterparty ("CCP"), to "establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [m]aintain sufficient financial resources to withstand, at a minimum, a default by the participant family to which it has the largest exposure in extreme but plausible market conditions . . . ." The Commission believes that the proposal is consistent with Exchange Act Rule 17Ad-22(b)(3) because OCC's proposal to enter into the New Facility, thereby ensuring continued access to a committed bank syndicated credit facility, will help OCC maintain sufficient financial resources to withstand, at a minimum, a default by an clearing member family to which it has the largest exposure.

For these reasons, the Commission believes the proposal contained in the advance notice is consistent with the objectives and principles described in Section 805(b) of the Clearing Supervision Act, including that it reduces systemic risks and promote the safety and soundness of the broader financial system. As discussed above, the New Facility will continue to promote the reduction of risks to OCC, its clearing members, and the options market in general because it

will allow OCC to obtain short-term funds to address liquidity demands, which should ensure clearance and settlement of transactions in options and other contracts without interruption. Given that OCC has been designated as a systemically important FMU, its ability to access financial resources to address short-term liquidity demands contributes to reducing systemic risks and supporting the stability of the broader financial system.

For these reasons, stated above, the Commission does not object to the advance notice.

VI. Conclusion

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,[15] that the Commission DOES NOT OBJECT to the proposed change, and authorizes OCC to implement the change in the advance notice (SR-OCC-2015-803) as of the date of this notice.

By the Commission.

Robert W. Errett
Deputy Secretary

[15] 12 U.S.C. 5465(e)(1)(I).

Commissioner Aguilar Disapproved
Commissioner Gallagher Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76065 / October 1, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3710 / October 1, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16879

In the Matter of **GRANT THORNTON INDIA LLP** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission" or "SEC") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 4C(a)(2)[1] and 21C[2] of the Securities Exchange Act of 1934 ("Exchange Act") and Rule

[1] Section 4C(a)(2) provides, in relevant part, that:

The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . to have engaged in unethical or improper professional conduct.

[2] Section 21C provides, in relevant part, that:

If the Commission finds...that any person...has violated...any provision of this title, or any rule or regulation thereunder, the Commission may...enter an order requiring such person, and any other person that ...was...a cause of the violation...to cease and desist from committing or causing such violation and any future violation of the same provision, rule, or regulation.

102(e)(1)(ii)[3] of the Commission's Rules of Practice against Grant Thornton India LLP ("GT India" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[4] that:

A. **SUMMARY**

1. This matter arises out of violations of the auditor independence rules by GT India. The violations occurred in connection with two partners from Grant Thornton Mauritius ("GT Mauritius") who, through an entity co-owned by them, incorporated a Mauritius-based subsidiary of GT India's issuer audit client, served on the board of directors of that subsidiary, and performed prohibited non-audit services for that subsidiary. GT India's violations occurred for that issuer audit client's fiscal year ended March 31, 2013.

B. **RESPONDENT**

2. GT India, with offices located throughout India, is an accounting and advisory firm and a member firm of Grant Thornton International Ltd. GT India is registered with the Public Company Accounting Oversight Board ("PCAOB").

C. **OTHER RELEVANT ENTITIES**

3. GT Mauritius is an accounting and advisory firm and a member firm of Grant Thornton International Ltd. GT Mauritius is not registered with the PCAOB.

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[3] Rule 102(e)(1)(ii) provides, in pertinent part, that:

The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

[4] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

4. Grant Thornton International Ltd. ("GT International"), incorporated in London, United Kingdom, is the world's sixth largest professional services network of independent accounting and consulting member firms. GT International member firms provide assurance, tax and advisory services to privately held businesses, public interest entities, and public sector entities in over 125 countries.

5. Anex Management Services Limited ("Anex") is a Mauritius company that was created in 1994 and operates in Mauritius. Anex creates, structures, licenses, administers, and manages Mauritius-based corporations for non-domestic corporate groups by providing, for example, resident directors as required by Mauritius law. During the relevant time, Anex was owned by two partners of GT Mauritius.

6. At all relevant times, Client A had shares registered with the Commission pursuant to Section 12(b) of the Exchange Act and filed annual reports on Form 20-F with the Commission.

D. FACTS

7. In early 2012, Client A began restructuring itself in preparation of a planned initial public offering to be registered with the Commission. On February 15, 2012, it engaged GT India to audit the financial statements of Client A's core operating company for each of the three years ended March 31, 2010, 2011, and 2012. On February 20, 2012, Client A incorporated what would become a public holding company.

8. On June 15, 2012, GT India completed its audit of Client A's financial statements, which at the time was not a Commission registrant. GT India issued an audit report dated June 15, 2012 with an unqualified opinion for each of the three fiscal year ended March 31, 2012. About one month later, a Client A employee asked an associate tax director from GT India to recommend a company that could incorporate a Mauritius-based subsidiary as a final step in Client A's restructuring. The associate tax director of GT India, who was also a member of the audit engagement team, contacted a partner of GT Mauritius seeking a recommendation. Shortly following this discussion, Client A retained Anex, a corporate services company located in Mauritius, to incorporate and manage its new Mauritius subsidiary.

9. On August 16, 2012, Anex incorporated Client A's Mauritius subsidiary. Because Mauritius law required that board of directors of Mauritius corporations have at least two resident directors, Anex appointed its co-owners, who were, and continue to be, GT Mauritius partners, to the board of Client A's Mauritius subsidiary. As directors, the two GT Mauritius partners had signatory authority over the bank accounts of Client A's Mauritius subsidiary, were authorized agents of the company, and were responsible for signing any audited statutory financial statements.

10. On August 29, 2012, Client A filed a registration statement with the Commission on Form F-1, which included GT India's audit report of June 15, 2012. About six weeks later, on October 15, 2012, Client A completed its initial public offering and moved $100 million in offering proceeds to Client A's Mauritius subsidiary to purchase a controlling interest in Client A's operating company.

11. GT India subsequently audited Client A's 2013 financial statements for its fiscal year ended March 31, 2013, and GT India issued its audit report dated June 13, 2013. Client A included that audit report in its annual report on Form 20-F, which was filed with the Commission on June 13, 2013. That audit report stated that Respondent GT India had "conducted [its] audit in accordance with the standards of the Public Company Accounting Oversight Board (United States)." However, GT India was not independent because (1) partners of GT Mauritius sat on the board of directors of Client A's Mauritius subsidiary when Respondent audited Client A's publicly-held parent; and (2) GT Mauritius' related party, Anex, provided prohibited non-audit services to the audit client of Respondent. For its 2013 audit of Client A's financial statements, GT India received total audit fees of $128,905.

12. As early as 2006, GT International required member firms proposing to audit a Commission registrant to submit an International Relationship Check ("IRC")[5] for circulation to GT International member firms in countries where the proposed client had related entities. The purpose of the IRC was to determine whether the member firm or its network firms in the other countries had any existing relationship with a corporate group of the proposed audit client. GT International defined "network firm" to include "(a) a firm that is part of a larger structure and that (i) uses a name in its firm name that is common to the larger structure; or (ii) shares significant professional resources with other firms in the larger structure; or (iii) shares profits or costs with other firms within the larger structure," or (b) an entity that controls, is controlled by, or is under common control with the firm through ownership, management, or other means." Under this definition, the Mauritius corporate services company fell within the definition of a network firm of GT Mauritius, as it was under common control through the two GT Mauritius partners.

13. In addition, GT International's global audit manual required its member firms to obtain annual independence confirmation letters in connection with auditing work. Specifically, the manual provided: "To assist in maintaining our independence, an independence letter must also be obtained from [GT International] member firms in countries where Commission audit clients have subsidiaries or operating units, even if a [GT International] member firm does not audit the subsidiary or operating unit in that country."

14. On December 31, 2012, during the course of Client A's 2013 audit, GT India sent an IRC to GT International for circulation to relevant GT International member firms. The IRC asked about independence or potential conflicts concerning GT India's audit of Client A. GT India specifically referenced, among other names to be examined, the two GT Mauritius partners, who

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[5] At all relevant times, GT International required its member firms with audit clients whose securities were registered with the Commission to employ IRCs, which are conflict-of-interest and independence checks. According to GT International, its IRC process is

> designed to check for the existence of relationships in order to identify potential conflicts of interest and/or threats to independence. These IRCs take the form of emails sent to member firms [by Grant Thornton International, at the request of the member firm auditing the client] asking about the existence of client, vendor or business relationships.

The emails included GT International forms on which the firm proposing to audit an entity included names of individuals and entities related to the entity, and a form on which the responding firm would identify reportable relationships.

were listed on the IRC as directors of Client A's Mauritius subsidiary. GT International circulated the IRC to a number of its member firms, including GT Mauritius, on January 25, 2013.

15. Three days later, a GT Mauritius employee incorrectly responded to the IRC stating, "[w]e have no relationships to report.", despite the fact that the two GT Mauritius partners were acting as directors of Client A's subsidiary in Mauritius and Anex was performing other prohibited non-audit services to that subsidiary. GT India thereafter, in reliance on GT Mauritius response to the IRC, audited Client A's financial statements for fiscal year ended March 31, 2013, and issued an unqualified audit report dated June 13, 2013. Client A included that audit report in its annual report on Form 20-F, which was filed with the Commission on June 13, 2013. Although GT India had sent GT International an IRC at the end of calendar year 2012, it did not simultaneously request from GT Mauritius the annual independence confirmation, as required by GT International compliance control procedures governing the independence and conflict check process. This confirmation sought the same information on independence as that requested by the IRC. GT Mauritius, including the two partners who were acting as directors on Client A's subsidiary, did not participate in GT India's audit.

E. VIOLATIONS

16. The Supreme Court has observed that "[p]ublic faith in the reliability of a corporation's financial statements depends upon the public perception of the outside auditor as an independent professional." *U.S. v. Arthur Young*, 465 U.S. 805, 819 n.15 (1984). To insure such independence, Rule 2-02(b)(1) of Regulation S-X requires each accountant's report to state "whether the audit was made in accordance with generally accepted auditing standards" ("GAAS"). GAAS, in turn, require auditors to maintain strict independence—both in fact and appearance—from their audit clients.[6] For purposes of the independence rules, Rule 2-01(f)(2) of Regulation S-X defines an accounting firm to include its associated entities.

17. The objective of Rule 2-01 of Regulation S-X is to ensure that auditors are qualified and independent of their Commission audit clients[7]—both in fact and in appearance—throughout the audit and professional engagement period.[8] The rule sets forth a non-exhaustive list of

[6] The Commission has stated that for audit reports issued on or after May 24, 2004, the reference in Rule 2-02(b)(1) to "generally accepted auditing standards" means the standards of the PCAOB and the applicable Commission regulations, both of which require an auditor to be independent of its client. *See,* "Commission Guidance Regarding the Public Company Accounting Oversight Board's Auditing and Related Professional Practice Standard No. 1," Exchange Act Rel. No. 49708, 82 SEC Docket 3060 (May 14, 2004). *See, also,* PCAOB Rule 3520 ("A registered public accounting firm and its associated persons must be independent of the firm's audit client throughout the audit and professional engagement period."); and PCAOB Auditing Standards, Independence, AU § 220.

[7] With certain exceptions that are not relevant here, "audit client" is defined as "the entity whose financial statements or other information is [*sic*] being audited, reviewed, or attested and any affiliates, of the audit client." 17 C.F.R. § 210-2.01(f)(6) (emphasis added). In turn, "affiliate" is defined to include "[a]n entity that has control over the audit client, over which the audit client has control, or which is under common control with the audit client, including the client's parents and subsidiaries. . . ." 17 C.F.R. § 210-2.01(f)(4)(i).

[8] Audit and professional engagement period includes both the periods covered by any financial statements being audited and the period of the engagements to audit the financial statements or to prepare a report filed with the Commission. This period ends when the audit client or the accountant notifies the Commission that the client is no longer that accountant's audit client.17 C.F.R. § 210-2.01(f)(5).

non-audit services which an auditor cannot provide to its audit clients and be considered independent. *See* 17 C.F.R. § 210-2.01(c)(4)(i)-(x). Among other things, it prohibits an auditor from providing bookkeeping services, payroll services, appraisal or valuation services, internal audit outsourcing services, legal services, expert services, and broker-dealer, investment adviser, or investment bank services. *Id.* It also prohibits an auditor from designing and implementing financial information systems or performing human resources or management functions for its audit clients. *See* 17 C.F.R. § 210-2.01(c)(4)(ii), (vi) and (vii). Rule 2-01(c)(4)(viii) further prohibits the auditor from having custody of the assets of the audit client.

18. Rule 2-01(c)(2) of Regulation S-X provides that an auditor is not independent of its audit client if "a current partner, principal, shareholder, or professional employee of the accounting firm is employed by the audit client or serves as a member of the board of directors or similar management or governing body of the audit client." Rule 2-01(c)(4)(vi) of Regulation S-X also provides that an auditor is not independent of its audit client if the auditor is "[a]cting, temporarily or permanently, as a director, officer, or employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client." 17 C.F.R. § 210-2.01(c)(4)(vi). Similarly, Preliminary Note 2 to Rule 2-01 of Regulation S-X makes clear that, in applying the general standard of auditor independence set forth in Rule 2-01(b), the Commission considers, among three other principles, whether a relationship or service "results in the accountant acting as management or an employee of the audit client." 17 C.F.R. § 210-2.01, Preliminary Note 2.

19. PCAOB Standards require auditors to be independent of their audit clients. To affirm that one's audit was conducted in accordance with PCAOB Standards when one was not independent (because of a prohibited employment relationship with or provision of prohibited non-audit services to an audit client) is a direct violation of Rule 2-02(b)(1) of Regulation S-X. Such an independence violation also constitutes (i) improper professional conduct under Rule 102(e) of the Commission's Rules of Practice and Section 4C of the Exchange Act and (ii) causing violations of Section 13(a) of the Exchange Act and Rule 13a-1 thereunder because the filing fails to include financial statements audited by an independent accountant.

20. The financial statements Client A filed with the Commission in its Form 20-F on June 13, 2013, included GT India's audit report dated June 13, 2013, which stated, "[w]e conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States)." The 2013 audit was not conducted in accordance with PCAOB standards because these standards require auditor independence and GT India was not independent during the audit and professional engagement period. GT India was not independent because (1) partners of GT Mauritius sat on the board of directors of Client A's Mauritius subsidiary when Respondent audited Client A's publicly-held parent; and (2) GT Mauritius' related party, Anex, provided prohibited non-audit services to the audit client of Respondent. As a consequence, GT India violated Rule 2-02(b)(1) of Regulation S-X and caused Client A to violate Section 13(a) of the Exchange Act and Rule 13a-1 thereunder. Respondent's conduct also constituted improper professional conduct pursuant to Section 4C(a)(c) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rule of Practice.

21. Section 13(a) of the Exchange Act requires, among other things, every issuer of a security registered pursuant to Section 12 of the Exchange Act to file with the Commission annual

reports audited by independent public accountants. Rule 13a-1 under the Exchange Act provides that each such registrant "shall file an annual report on the appropriate form authorized or prescribed therefor for each fiscal year." Item 8 ("Financial Statements and Supplementary Data") of Form 10-K, in turn, requires an issuer filing an annual report on that Form to "[f]urnish financial statements meeting the requirements of Regulation S-X." Rules 3-01 and 3-02 of Regulation S-X require the filing of "audited" balance sheets and "audited" statements of income and cash flows, and Rule 1-02(d) of Regulation S-X provides that an "audit" is "an examination of the financial statements by an independent accountant in accordance with generally accepted auditing standards." Foreign private issuers with securities registered pursuant to Section 12 of the Exchange Act are required to file their annual reports on Form 20-F. Item 17(a) of Form 20-F requires registrants to furnish financial statements for the same fiscal years and accountants' certificates that would be required to be furnished if the registration statement were on Form 10 or the annual report on Form 10-K.

22. The annual report Client A filed with the Commission on Form 20-F for its fiscal year ended March 31, 2013, included financial statements audited by GT India. As set forth above, however, at the time Client A filed its annual report, it did not include financial statements that had been audited by an independent accountant because GT India's independence with regard to Client A was impaired. Therefore, in filing the Form 20-F, Client A violated Section 13(a) of the Exchange Act and Rule 13a-1 promulgated thereunder, and GT India caused Client A's violations of those provisions.

23. Rule 102(e)(1)(ii) of the Commission's Rules of Practice, as codified in Section 4C(a)(2) of the Exchange Act, allows the Commission to censure a person, or deny such person, temporarily or permanently, the privilege of appearing or practicing before the Commission, if it finds that such person has engaged in "improper professional conduct." For accountants, the definition of "improper professional conduct" includes:

> 1. "Intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards." Exchange Act Section 4C(b)(1), Rule 102(e)(1)(iv)(A); or
>
> 2. Either of the following two types of negligent conduct:
>
> (A) A single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted; or
>
> (B) Repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards that indicate a lack of competence to practice before the Commission.[9]

[9] In October 1998, the Commission amended its definition of "improper professional conduct" to include these two negligence standards, noting that "a negligent auditor can do just as much harm to the Commission's processes as one who acts with an improper motive." *See, Amendment to Rule 102(e) of the Commission's Rules of Practice,* 63 Fed. Reg. 57,164, 57,167 (October 26, 1998)(codified at 17 C.F.R. Part 201).

Exchange Act Section 4C(b)(2).

The Commission has defined the "highly unreasonable" standard as:

> an intermediate standard, higher than ordinary negligence but lower than the traditional definition of recklessness used in cases brought under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The highly unreasonable standard is an objective standard. The conduct at issue is measured by the degree of the departure from professional standards and not the intent of the accountant.

See, Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57,164, 57,168 (October 26, 1998)(codified at 17 C.F.R. Part 201). In addition, the standard does not depend on the impact on financial statements; rather, the "proper focus should be on the conduct itself, rather than on the risk of harm." *Amendment to Rule 102(e)*, 63 Fed. Reg. 57,168. Thus, the Commission has found negligent conduct where an auditor, when it knew or should have known that independence was implicated, failed to gather all the salient relevant facts pertinent to the independence determination. *KPMG Peat Marwick LLP*, Lit. Release. No. 34-43862, 74 SEC Docket 357, 377-79 (January 19, 2001).

24. Importantly, in determining what constitutes "highly unreasonable conduct," the Commission has specifically addressed auditor independence issues, noting, "[b]ecause of the importance of an accountant's independence to the integrity of the financial reporting system, the Commission has concluded that circumstances that raise questions about an accountant's independence always merit heightened scrutiny. Therefore, if an accountant acts highly unreasonably with respect to an independence issue, that accountant has engaged in "improper professional conduct." *See, Amendment to Rule 102(e) of the Commission's Rules of Practice,* 63 Fed. Reg. 57,164, 57,168 (October 26, 1998)(codified at 17 C.F.R. Part 201).

25. In issuing its audit report on Client A's 2013 financial statements, GT India represented that "[w]e conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States)." GT India was not independent of Client A. GT India's reliance on GT Mauritius's incorrect assertion in the IRC that GT Mauritius "[had] no relationships to report" constituted a single instance of highly unreasonable conduct that resulted in a violation of applicable professional standards. As a result, GT India violated the applicable professional standards as defined by Section 4C(a)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

F. RESPONDENT'S REMEDIAL EFFORTS

26. In determining to accept Respondent's Offer, the Commission has considered remedial acts undertaken by Respondent as well as the cooperation Respondent has afforded the Commission staff. Since these matters emerged, Respondent has undertaken firm-specific actions to improve compliance with GT International's revised independence compliance requirements. Respondent, among other things, has imposed training and certification requirements for their employees; has reviewed all former and present audit clients that were Commission registrants;

has taken steps to prevent and detect possible future violations; and has implemented audit tools designed to ensure compliance with SEC independence rules.

G. FINDINGS

27. Based on the foregoing, the Commission finds that Respondent: (a) violated Rule 2-02(b)(1) of Regulation S-X; (b) caused violations of Exchange Act Section 13(a) and Exchange Act Rule 13a-1 by Client A; and (c) engaged in improper professional conduct pursuant to Exchange Act Section 4C(a)(2) and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Respondent GT India shall cease and desist from committing or causing any violations and any future violations of Rule 2-02(b)(1) of Regulation S-X, Section 13(a) of the Exchange Act, and Rule 13a-1 promulgated thereunder.

B. Respondent GT India is hereby censured.

C. Respondent GT India shall, within thirty (30) days of the issuance of this Order, pay disgorgement of $128,905 in audit fees, prejudgment interest of $8,977, and a civil money penalty in the amount of $50,000, for a total of $187,882, to the to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3). If timely payment is not made on the disgorgement and prejudgment interest, additional interest shall accrue pursuant to Commission Rule of Practice 600. If timely payment is not made on the civil money penalties, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the Commission website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341

6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying GT India as a Respondent in these proceedings, and the file number of these proceedings. A copy of the cover letter and check or money order must be simultaneously sent to Gerald W. Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549.

To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar Disapproved
Commissioner Gallagher Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76066 / October 1, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3711 / October 1, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16880

In the Matter of

GRANT THORNTON AUDIT PTY LIMITED

Respondent.

ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission" or "SEC") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 4C(a)(2)[1] and 21C[2] of the Securities Exchange Act of 1934

[1] Section 4C(a)(2) provides, in relevant part, that:

The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct.

[2] Section 21C provides, in relevant part, that:

If the Commission finds...that any person...has violated...any provision of this title, or any rule or regulation thereunder, the Commission may...enter an order requiring such person, and any other person that ...was...a cause of the violation...to cease and desist from committing or causing such violation and any future violation of the same provision, rule, or regulation.

("Exchange Act") and Rule 102(e)(1)(ii)[3] of the Commission's Rules of Practice against Grant Thornton Audit Pty Limited ("Respondent GT Australia/Audit" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[4] that:

A. SUMMARY

1. This matter arises out of violations of the auditor independence rules by Respondent GT Australia/Audit. The violations occurred in connection with two Grant Thornton Mauritius ("GT Mauritius") partners serving on the board of directors of a Mauritius-based subsidiary of Respondent's audit client, and their performance of prohibited non-audit services for that subsidiary. Respondent's violations occurred for the fiscal years ended June 30, 2008, 2009, 2010, and 2011.

B. RESPONDENT

2. Respondent GT Australia/Audit is an audit firm with its principal office in Sydney Australia. Respondent is a related entity to Grant Thornton Australia Limited, which is a member firm of Grant Thornton International Ltd. Respondent, through its relationship with Grant Thornton Australia Limited, is legally bound by the rules applying to members of Grant Thornton International Ltd. GT Australia/Audit is registered with the PCAOB.

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[3] Rule 102(e)(1)(ii) provides, in pertinent part, that:

The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to be lacking in character or integrity or to have engaged in unethical or improper professional conduct.

[4] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

C. OTHER RELEVANT ENTITIES

3. GT Mauritius is an accounting and advisory firm and a member firm of Grant Thornton International Ltd. GT Mauritius is not registered with the PCAOB.

4. Grant Thornton International Ltd. ("GT International"), incorporated in London, United Kingdom, is the world's sixth largest professional services network of independent accounting and consulting member firms. GT International member firms provide assurance, tax and advisory services to privately held businesses, public interest entities, and public sector entities in over 125 countries.

5. Anex Management Services Limited ("Anex") is a Mauritius company that was created in 1994 and operates in Mauritius. Anex creates, structures, licenses, administers, and manages Mauritius-based corporations for non-domestic corporate groups by providing, for example, resident directors as required by Mauritius law. During the relevant time, Anex was owned by two partners of GT Mauritius.

6. Beginning on November 8, 2010, Client A had shares registered with the Commission and, until July 2012, its shares traded on the NASDAQ Global Market. Client A filed an initial registration statement on Form F-1 and Annual Reports on Form 20-F with the Commission.

D. FACTS

7. Client A was founded as a private Australian company in November 2005, and in May 2006, its securities began trading on the Australia Stock Exchange (ASX). At that time, a former GT International member firm in Australia served as Client A's outside auditor. By late 2006, Client A's finance director asked a partner of the former GT International member firm to recommend a company that would incorporate a wholly-owned subsidiary in Mauritius. Client A wanted to restructure its corporate group by creating a new "mezzanine" subsidiary to own its operating company, which would enable it to avail itself of favorable tax laws in Mauritius. In early July 2006, Client A was put in touch with Anex, which was then owned by two partners of GT Mauritius, a member firm of GT International.

8. In or about September 2006, Client A executed a services agreement with Anex. On September 8, 2006, Anex incorporated a wholly-owned subsidiary in Mauritius as a holding company of Client A. Because Mauritius law required that the board of directors of Mauritius corporations have at least two resident directors, Anex appointed its co-owners, both of whom were, and continue to be, GT Mauritius partners, to the board of Client A's Mauritius subsidiary. As directors, the two GT Mauritius partners had signatory authority over the bank accounts of Client A's subsidiary and provided management representations in connection with the Australian-based statutory audits of the company. The two GT Mauritius partners also maintained Client A's subsidiary registered office and agent and its stock and minutes books, all of which were prohibited non-audit services under the Commission's auditor independence rules. In total, Client A paid Anex $78,545 for these services.

9. On November 26, 2009, Respondent GT Australia/Audit became Client A's auditor. The former GT International member firm that served as Client A's outside auditor had

left the GT network before Client A's audit for the year ending in June 30, 2007, and there was no affiliation or continuity of engagements between Client A's former auditor and Respondent GT Australia/Audit. The audit work papers that Respondent GT Australia/Audit obtained from Client A's former auditor did not disclose the referral or the relationship between GT Mauritius, Anex, and Client A. GT Mauritius, including the two partners who were acting as directors of Client A's subsidiary, did not participate in Respondent GT Australia/Audit's audit.

10. On November 8, 2010, Client A filed with the Commission an initial registration statement on Form F-1, and on April 20, 2011, Client A became listed on NASDAQ. The Form F-1 filing included Client A's consolidated financial statements for each of its three fiscal years ended June 30, 2008, 2009 and 2010, which had been audited by Respondent. Client A thereafter filed an annual report on Form 20-F with the Commission on December 28, 2011, for fiscal year ended June 30, 2011. These filings included Respondent GT Australia/Audit's audit reports, which stated that Respondent GT Australia/Audit had "conducted [its] audit in accordance with the standards of the Public Company Accounting Oversight Board (United States)." However, GT Australia/Audit was not independent because (1) partners of GT Mauritius sat on the board of directors of Client A's Mauritius subsidiary when Respondent audited Client A's publicly-held parent; and (2) GT Mauritius' related party, Anex, provided prohibited non-audit services to the audit client of Respondent. Client A paid GT Australia/Audit total audit fees of $88,683 for the audits of its financial statements for the four fiscal years ended through 2011. GT Audit resigned as Client A's auditor in November 2012.

11. As early as 2006, GT International required member firms proposing to audit a Commission registrant to submit an International Relationship Check ("IRC")[5] for circulation to GT International member firms in countries where the proposed client had related entities. The purpose of the IRC was to determine whether the member firm or its network firms in the other countries had any existing relationship with a corporate group of the proposed audit client. GT International defined "network firm" to include "(a) a firm that is part of a larger structure and that (i) uses a name in its firm name that is common to the larger structure; or (ii) shares significant professional resources with other firms in the larger structure; or (iii) shares profits or costs with other firms within the larger structure," or (b) an entity that controls, is controlled by, or is under common control with the firm through ownership, management, or other means." Under this definition, Anex fell within the definition of a network firm of GT Mauritius, as it was under common control through the two GT Mauritius partners.

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[5] At all relevant times, GT International required its member firms with audit clients whose securities were registered with the Commission to employ IRCs, which are conflict-of-interest and independence checks. According to GT International, its IRC process is

> designed to check for the existence of relationships in order to identify potential conflicts of interest and/or threats to independence. These IRCs take the form of emails sent to member firms [by Grant Thornton International, at the request of the member firm auditing the client] asking about the existence of client, vendor or business relationships.

The emails included GT International forms on which the firm proposing to audit an entity included names of individuals and entities related to the entity, and a form on which the responding firm would identify reportable relationships.

12. In addition, GT International's global audit manual required its member firms to obtain annual independence confirmation letters in connection with auditing work. Specifically, the manual provided: "To assist in maintaining our independence, an independence letter must also be obtained from [GT International] member firms in countries where Commission audit clients have subsidiaries or operating units, even if a [GT International] member firm does not audit the subsidiary or operating unit in that country."

13. With regard to the 2008, 2009, 2010 and 2011 audits of Client A, Respondent GT Australia/Audit failed to follow required independence compliance checks for GT Mauritius, including the IRC process and annual independence confirmations, although Respondent did send annual independence confirmations to GT member firms in the countries where a supporting audit was required. Respondent did not make efforts over the course of the performance of these audits to learn whether an independence violation was implicated by Client A's corporate presence in Mauritius or the activities of GT Mauritius' partners.

E. VIOLATIONS

14. The Supreme Court has observed that "[p]ublic faith in the reliability of a corporation's financial statements depends upon the public perception of the outside auditor as an independent professional." *U.S. v. Arthur Young*, 465 U.S. 805, 819 n.15 (1984). To insure such independence, Rule 2-02(b)(1) of Regulation S-X requires each accountant's report to state "whether the audit was made in accordance with generally accepted auditing standards" ("GAAS"). GAAS, in turn, require auditors to maintain strict independence—both in fact and appearance—from their audit clients.[6] For purposes of the independence rules, Rule 2-01(f)(2) of Regulation S-X defines an accounting firm to include its associated entities.

15. The objective of Rule 2-01 of Regulation S-X is to ensure that auditors are qualified and independent of their Commission audit clients[7]—both in fact and in appearance—throughout the audit and professional engagement period.[8] The rule sets forth a non-exhaustive list of non-audit services which an auditor cannot provide to its audit clients and be considered independent. *See* 17 C.F.R. § 210-2.01(c)(4)(i)-(x). Among other things, it prohibits an auditor

[6] The Commission has stated that for audit reports issued on or after May 24, 2004, the reference in Rule 2-02(b)(1) to "generally accepted auditing standards" means the standards of the PCAOB and the applicable Commission regulations, both of which require an auditor to be independent of its client. *See,* "Commission Guidance Regarding the Public Company Accounting Oversight Board's Auditing and Related Professional Practice Standard No. 1," Exchange Act Rel. No. 49708, 82 SEC Docket 3060 (May 14, 2004). *See, also,* PCAOB Rule 3520 ("A registered public accounting firm and its associated persons must be independent of the firm's audit client throughout the audit and professional engagement period."); and PCAOB Auditing Standards, Independence, AU § 220.

[7] With certain exceptions that are not relevant here, "audit client" is defined as "the entity whose financial statements or other information is [*sic*] being audited, reviewed, or attested and any affiliates, of the audit client." 17 C.F.R. § 210-2.01(f)(6) (emphasis added). In turn, "affiliate" is defined to include "[a]n entity that has control over the audit client, over which the audit client has control, or which is under common control with the audit client, including the client's parents and subsidiaries. . . ." 17 C.F.R. § 210-2.01(f)(4)(i).

[8] Audit and professional engagement period includes both the periods covered by any financial statements being audited and the period of the engagements to audit the financial statements or to prepare a report filed with the Commission. This period ends when the audit client or the accountant notifies the Commission that the client is no longer that accountant's audit client.17 C.F.R. § 210-2.01(f)(5).

from providing bookkeeping services, payroll services, appraisal or valuation services, internal audit outsourcing services, legal services, expert services, and broker-dealer, investment adviser, or investment bank services. *Id.* It also prohibits an auditor from designing and implementing financial information systems or performing human resources or management functions for its audit clients. *See* 17 C.F.R. § 210-2.01(c)(4)(ii), (vi) and (vii). Rule 2-01(c)(4)(viii) further prohibits the auditor from having custody of the assets of the audit client.

16. Rule 2-01(c)(2) of Regulation S-X provides that an auditor is not independent of its audit client if "a current partner, principal, shareholder, or professional employee of the accounting firm is employed by the audit client or serves as a member of the board of directors or similar management or governing body of the audit client." Rule 2-01(c)(4)(vi) of Regulation S-X also provides that an auditor is not independent of its audit client if the auditor is "[a]cting, temporarily or permanently, as a director, officer, or employee of an audit client, or performing any decision-making, supervisory, or ongoing monitoring function for the audit client." 17 C.F.R. § 210-2.01(c)(4)(vi). Similarly, Preliminary Note 2 to Rule 2-01 of Regulation S-X makes clear that, in applying the general standard of auditor independence set forth in Rule 2-01(b), the Commission considers, among three other principles, whether a relationship or service "results in the accountant acting as management or an employee of the audit client." 17 C.F.R. § 210-2.01, Preliminary Note 2.

17. PCAOB Standards require auditors to be independent of their audit clients. To affirm that one's audit was conducted in accordance with PCAOB Standards when one was not independent (because of a prohibited employment relationship with or provision of prohibited non-audit services to an audit client) is a direct violation of Rule 2-02(b)(1) of Regulation S-X. Such an independence violation also constitutes (i) improper professional conduct under Rule 102(e) of the Commission's Rules of Practice and Section 4C of the Exchange Act and (ii) causing violations of Section 13(a) of the Exchange Act and Rule 13a-1 thereunder because the filing fails to include financial statements audited by an independent accountant.

18. Client A included its consolidated financial statements for three fiscal years ended June 30, 2008, 2009 and 2010 in its Form F-1 filed with the Commission on November 8, 2010. Client A also included GT Australia/Audit's audit report in its Annual Report on Form 20-F filed on December 28, 2011. In those audit reports, GT Australia/Audit stated that, "We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States)." However, the audits were not conducted in accordance with PCAOB standards because these standards require auditor independence and GT Australia/Audit was not independent during the audit and professional engagement period. GT Australia/Audit was not independent because (1) partners of GT Mauritius sat on the board of directors of Client A's Mauritius subsidiary when Respondent audited Client A's publicly-held parent; and (2) GT Mauritius' related party, Anex, provided prohibited non-audit services to the audit client of Respondent. As a consequence, GT Australia/Audit violated Rule 2-02(b)(1) of Regulation S-X and caused Client A to violate Section 13(a) of the Exchange Act and Rule 13a-1 thereunder. Respondent's conduct also constituted improper professional conduct pursuant to Section 4C(a)(c) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rule of Practice.

19. Section 13(a) of the Exchange Act requires, among other things, every issuer of a security registered pursuant to Section 12 of the Exchange Act to file with the Commission

annual reports audited by independent public accountants. Rule 13a-1 under the Exchange Act provides that each such registrant "shall file an annual report on the appropriate form authorized or prescribed therefor for each fiscal year." Item 8 ("Financial Statements and Supplementary Data") of Form 10-K, in turn, requires an issuer filing an annual report on that Form to "[f]urnish financial statements meeting the requirements of Regulation S-X." Rules 3-01 and 3-02 of Regulation S-X require the filing of "audited" balance sheets and "audited" statements of income and cash flows, and Rule 1-02(d) of Regulation S-X provides that an "audit" is "an examination of the financial statements by an independent accountant in accordance with generally accepted auditing standards." Foreign private issuers with securities registered pursuant to Section 12 of the Exchange Act are required to file their annual reports on Form 20-F. Item 17(a) of Form 20-F requires registrants to furnish financial statements for the same fiscal years and accountants' certificates that would be required to be furnished if the registration statement were on Form 10 or the annual report on Form 10-K.

20. The registration statement on Form F-1 and annual report on Form 20-F that Client A filed with the Commission included financial statements audited by Respondent GT Australia/Audit for its four fiscal years ended June 30, 2011. As set forth above, however, at the time Client A filed its registration statement and annual reports, it did not include financial statements that had been examined by an independent accountant because Respondent's independence with regard to Client A was impaired. Therefore, Client A violated Section 13(a) of the Exchange Act and Rule 13a-1 promulgated thereunder, and GT Australia/Audit caused Client A's violations of those provisions.

21. Rule 102(e)(1)(ii) of the Commission's Rules of Practice, as codified in Section 4C(a)(2) of the Exchange Act, allows the Commission to censure a person, or deny such person, temporarily or permanently, the privilege of appearing or practicing before the Commission, if it finds that such person has engaged in "improper professional conduct." For accountants, the definition of "improper professional conduct" includes:

> 1. "Intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards." Exchange Act Section 4C(b)(1), Rule 102(e)(1)(iv)(A); or
>
> 2. Either of the following two types of negligent conduct:
>
> (A) A single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted; or
>
> (B) Repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards that indicate a lack of competence to practice before the Commission.[9]

[9] In October 1998, the Commission amended its definition of "improper professional conduct" to include these two negligence standards, noting that "a negligent auditor can do just as much harm to the Commission's processes as one who acts with an improper motive." *See, Amendment to Rule 102(e) of the Commission's Rules of Practice,* 63 Fed. Reg. 57,164, 57,167 (October 26, 1998)(codified at 17 C.F.R. Part 201).

Exchange Act Section 4C(b)(2).

The Commission has defined the "highly unreasonable" standard as:

> an intermediate standard, higher than ordinary negligence but lower than the traditional definition of recklessness used in cases brought under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. The highly unreasonable standard is an objective standard. The conduct at issue is measured by the degree of the departure from professional standards and not the intent of the accountant.

See, Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57,164, 57,168 (October 26, 1998)(codified at 17 C.F.R. Part 201). In addition, the standard does not depend on the impact on financial statements; rather, the "proper focus should be on the conduct itself, rather than on the risk of harm." *Amendment to Rule 102(e),* 63 Fed. Reg. 57,168. Thus, the Commission has found negligent conduct where an auditor, when it knew or should have known that independence was implicated, failed to gather all the salient relevant facts pertinent to the independence determination. *KPMG Peat Marwick LLP*, Lit. Release. No. 34-43862, 74 SEC Docket 357, 377-79 (January 19, 2001).

22. Importantly, in determining what constitutes "highly unreasonable conduct," the Commission has specifically addressed auditor independence issues, noting, "[b]ecause of the importance of an accountant's independence to the integrity of the financial reporting system, the Commission has concluded that circumstances that raise questions about an accountant's independence always merit heightened scrutiny. Therefore, if an accountant acts highly unreasonably with respect to an independence issue, that accountant has engaged in "improper professional conduct." *See, Amendment to Rule 102(e) of the Commission's Rules of Practice,* 63 Fed. Reg. 57,164, 57,168 (October 26, 1998)(codified at 17 C.F.R. Part 201).

23. In issuing its multiple audit reports on Client A's financial statements, Respondent GT Australia/Audit represented that "[w]e conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States)." However, GT Australia/Audit was not independent of Client A at the time it issued its audit reports. As a result, GT Australia/Audit's conduct constituted a single instance of highly unreasonable conduct and/or multiple instances of highly unreasonable conduct and violated the applicable professional standards as defined by Section 4C(a)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

F. RESPONDENT'S REMEDIAL EFFORTS

24. In determining to accept Respondent's Offer, the Commission has considered remedial acts undertaken by Respondent GT Australia/Audit and the cooperation the Respondent afforded the Commission staff in the investigation, including by promptly self-reporting the violations. Since these matters arose, Respondent GT Australia/Audit has undertaken firm-specific actions to implement GT International's revised compliance requirements. Respondent, among other things, has imposed training requirements for their firm members. Respondent has reviewed all former and present audit clients that were Commission registrants and has taken steps to detect possible future violations. Respondent has also implemented an audit tool

designed to ensure compliance with U.S. audit rules. Finally, Respondent now requires positive annual independence confirmations to cover the international operations of all public interest entities, not just Commission registrants.

G. FINDINGS

25. Based on the foregoing, the Commission finds that Respondent: (a) violated Rule 2-02(b)(1) of Regulation S-X; (b) caused violations of Exchange Act Section 13(a) and Exchange Act Rule 13a-1 by Client A; and (c) engaged in improper professional conduct pursuant to Exchange Act Section 4C(a)(2) and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Rule 2-02(b)(1) of Regulation S-X, Section 13(a) of the Exchange Act, and Rule 13a-1 promulgated thereunder.

B. Respondent is hereby censured.

C. Respondent shall, within ten (10) days of the issuance of this Order, pay disgorgement of $88,683 in audit fees, prejudgment interest of $13,520, and a civil money penalty in the amount of $75,000, for a total of $177,203, to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3). If timely payment is not made on the disgorgement and prejudgment interest, additional interest shall accrue pursuant to Commission Rule of Practice 600. If timely payment is not made on the civil money penalties, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the Commission website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying GT Australia/Audit as a Respondent in these proceedings, and the file number of these proceedings. A copy of the cover letter and check or money order must be simultaneously sent to Gerald W. Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549.

To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-76075; File No. SR-NSCC-2015-803)

October 5, 2015

Self-Regulatory Organizations; National Securities Clearing Corporation; Notice of No Objection to Advance Notice Filing to Enhance NSCC's Margining Methodology as Applied to Family-Issued Securities of Certain NSCC Members

National Securities Clearing Corporation ("NSCC") filed on August 14, 2015 with the Securities and Exchange Commission ("Commission") advance notice SR-NSCC-2015-803 ("Advance Notice") pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 ("Payment, Clearing and Settlement Supervision Act")[1] and Rule 19b-4(n)(1)(i)[2] under the Securities Exchange Act of 1934 ("Exchange Act") to change its margin charge with respect to a member's positions in securities that are issued by such member or its affiliate (i.e., "family-issued securities") by excluding positions in these securities, when the member is on NSCC's Watch List,[3] from its volatility margining model. The Advance Notice was published for comment in

1 12 U.S.C. 5465(e)(1). The Financial Stability Oversight Council designated NSCC a systemically important financial market utility on July 18, 2012. See Financial Stability Oversight Council 2012 Annual Report, Appendix A, http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf. Therefore, NSCC is required to comply with the Payment, Clearing and Settlement Supervision Act and file advance notices with the Commission. See 12 U.S.C. 5465(e).

2 17 CFR 240.19b-4(n)(1)(i).

3 As part of its ongoing monitoring of its membership, NSCC utilizes an internal credit risk rating matrix to rate its risk exposures to its members based on a scale from 1 (the strongest) to 7 (the weakest). Members that fall within the weakest three rating categories (i.e., 5, 6, and 7) are placed on NSCC's "Watch List" and, as provided under NSCC's Rules and Procedures ("Rules"), may be subject to enhanced surveillance or additional margin charges. See Section 4 of Rule 2B and Section I(B)(1) of Procedure XV of NSCC's Rules, available at http://dtcc.com/~/media/Files/Downloads/legal/rules/nscc_rules.pdf.

authority to adjust these haircut rates from time to time within these parameters as described in Procedure XV of NSCC's Rules without filing a proposed rule change with the Commission pursuant to Section 19(b)(1) of the Exchange Act,[6] and the rules thereunder, or an advance notice with the Commission pursuant to Section 806(e)(1) of the Payment, Clearing and Settlement Supervision Act,[7] and the rules thereunder.

As described by NSCC in the Advance Notice, NSCC, as a central counterparty ("CCP"), occupies an important role in the securities settlement system by interposing itself between counterparties to financial transactions and thereby reducing the risk faced by participants and contributing to global financial stability. The effectiveness of a CCP's risk controls and the adequacy of its financial resources are critical to achieving these risk-reducing goals. In that context, NSCC continuously reviews its margining methodology in order to ensure the reliability of its margining in achieving the desired coverage. In order to be most effective, NSCC must take into consideration the risk characteristics specific to certain securities when margining those securities.

Among the various risks that NSCC considers when evaluating the effectiveness of its margining methodology are its counterparty risks and identification and mitigation of "wrong-way" risk, particularly specific wrong-way risk, defined as the risk that an exposure to a counterparty is highly likely to increase when the creditworthiness of that counterparty deteriorates.[8] NSCC has identified an exposure to wrong-way risk when it

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6 15 U.S.C. 78s(b)(1).

7 12 U.S.C. 5465(e)(1).

8 See Principles for financial market infrastructures, issued by the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions 47 n.65 (April 2012), available at http://www.bis.org/publ/cpss101a.pdf.

family-issued securities of members that are on the Watch List at this time because, as stated above, these members present a heightened credit risk to the clearing agency or have demonstrated higher risk related to their ability to meet settlement. As such, there is a clear and more urgent need to address NSCC's exposure to wrong-way risk presented by these firms' family-issued securities. However, any future change to the margining methodology as applied to the family-issued securities of members that are not on the Watch List would be subject to a separate proposed rule change pursuant to Section 19(b)(1) of the Exchange Act,[9] and the rules thereunder and an advance notice pursuant to Section 806(e)(1) of the Payment, Clearing and Settlement Supervision Act,[10] and the rules thereunder.

II. Discussion and Commission Findings

Although the Payment, Clearing and Settlement Supervision Act does not specify a standard of review for an advance notice, the Commission believes that the stated purpose of the Payment, Clearing and Settlement Supervision Act is instructive.[11] The stated purpose of the Payment, Clearing and Settlement Supervision Act is to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.[12]

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9 15 U.S.C. 78s(b)(1).

10 12 U.S.C. 5465(e)(1).

11 See 12 U.S.C. 5461(b).

12 Id.

these Clearing Agency Standards, and the objectives and principles of these risk management standards as described in Section 805(b) of the Payment, Clearing and Settlement Supervision Act.[17]

The Commission believes the proposal in the Advance Notice is consistent with the objectives and principles described in Section 805(b) of the Payment, Clearing and Settlement Supervision Act,[18] and the Clearing Agency Standards, in particular, Rule 17Ad-22(b)(1)[19] and Rule 17Ad-22(b)(2)[20] under the Exchange Act, as described in detail below.

Consistency with Section 805(b) of the Act. The objectives and principles of Section 805(b) of the Payment, Clearing and Settlement Supervision Act are to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.[21] By enhancing the margin methodology applied to family-issued securities of members that are on NSCC's Watch List, the proposal will assist NSCC in collecting margin that more accurately reflects NSCC's exposure to a clearing member that clears family-issued securities and will assist

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clearing entities and financial institutions engaged in designated activities for which the Commission or the Commodity Futures Trading Commission is the Supervisory Agency. See Financial Market Utilities, 77 FR 45907 (August 2, 2012).

17 12 U.S.C. 5464(b).

18 Id.

19 17 CFR 240.17Ad-22(b)(1).

20 17 CFR 240.17Ad-22(b)(2).

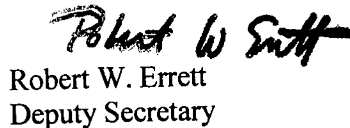
21 12 U.S.C. 5464(b).

methodology applied to family-issued securities of NSCC's members that are on its Watch List, the proposal will better account for and cover NSCC's credit exposure to less creditworthy members. In addition, by taking into account specific wrong-way risk arising from family-issued securities submitted to NSCC, the proposal is consistent with using risk based models and parameters to set margin requirements. As such, the Commission believes that the proposal is consistent with Rule 17Ad-22(b)(2).

III. Conclusion

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Payment, Clearing and Settlement Supervision Act,[24] that the Commission DOES NOT OBJECT to Advance Notice and that NSCC is AUTHORIZED to implement the proposal.

By the Commission.



Robert W. Errett
Deputy Secretary

[24] 12 U.S.C. 5465(e)(1)(I).

Commissioner Gallagher
Commissioner Piwowar
Dissented as to the
Corporate penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76074 / October 5, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3713 / October 5, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16882

In the Matter of **Home Loan Servicing Solutions, Ltd.** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Home Loan Servicing Solutions, Ltd. ("HLSS") ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Pursuant to Section 21C of the Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

1. This matter involves two sets of misstatements made by HLSS from 2012 to 2014, one concerning related party transactions and the other concerning valuation of company assets. First, HLSS inaccurately disclosed that it had policies governing conflicts of interest inherent in related party transactions, which included the recusal of its Chairman of the Board (the "Chairman") from negotiating and approving transactions with related parties such as Ocwen Financial Corp. ("Ocwen"), for which the Chairman also served as Executive Chairman. Second, HLSS's erroneous valuations of its primary asset, contributed to HLSS misstating its financial results for the years 2012 and 2013 and the first quarter of 2014. These misstatements resulted from an internal accounting controls failure that allowed the company to adopt a valuation methodology that did not conform to U.S. Generally Accepted Accounting Principles ("GAAP").

2. In its Forms 10-K and 10-KA for the year 2013, HLSS disclosed in the 1A "Risk Factors" section that it had "adopted policies, procedures and practices to avoid potential conflicts with respect to [its] dealings with [Ocwen and other related entities], including [the Chairman] recusing himself from negotiations regarding, and approvals of, transactions with these entities." In the "Business and Related Transactions" section of two 14A proxy statements filed in 2013 and 2014 and incorporated in the Part III Item 10 Section headed "Directors, Executive Officers and Corporate Governance" of its Forms 10-K for the years 2012 and 2013, HLSS likewise disclosed, "Due to the nature of [the Chairman's] obligations to each of the [related entities], he recuses himself from decisions pertaining to related transactions." The purpose of these disclosures was to assure investors that HLSS was safeguarding against potential conflicts due to the Chairman's role as Chairman of Ocwen and other related entities as well as HLSS. Because of HLSS's unique relationship with Ocwen, from which HLSS purchased all of its assets of significance and to which it provided services, the potential for conflicts was a major concern for investors.

3. Contrary to its public disclosures, HLSS had no written policies or procedures concerning recusals for related party transactions. And, although the Chairman had a practice of recusing himself from certain negotiations and approvals of related party transactions, that practice was inconsistent and ad hoc. As a result, HLSS failed to devise and maintain its disclosed internal accounting controls to prevent potential conflicts of interest in its related party transactions. Due to these control failures, the Chairman approved many transactions between HLSS and Ocwen in both his HLSS- and Ocwen-related capacities. Also, due to other internal accounting control

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

deficiencies, for three transactions in late 2013 and early 2014, HLSS had no documentation of approvals.

4. Separately, HLSS misstated its net income for the years 2012 and 2013 and the first quarter of 2014 by adopting an accounting methodology that did not conform to GAAP relating to the valuation of HLSS's most significant asset – rights to mortgage servicing rights ("Rights to MSRs") purchased from Ocwen. HLSS publicly disclosed that it valued these Rights to MSRs at fair value; however, it assigned them a value that was equivalent to their carrying value, and not to its best estimate of fair value, so long as the price reflected in the carrying value was within 5 percent of the price reflected in a fair value estimate provided by a third party. The Chairman warned HLSS senior management that this valuation methodology would inevitably result in differences between the carrying value and the third party fair value estimate that, while within 5 percent, were material to HLSS's financial statements. Despite this warning, HLSS's management and its Audit Committee failed to adequately review whether this valuation methodology complied with GAAP.

Respondent

5. HLSS is a Cayman Islands corporation with its principal executive offices in the Cayman Islands. HLSS's common stock became registered with the Commission pursuant to Section 12(b) of the Exchange Act in February 2012 and, from that date until approximately April 2015, traded on the NASDAQ Global Market. HLSS was founded by its Chairman in 2010 and conducted an initial public offering in February 2012. The Chairman owned 100 percent of HLSS's ordinary shares of common stock prior to the initial public offering, 5 percent after the offering, and approximately 1 percent between 2013 and 2014.

Other Relevant Entity

6. Ocwen is a Florida corporation with its principal place of business in Atlanta, Georgia. Ocwen's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the New York Stock Exchange. Between 2012 and 2014, HLSS's Chairman served as Ocwen's Executive Chairman and owned approximately 13 percent of Ocwen's common stock.

Background

A. HLSS's Related Party Transactions

HLSS's Relationship with Ocwen

7. Ocwen is a servicer of mortgages that have been securitized and are owned by residential mortgage-backed securities trusts. As one of its obligations as a mortgage servicer, Ocwen advances funds to the trusts to cover payments missed by borrowers.

8. Ocwen's Executive Chairman sought to make Ocwen "capital-light" by creating HLSS and making it responsible for funding Ocwen's servicer advances. HLSS was to purchase Ocwen's mortgage servicing rights ("MSRs"), and thereby receive the future servicing fees owed to Ocwen in connection with those MSRs and, as a result of that purchase, would be responsible for funding servicer advances. As a part of this arrangement, HLSS would retain Ocwen as the subservicer for all mortgages underlying the Rights to MSRs purchased by HLSS. In addition to the Chairman, certain managers and members of the board of directors at Ocwen became executives and board members at HLSS.

9. Due to difficulties encountered with transferring title to the MSRs to HLSS, Ocwen retained title and HLSS agreed to purchase the Rights to the MSRs. On March 5, 2012, HLSS executed a master purchase agreement with Ocwen and completed an initial purchase of Rights to MSRs on mortgages with an unpaid principal balance ("UPB") of $15.2 billion. Simultaneous with the purchase, HLSS entered into a master subservicing agreement with Ocwen for these mortgages. Under this agreement, Ocwen serviced the mortgages, collected the servicing fees from borrowers and remitted the fees to HLSS. From the total servicing fees remitted, HLSS paid Ocwen a base fee for its services and a performance fee when Ocwen met certain targets for advance levels. Because of his role at Ocwen, the Chairman recused himself from negotiating and voting on the approval of the master agreements and initial purchase.

HLSS's Control Breakdowns Relating to Related Party Transactions

10. There were no written policies or procedures governing when an officer or director with a conflict of interest was required to recuse himself from negotiating or approving a related party transaction. While the Chairman routinely recused himself from negotiations with Ocwen and recused himself from approvals of transactions in certain instances, including the master purchase and subservicing agreements and the initial purchase of Rights to MSRs, HLSS personnel never discussed the guidelines under which such recusal would be appropriate. This caused a number of control deficiencies.

11. First, the responsibility for determining whether recusal was appropriate was left largely to the person with the conflict of interest. There was no meaningful oversight of that person's determination.

12. Second, HLSS personnel lacked a clear understanding of when recusals were required. Although HLSS stated that it had "adopted policies, procedures and practices to avoid potential conflicts" present in related party transactions, several individuals within the company believed that recusals were needed only for significant transactions with related parties. Because there was never a discussion of the guidelines governing recusals, HLSS personnel never considered whether that belief was consistent with the company's public disclosures. Also, HLSS personnel had conflicting understandings of what types of transactions could qualify as significant, and they never attempted to reconcile these conflicting understandings. In addition, the Chairman believed that the need to approve transactions in the Cayman Islands for tax reasons may have been grounds

for not recusing himself. HLSS's disclosures, however, do not include this exception, and this belief was not given sufficient consideration internally.

13. Due to these control deficiencies, the practice at HLSS for recusals was not consistent with its public disclosures.

HLSS's Chairman Approved Transactions with Ocwen

14. After Ocwen and HLSS executed the master purchase and subservicing agreements, HLSS disclosed that it anticipated future growth through subsequent acquisitions of rights to Ocwen's MSRs. Accordingly, HLSS purchased additional Rights to MSRs from Ocwen through nine transactions (the "Flow Transactions") during 2012 and 2013. As HLSS's only asset of significance were Rights to MSRs purchased from Ocwen, these transactions were fundamental to its business.

15. While HLSS and Ocwen based the purchase price for the Rights to MSRs for each Flow Transaction on an appraisal by a third party valuation firm, other terms varied. For example, for each Flow Transaction, HLSS and Ocwen negotiated HLSS's retained fees, which were the servicing fees retained by HLSS from those collected and remitted to it by Ocwen after payment of the base and performance fees owed back to Ocwen. The retained servicing fee for each Flow Transaction was based on the agreed-upon advance target for Ocwen and other assumptions that were jointly set by HLSS and Ocwen such as the prepayment rate on the underlying loan balances, financing cost and advance borrowing rate.

16. HLSS personnel submitted proposals for these transactions to the Credit Committee for approval. Approval by the HLSS Credit Committee was necessary for a Flow Transaction to be approved by the HLSS Board of Directors and ultimately consummated. The Credit Committee was comprised of senior managers and directors appointed by HLSS's Board of Directors. The role of HLSS's Credit Committee, according to its charter, was to provide direction and oversight over all matters concerning HLSS's finance, investment, treasury and financial risk management. In addition to his other roles, the Chairman was a member of HLSS's Credit Committee and was also a member of Ocwen's Credit Committee, which performed an analogous role.

17. The routine process for the Credit Committee to review and approve transactions was to circulate a memorandum that presented analysis of the proposed price of the Rights to MSRs, the retained fees and the varying underlying assumptions. The memoranda circulated typically included a signature page to indicate approval by each of the committee members. The committee members either executed the signature pages or indicated their approval of the transactions by email.

18. In 2012, HLSS entered into five Flow Transactions with Ocwen totaling approximately $67.5 billion in UPB. The Chairman did not participate in the negotiations but approved all of these transactions in his capacity as a member of the HLSS Credit Committee.

19. In 2013, HLSS entered into four Flow Transactions with Ocwen totaling approximately $120 billion UPB. The Chairman recused himself from the first transaction but then approved the second one. Even when the Chairman recused himself, he still received the Credit Committee memorandum because, according to him, "I'm interested in valuation [and] I still thought I had the right to say, 'No, this isn't going to happen.'"

20. When the Chairman reviewed and approved these transactions, he typically did the same on the Ocwen side of the transactions either through Ocwen's Credit Committee or its Executive Committee which acted on behalf of the Board when it was not in session.

21. In 2014, the Chairman approved another type of transaction between Ocwen and HLSS concerning early buy-out loans, which are delinquent loans eligible for purchase by the mortgage servicer. In this transaction, HLSS purchased $672 million that comprised the most delinquent portion of a portfolio of early buy-out loans that Ocwen recently had purchased. In a February 2014 email addressed to members of both HLSS and Ocwen senior management, the Chairman approved this purchase on the condition that it did not trigger losses for HLSS.

HLSS Failure to Document Credit Committee Approvals

22. As to the latter two of the four Flow Transactions between HLSS and Ocwen in 2013, HLSS was unable to locate final executed Credit Committee memoranda or approving emails. Contemporaneous emails for the last of these transactions in October 2013, however, show a request to schedule a phone call for the Credit Committee to discuss the analysis contained in the memorandum and a subsequent modification of the retained servicing fee based on a change to an underlying assumption.

23. Documentation of HLSS's Credit Committee approval process again broke down in February 2014 in connection with the early buy-out loan purchase agreement between HLSS and Ocwen. HLSS was unable to locate any Credit Committee approvals for this transaction.

B. Improper Valuation of Rights to MSRs

24. HLSS's quarterly and annual filings with the Commission stated that its financial statements were prepared in accordance with GAAP. These filings also stated that HLSS recorded the Rights to MSRs that it purchased from Ocwen at fair value.

25. FASB Financial Accounting Standards Codification Topic 820 ("ASC 820") – Fair Value Measurements and Disclosures defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Because Rights to MSRs are not frequently bought or sold, there rarely are observable market prices for them. Rights to MSRs are therefore considered to be a Level 3 asset in the fair value hierarchy, which are assets that do not have observable inputs for a fair value measurement. While Level 3 assets are more difficult to value, the fair value measurement

objective remains the same, that is, an exit price from the perspective of a market participant that holds the asset.

26. HLSS retained a third party with expertise in valuing MSRs to calculate the fair value of its Rights to MSRs. Each quarter, the third party valuation firm performed an analysis of the Rights to MSRs and provided HLSS with a valuation report. The valuation reports included an estimate of fair value based on inputs that affected the fair value of the MSRs, such as then-current prepayment rates, pre-tax discount rates, and costs to service. This estimate was represented as a specific price that was reflected in basis points.[2] Multiplying this best-point estimate by the UPB for HLSS's Rights to MSRs would provide a fair value measurement for those Rights to MSRs. In a prefatory note, the valuation reports stated that a sale of the Rights to MSRs in an orderly market should not differ by more than 7.5, or in some instances 10, basis points from the best-point estimate provided.

27. In addition to the fair value measurement provided in the valuation report, HLSS independently determined the carrying value of its Rights to MSRs. As part of this determination, HLSS calculated an "Inception BPS," also reflected in basis points, by dividing the UPB of the mortgages underlying the MSRs as of the date of their acquisition by HLSS's purchase price of the Rights to MSRs. Over time, the UPB of the mortgages generally decreased as borrowers paid down their mortgages. At the end of each quarter, HLSS calculated the carrying value for the Rights to MSRs by multiplying the Inception BPS by the amount of the UPB as of the end of the quarter. This amortization was driven entirely by the decline in size of the mortgages' UPB and did not consider any of the various factors that would also affect a fair value measurement.

HLSS's Valuation Methodology

28. Because the value of the MSRs for which HLSS had obtained the rights historically had been fairly stable, HLSS developed a valuation methodology that used the carrying value of the Rights to MSRs as the presumptive fair value measurement. This methodology was reviewed by HLSS's external auditors. For each reporting date, HLSS compared the carrying value of its Rights to MSRs (as calculated above) to the third party valuation report's best-point estimate and would record an adjustment to the value of the Rights to MSRs, which HLSS disclosed reflected fair value, only if there was a variation in price of at least 5 percent.

29. To illustrate, the third party valuation firm provided a report with a valuation date of November 29, 2013 estimating the price of HLSS's Rights to MSRs, which had underlying mortgages with an UPB of approximately $159.56 billion, at 37.08 basis points. Multiplying the UPB by the estimated price, the third party valued the Rights to these MSRs at approximately $592 million. Under HLSS's valuation methodology, HLSS would apply 5 percent bands around the third party valuation firm's best-point estimate of 37.08 basis points, which would create a range from 35.23 basis points (5 percent below) to 38.93 basis points (5 percent above), and would report

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[2] A basis point is one hundredth of one percent.

the carrying value of its Rights to MSRs as their fair value so long as the carrying value was within the range of values created by the 5 percent bands. In other words, so long as HLSS's carrying value was within approximately $562 million (35.23 basis points multiplied by the UPB) and approximately $621 million (38.93 basis points multiplied by the UPB), it would report the carrying value as fair value. Based on HLSS's financial results for the fourth quarter of 2013, this approximately $56 million range was equivalent to 75 percent of its total revenues and 148 percent of its net income.

30. The valuation of Rights to MSRs was listed as a "Critical Accounting Policy" in HLSS's quarterly and annual filings and was highly important to investors. In fact, HLSS repeatedly emphasized the stability of its valuations and its limited asset valuation risk at investor presentations, in press releases, and during earnings calls.

HLSS's Internal Accounting Controls Deficiencies Relating to Valuation

31. Neither HLSS's management nor its Audit Committee adequately reviewed or considered HLSS's valuation methodology for the Rights to MSRs.

32. Before HLSS implemented the valuation methodology, the Chairman perceived a problem with it. Because the 5 percent bands created a very large range in terms of dollars, HLSS easily could have had a difference between the carrying value of the Rights to MSRs and their best-point estimate that was both material to the company's reported results and still within the 5 percent bands. Consequently, the Chairman concluded "the math would never work" and expressed his concerns to a member of HLSS senior management. The Chairman explained to this member of senior management, "if you have a 5 percent change in the asset, you're going to blow through [the threshold for materiality] so fast, it's almost a fait accompli at that particular point." To the Chairman, this problem was apparent from the beginning. As he later commented on the lack of appreciation on this point, "when you launch a ship . . . , the ship is going to hit the water, [so] don't expect the hull to not get wet."

33. The Chairman's concerns were not shared with the rest of HLSS senior management before, during, or after the implementation of the valuation methodology.

34. The Audit Committee of HLSS's Board of Directors also failed to give sufficient consideration to the valuation methodology. The Audit Committee's charter provides that it shall:

> (j) Review with management, the Company's independent auditors and the director of the Company's internal auditing department, the following:
>
> (i) critical accounting policies and such other accounting policies of the Company as are deemed appropriate for review by the Committee prior to any interim or year-end filings with the SEC or other regulatory body, including any

financial reporting issues which could have a material impact on the Company's financial statements . . . .

35. HLSS's Audit Committee did not review the valuation methodology with HLSS's external auditors, had no discussions of substance concerning the development of the valuation methodology with HLSS management, were not provided any documentation explaining the valuation methodology, and were not apprised of the Chairman's concerns. As a result, the Audit Committee did not consider whether the valuation methodology was an appropriate fair value measurement under GAAP, nor did it consider whether the valuation methodology could result in a variance between the third party valuation firm's best-point estimate and the carrying value that was material to HLSS's reported results.

HLSS Applied Its Valuation Methodology and Then Restated Its Financials

36. The best-point estimate in the valuation reports fluctuated from quarter to quarter; however, under its valuation methodology, HLSS did not make any adjustment to the fair value of its Rights to MSRs because the Inception BPS used to calculate carrying value did not differ by 5 percent or more from the best-point estimate.

37. HLSS revisited the use of the valuation methodology in 2014 and, with the involvement of its external auditors, determined that, while the carrying value is within the 5 percent band, the carrying value was not a fair value measurement under GAAP. Management, therefore, determined that HLSS was required to restate the value of its Rights to MSRs to the best-point estimate of fair value provided in the valuation reports.

38. In August 2014, HLSS restated its Forms 10-K for the years 2012 and 2013 and Form 10-Q for the quarter ended March 31, 2014 as a result of this required adjustment and an unrelated data input error.[3] At the time of the restatement, HLSS disclosed that it concluded the methodology it historically used to assess the value of its Rights to MSRs constituted a departure from GAAP. As per the chart below, HLSS's improper accounting resulted in material errors to HLSS's reported results in quarterly and annual filings and in earnings releases filed on Form 8-K.

[3] This data input error related to a subset of the Rights to MSRs as of the fourth quarter of 2013 and the first quarter of 2014. The impact of the data error was $5.9 million and $9.3 million as of December 31, 2013 and March 31, 2014, respectively.

Dollars in thousands

	Net Income as Restated ($)	Adjustment Relating to Accounting Error ($)	Adjustment as a % of Restated Net Income
1Q 14	64,360	11,386	18%
FY 2013	117,657	(4,137)	-4%
4Q 13	6,580	(27,617)	-420%
3Q 13	39,166	4,243	11%
2Q 13	43,826	15,940	36%
1Q 13	28,085	3,297	12%
FY 2012	19,617	(7,254)	-37%
4Q 12	7,326	(7,020)	-96%
3Q 12	5,438	(1,134)	-21%
2Q 12	5,901	1,242	21%
1Q 12	952	(342)	-36%

C. Violations

39. As a result of the conduct described above, HLSS violated Section 13(a) of the Exchange Act, Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder, which require issuers to file true, accurate, and complete annual, quarterly and current reports with the Commission.

40. As a result of the conduct described above, HLSS violated Section 13(b)(2)(A) of the Exchange Act, which requires public companies to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer."

41. As a result of the conduct described above, HLSS violated Section 13(b)(2)(B) of the Exchange Act, which requires public companies to "devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that . . . (ii) transactions are recorded

as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets."

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act of 1934 it is hereby ORDERED that:

A. Respondent HLSS cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11, and 13a-13 thereunder.

B. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $1,500,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C § 3717.

Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying HLSS as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent

to Michael J. Osnato, Chief, Complex Financial Instruments Unit, Division of Enforcement, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY, 10281.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76073 / October 5, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16881

In the Matter of **BRISTOL-MYERS SQUIBB COMPANY** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Bristol-Myers Squibb Company ("BMS" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

SUMMARY

These proceedings arise out of violations of the internal controls and recordkeeping provisions of the Foreign Corrupt Practices Act (the "FCPA") by BMS and its majority-owned joint venture in China. Between 2009 and 2014, BMS failed to design and maintain effective internal controls relating to interactions with health care providers ("HCPs") at state-owned and state-controlled hospitals in China. Through various mechanisms during this period, certain sales representatives of the joint venture improperly generated funds that were used to provide corrupt inducements to HCPs in the form of cash payments, gifts, meals, travel, entertainment, and sponsorships for conferences and meetings in order to secure new sales and increase existing sales. BMS falsely recorded the relevant transactions as legitimate business expenses in its books and records.

RESPONDENT

1. BMS, a Delaware corporation based in New York, NY, develops, licenses, manufactures, markets, distributes, and sells pharmaceutical and over-the-counter products on a worldwide basis. The common stock of BMS is registered with the Commission under Section 12(b) of the Exchange Act and its convertible preferred stock is registered with the Commission under Section 12(g) of the Exchange Act. The common stock of BMS trades on the New York Stock Exchange under the symbol BMY.

OTHER RELEVANT ENTITIES

2. Bristol-Myers Squibb (China) Investment Co. Limited ("BMS China") is a company through which BMS conducts business in China. BMS China, in turn, primarily operates through Sino-American Shanghai Squibb Pharmaceuticals Limited ("SASS"), a majority-owned joint venture. BMS holds a 60% equity interest in SASS and has held operational control over this entity since 2009 when it obtained the right to name the President of SASS and a majority of the members of SASS's Board of Directors.

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

FACTS

3. BMS began operating in China in 1982 when it formed SASS, the first Sino-American pharmaceutical joint venture. Following a successful product launch in 2005, BMS China's business grew quickly. By 2009, BMS China had 1490 full-time employees and net sales of more than $200 million. This upward trend continued through 2014 when the number of full-time employees expanded to 2464 and net sales reached nearly $500 million.

4. Certain BMS China employees achieved their sales, in part, by providing HCPs and other government officials with cash and other inducements in exchange for prescriptions and drug listings.

Failure to Respond to Red Flags

5. BMS China failed to respond effectively to red flags indicating that sales personnel provided improper payments and other benefits in order to generate sales from HCPs. In 2009, BMS China initiated a review of travel and entertainment expenses submitted for reimbursement by its sales personnel and found non-compliant claims, fake and altered invoices and receipts, and consecutively numbered receipts. Shortly thereafter, BMS China retained a local accounting firm to conduct monthly post-payment reviews of all claims for travel, entertainment, and meeting expenses to identify false, improperly documented, and unsubstantiated claims. BMS China brought this function in-house in early 2011 and the results of both the external and internal reviews were provided to management of BMS China as well as regional compliance and corporate business managers who reported directly to senior management of BMS.

6. During the period between mid-2009 and late 2013, BMS China identified numerous irregularities in travel and entertainment and event documentation, including fake and altered purchase orders, invoices, agendas, and attendance sheets for meetings with HCPs that likely had not occurred. BMS China inaccurately recorded the reimbursement of these false claims as legitimate business expenses in its books and records, which were then consolidated into the books and records of BMS.

7. Certain BMS China employees admitted that they had submitted false reimbursement claims and used the funds for the benefit of HCPs in support of sales by BMS China. They also alleged that the use of false reimbursement claims to fund payments to and for the benefit of HCPs in order to secure prescription sales was a widespread practice at BMS China. In emails to the BMS China President in November 2010 and January 2011, certain terminated employees wrote that they used the funds to pay rebates, provide entertainment, and fund gift cards for HCPs, as there was no other way to meet their sales targets. Citing the "open secret" that HCPs in China rely upon the "gray income" to maintain their livelihood, they said that they tried to meet the demands of the HCPs for the benefit of BMS China. Despite the widespread exceptions and serious allegations of potentially widespread bribery practices, BMS China did not investigate these claims.

Compliance and Controls Environment

8. Despite its longstanding presence in China, BMS did not implement a formal FCPA compliance program until April 2006 when it adopted its first standalone anti-bribery policy and corresponding corporative directive. At approximately the same time, BMS began conducting compliance assessments and audits of BMS China that included a review of internal controls relating to anti-bribery risks. These internal reviews revealed weaknesses in the monitoring of payments made to HCPs, the lack of formal processes around the selection and compensation of HCPs as speakers, deficiencies in obtaining and documenting the approval of donations, sponsorships, and consulting arrangements with HCPs, and the failure to conduct post-event verification of meetings and conferences sponsored by sales representatives. Reports of these findings were provided to senior management of BMS China as well as members of BMS's global compliance department.

9. These identified controls deficiencies were not timely remediated and compliance resources were minimal. The corporate compliance officer responsible for the Asia-Pacific region through 2012 was based in the U.S. and rarely traveled to China. There was no dedicated compliance officer for BMS China until 2008, and no permanent compliance position in China until 2010. In addition, the BMS sales force in China received limited training and much of it was inaccessible to a large number of sales representatives who worked in remote locations. For example, when BMS rolled out mandatory anti-bribery training in late 2009, 67% of employees in China failed to complete the training by the due date.

10. Annual internal audits of BMS China repeatedly identified substantial gaps in internal controls, and the results were reported to the Audit Committee and senior management of BMS. In connection with each audit, the audit team cited a lack of effective controls and documentation relating to interactions with HCPs and the monitoring of potential inappropriate payments to HCPs. Among Internal Audit's conclusions were that BMS China's controls around the review and approval of travel and entertainment expenses and gifts to HCPs were not effective and that it failed to track payments to HCPs, including high-risk payments, in its quarterly review of potential inappropriate payments, and to enforce controls relating to the documentation, approval, and payment of distributor rebates. Internal Audit also cited the lack of due diligence assessments of distributor compliance, including anti-bribery compliance, the failure to properly document and approve agreements with HCPs who served as speakers, and the lack of a mechanism to ensure that services were received in exchange for sponsorships. As a result, Internal Audit issued a series of qualified opinions in connection with its annual audits of BMS China between 2009 and 2013.

Internal Documents Reveal Improper Benefits Provided to HCPs

11. Emails and other BMS China documents detail, among other things, proposed "activity plans," "action plans," and plans for "investments" in HCPs to increase prescription sales. These contemporaneous documents were prepared at the direction of, and sometimes transmitted to, district and regional sales managers of BMS China, and show that sales representatives used funds derived from travel and expense claims to make cash payments to HCPs and to provide gifts,

meals, entertainment, and travel to HCPs in order to induce them to prescribe products sold and marketed by BMS China. The sales representatives provided a variety of benefits to HCPs, ranging from small food and personal care items to shopping cards, jewelry, sightseeing, and cash payments, in exchange for prescription sales. This kind of conduct was captured in a July 2013 email from a sales representative to a regional manager. The sales representative explained that a former sales representative had offered cash for sales to HCPs at a local hospital and "the attitude of the director of the infectious diseases department was extremely clear when I took over: 'No money, no prescription.'" Similarly, the work plans prepared by other sales representatives also identified correlations between the value of the benefits provided to specific HCPs and the volume of prescription sales expected.

12. Certain documents within BMS China were replete with references to "investments" made in order to obtain sales, such as offering speaking engagements and sponsorships for domestic and international conferences and meetings in exchange for prescriptions. Some sales representatives also sought to increase prescription sales and maintain drug listings at pharmacies by hosting cash promotions and events for pharmacy employees. Based on the volume of prescriptions, certain BMS China sales representatives gave cash, shopping cards, and foodstuffs as promotional prizes to pharmacy employees; at least one sales representative characterized the expenses as a "departmental development fee" in contemporaneous documents.

LEGAL STANDARDS

13. Under Section 21C(a) of the Exchange Act, the Commission may impose a cease-and-desist order upon any person who is violating, has violated, or is about to violate any provision of the Exchange Act or any rule or regulation thereunder or any other person that is, was, or would be a cause of the violation due to an act or omission the person knew or should have known would contribute to such violation.

Violations of the Recordkeeping and Internal Controls Provisions of the FCPA

14. Section 13(b)(2)(A) of the Exchange Act requires issuers to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and disposition of the assets of the issuer. 15 U.S.C. §78m(b)(2)(A).

15. Section 13(b)(2)(B) of the Exchange Act requires issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that (i) transactions are executed in accordance with management's general or specific authorization; (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management's general or specific authorization; and (iv) the recorded

accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences. 15 U.S.C. § 78m(b)(2)(B).

16. As described herein, BMS, through the actions of certain BMS China employees, violated Section 13(b)(2)(A) of the Exchange Act by falsely recording, as advertising and promotional expenses, cash payments and expenses for gifts, meals, travel, entertainment, speaker fees, and sponsorships for conferences and meetings provided to foreign officials, such as HCPs at state-owned and state-controlled hospitals as well as employees of state-owned pharmacies in China, to secure prescription sales. BMS also violated Section 13(b)(2)(B) of the Exchange Act by failing to devise and maintain a system of internal accounting controls relating to payments and benefits provided by sales representatives at BMS China to these foreign officials. As identified in various internal reviews, audits, and investigations conducted since at least 2009, BMS lacked effective internal controls sufficient to provide reasonable assurances that funds advanced and reimbursed to employees of BMS China were used for appropriate and authorized purposes.

REMEDIAL EFFORTS

17. BMS has implemented significant measures to enhance its anti-bribery and general compliance training and policies and to strengthen its accounting and monitoring controls relating to interactions with HCPs, including travel and entertainment expenses, meetings, sponsorships, grants, and donations funded by BMS China. BMS took numerous steps to improve the internal controls and compliance program at BMS China. Examples include a 100% pre-reimbursement review of all expense claims; the implementation of an accounting system designed to track each expense claim, including the request, approval, and payment of each claim; and the retention of a third-party vendor to conduct surprise checks at events sponsored by sales representatives. Additionally, BMS terminated over ninety employees, and disciplined an additional ninety employees, including sales representatives and managers of BMS China, who failed to comply with or sufficiently supervise compliance with relevant policies. In addition, BMS replaced certain BMS China officers as part of an overall effort to enhance "tone at the top" and a culture of compliance. Further, BMS revised the compensation structure for BMS China employees by reducing the portion of incentive-based compensation for sales and distribution, eliminated gifts to HCPs, implemented enhanced due diligence procedures for third-party agents, implemented monitoring systems for speaker fees and third-party events, and incorporated risk assessments based on data analytics into its compliance program.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent BMS's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Bristol-Myers Squibb Company cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(b)(2)(A) and 78m(b)(2)(B)].

B. Respondent shall, within fourteen (14) days of the entry of this Order, pay disgorgement of $11,442,000, which represents profits gained as a result of the conduct described herein, prejudgment interest of $500,000, and a civil penalty of $2,750,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Bristol-Myers Squibb Company as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Kara N. Brockmeyer, Chief, Foreign Corrupt Practices Act Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5646.

C. Respondent undertakes to:

(1) Report to the Commission periodically, at no less than nine-month intervals during a two-year term, the status of its FCPA and anti-corruption related remediation and implementation of compliance measures. During this two-year period, should the Respondent discover credible evidence, not already reported to the Commission, that questionable or corrupt payments or questionable or corrupt transfers of property or interests may have been offered, promised, paid, or authorized by any Respondent entity or person, or any entity or person acting on behalf of Respondent, or that related false books and records have been maintained, Respondent shall promptly report such conduct to the Commission staff. During this two-year period, Respondent shall (1) submit an initial report, and (2) conduct and prepare two follow-up reviews and reports, as described below:

a. Respondent shall submit to the Commission staff a written report within one-hundred eighty (180) calendar days of the entry of this Order setting forth a complete description of its remediation efforts to date, its plans for any future enhancements or improvements to its policies and procedures for ensuring compliance with the FCPA and other applicable anti-corruption laws, and the parameters of the subsequent reviews (the "Initial Report"). The Initial Report shall be transmitted to Charles E. Cain, Deputy Chief, FCPA Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5648. Respondent may extend the time period for issuance of the Initial Report with prior written approval of the Commission staff.

b. Respondent shall undertake two follow-up reviews and submit written reports relating to Respondent's remedial efforts to devise and maintain policies and procedures reasonably designed to detect and prevent violations of the FCPA and other applicable anti-corruption laws (the "Follow-up Reports").

c. The first Follow-up Report shall be completed by no later than two-hundred seventy (270) calendar days after the Initial Report. The final Follow-Up Report shall be completed by no later than two-hundred seventy (270) calendar days after the completion of the first Follow-Up Report. Respondent may extend the time period for issuance of each Follow-up Report with prior written approval of the Commission staff.

d. The periodic reviews and reports submitted by Respondent will likely include proprietary, financial, confidential, and competitive business information. Public disclosure of the reports could

discourage cooperation, impede pending or potential government investigations or undermine the objectives of the reporting requirement. For these reasons, among others, the reports and the contents thereof are intended to remain and shall remain non-public, except (a) pursuant to court order, (b) as agreed by the parties in writing, (c) to the extent that the Commission staff determines in its sole discretion that disclosure would be in furtherance of the Commission's discharge of its duties, or (d) is otherwise required by law.

(2) Certify, in writing, compliance with the undertaking set forth above. The certification and any supporting material shall be submitted to Charles E. Cain, Deputy Chief, FCPA Unit, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) calendar days from the date of the completion of the undertakings.

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76079 / October 5, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4215 / October 5, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31859 / October 5, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16883

In the Matter of **ARTHUR F. JACOB, CPA and INNOVATIVE BUSINESS SOLUTIONS, LLC** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940 AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Respondent, Innovative Business Solutions, LLC ("IBS") and Respondent, Arthur F. Jacob ("Jacob") (collectively "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. <u>SUMMARY</u>

1. These proceedings involve violations of the anti-fraud provisions of the federal securities laws by Respondent Arthur F. Jacob and his company, Respondent Innovative Business Solutions, LLC, unregistered investment advisers to about 30 client

households with approximately $18 million under management.

2. From approximately mid-2009 through at least July 2014, Jacob and IBS, which Jacob owns and controls, engaged in a fraudulent scheme involving material misrepresentations and omissions and other deceptive devices and practices. Jacob engaged in this scheme in order to obtain and retain investment advisory clients and thereby collect advisory fees.

3. For at least five years, Jacob (alone and acting through IBS) routinely made false statements and omissions to current clients, prospective clients, and others, where he:

- concealed his 2003 disbarment by the State of Maryland for misappropriating client funds, making false statements under oath, making numerous false statements to Bar Counsel, filing false tax returns on behalf of a client, willfully violating a court order, and charging unreasonable fees, as well as his 2005 suspension from practicing or appearing before the Internal Revenue Service ("IRS");

- misstated to clients the risks and profitability of their investments, including in investment newsletters Jacob drafted and distributed;

- falsely informed clients that he was not required to register as an investment adviser and failed to disclose that in fact, he and IBS were required to be registered as investment advisers with several states; and

- provided false information about the advisory services they provided in order to retain trading authority in clients' accounts.

4. Jacob's and IBS's false statements and failure to disclose material information was a breach of their duties as investment advisers to the clients.

5. As a result of their scheme, Jacob and IBS collected over $517,000 in investment advisory fees from their clients.

6. Jacob asserted his Fifth Amendment privilege against self-incrimination in testimony taken by the Commission during the Division's investigation of this matter.

B. <u>RESPONDENTS</u>

7. **Arthur F. Jacob**, age 56, is currently a resident of Orlando, Florida. He resided in Big Fork, Montana from September 2008 until February 2013, and in Scottsdale, Arizona from February 2013 until March 2014. He is a CPA licensed in the State of Maryland, and a co-owner (with his wife) of Innovative Business Solutions, LLC. Jacob was licensed as an attorney by the State of Maryland until he was disbarred

in 2003. In 2005, Jacob was also suspended from practicing before the Internal Revenue Service. Jacob has never been registered as an investment adviser with the Commission or any State.

8. **Innovative Business Solutions, LLC,** is a company co-owned by Jacob and his wife, incorporated in 2002 in Maryland to provide accounting and tax services to clients. Jacob and his wife have operated IBS in Maryland, Montana, Arizona, and now in Florida. By mid-2009, Jacob also conducted an investment advisory business through IBS. IBS was never registered with the Commission or any state in any capacity.

C. FACTS

9. Jacob's multi-year fraudulent scheme involved numerous material misstatements and omissions and various deceptive devices and practices. Jacob engaged in the scheme in order to obtain and retain clients, and to collect investment advisory fees.

Jacob and IBS Were Investment Advisers and Are Subject To the Anti-Fraud Provisions of the Investment Advisers Act of 1940.

10. From at least mid-2009 through at least July 2014 (the "relevant period"), Jacob and IBS acted as investment advisers, providing investment advice and advisory services to approximately 30 client households.

11. During the relevant period, Jacob and IBS conducted their investment advisory business in Montana and had more than 5 investment advisory clients in each of the states of Maryland and Georgia.

12. Jacob and IBS managed their clients' securities accounts, including investment retirement accounts—such as defined benefit plans, 401(k) plans, profit sharing plans, and retirement income plans. Many of the clients maintained multiple securities accounts for themselves, family members, and businesses that Jacob and IBS managed. The accounts had a total value of approximately $18 million.

13. From mid-2009 to late 2011, Jacob and his clients held accounts at a Montana branch of a large firm which is dually registered with the Commission as both an investment adviser and a broker-dealer ("Firm One"). At Firm One, Jacob's clients signed "Durable Power of Attorney / Security Account Limited Discretionary Authorization" forms which gave Jacob the ability to buy, sell, and trade in the client accounts.

14. In early 2012, Jacob moved his clients' accounts to a Florida branch office of a different large, dually registered firm ("Firm Two"), and later to a third firm. The latter two firms each ultimately terminated its relationship with Jacob. At Firm Two, Jacob's clients similarly signed "Third Party Authorization and Indemnity" forms giving Firm Two authorization to accept trade instructions from Jacob.

15. At Firm One and Firm Two, financial advisers or brokers were assigned to Jacob's clients' accounts and sometimes discussed with Jacob possible securities transactions. Jacob, however, was the only one to have discretionary trading authorization over the accounts, other than the client, and regularly provided trade instructions to the firms where the accounts were held. Jacob made the ultimate investment decisions for the clients' accounts, including the specific securities to be purchased or sold, the timing and amounts of the trades, the prices at which to buy or sell securities, the investment strategy to be employed and the asset allocation.

16. Jacob told a client who had recently terminated Jacob's investment advisory services that he and IBS had been responsible for the client's previous trading, not anyone at Firm One. Specifically, Jacob stated, "[D]on't come back to me and gripe when I turn out to be right and/or you can't react when a trade, etc. needs to be executed. Trust me, [Firm One] didn't so [*sic*] that either and won't in the future – it was <u>us</u> [Jacob and IBS] doing those profitable trades and <u>us</u> making the decisions [regarding the client's investments]–[Firm One] initiated nothing."

17. On a number of occasions, Jacob insisted on asset allocations and securities transactions that differed from the recommendations of the financial advisers assigned to the accounts at Firm One and transactions that differed from the recommendations of the broker assigned to the accounts at Firm Two. For instance, in December 2009, he wrote to two financial advisers at Firm One—copying their supervisor— after they had recommended against leaving a large percentage of the clients' accounts in cash. Jacob admonished that he had represented the clients at issue, "as an attorney, certified public accountant, and adviser for numerous years. . . ." He later noted that he "resent[ed] the inference [his] investment philosophy, strategy, or asset allocation [was] inappropriate."

18. Jacob had direct access to his clients' account statements. He kept track of the profits and losses in clients' accounts and provided the clients with analyses about their investment portfolios. For instance, in March 2009, Jacob provided an analysis to one client in which he explained the current market value of the invested assets, the change in the market value of those assets, and projected assets over a ten-year period. He also provided these types of analyses to clients throughout the relevant time period.

19. Jacob referred to himself as an investment adviser and described the services he provided as managing investment accounts in communications with clients, prospective clients and financial institutions. For instance, in a December 28, 2011 email to a law firm in reference to one of his clients' accounts, Jacob stated, "I am the Investment Advisor to that account."

20. In addition, on July 20, 2010, Jacob emailed a prospective client and stated, "Investment Management Services are separate from the on-going monthly accounting/tax/consulting fee....We are on-line with [Firm One] and actively manage the investment accounts, direct trading activity, establish targets, and supply monthly and quarterly, readable, reports and analyses."

21. In another example, in late 2011, Jacob sent multiple emails to Firm Two, copying his clients, in which he indicated that in order to open the clients' accounts at Firm Two he would require "Internet access to the accounts . . . as the Investment Adviser ... [and] Authorization to serve as the Investment Adviser for these accounts such that all investment decisions are made with unanimous consent of you and I."

22. Throughout the relevant period Jacob and IBS issued invoices for their investment advisory services which were separate and distinct from invoices they issued to clients for accounting, tax, and other consulting services.

23. The investment advisory services Jacob and IBS provided were not solely incidental to the accounting and tax services IBS and Jacob provided during the relevant period.

24. Jacob also routinely issued to clients email newsletters that discussed his investment strategies, his outlook on market conditions, and the purported profitability of clients' portfolios; and Jacob advised his clients where and when to move the investment accounts that Jacob managed.

25. The investment advisory fees Jacob and IBS charged usually consisted of a "performance fee" which was typically discounted from 2% to 1% of the managed portfolio, plus $750 per quarter for a "base/accounting fee" or a "discount" fee based on performance of the portfolio.

26. As investment advisers, Jacob and IBS owed to their clients an affirmative duty of utmost good faith, and full and fair disclosure of all material facts, as well as an affirmative obligation to employ reasonable care to avoid misleading their clients.

27. During the relevant period, Jacob and IBS collected more than $517,000 for providing investment advisory services. Jacob and IBS also collected in excess of $2 million for providing unrelated accounting, tax and consulting services to the same clients.

Jacob Concealed and Misrepresented His Disciplinary History and Touted His Credentials as an Attorney in Furtherance of His Scheme.

28. Jacob was an attorney licensed to practice law in the State of Maryland from December 1989 until July 2003, when he was disbarred. In connection with his disbarment, the Circuit Court of Baltimore County, Maryland held a five-day evidentiary hearing and issued a 32-page decision finding that Jacob had violated multiple rules of professional conduct. Specifically, the Court found that Jacob misappropriated at least $30,000 in client funds, charged excessive fees, made numerous false statements under oath, knowingly prepared and filed false tax returns on behalf of a client, and willfully violated a court order.

29. Faced with the Court's detailed factual and legal findings, and in lieu of an appeal, Jacob signed an affidavit acknowledging the Court's findings and consenting to

his disbarment.

30. During the relevant period, despite his disbarment, Jacob described himself as an attorney when extolling his abilities as an investment adviser to several clients and prospective clients; and he did so without disclosing his disbarment or the misconduct leading to it.

31. For example, on April 30, 2009, Jacob touted his qualifications in an email to a retired doctor who later became an advisory client of IBS and stated, "In my case, I know the results when I 'buy' and not when I am forced to 'sell'—which is what happens when a defense attorney trained as an auditor manages money—I ask no question I don't already know the answer to and I've hedged the bet on both sides of the balance sheet." Jacob forwarded this email to two other clients.

32. Also, on October 3, 2009, Jacob described himself to a prospective client as having "20-years experience as a tax/defense lawyer," and as rendering advice in the areas of "tax/financial/transition/estate planning, asset protection, and legal matters" to clients. On October 13, 2009, Jacob followed-up with the prospective client and sent an email describing the benefits of his services as follows: "Available 24/7, having investment advisers who understand, and work with the tax, pension, and legal issues and having a CPA legal consultant (who can also serve as the [third party agent]) who knows the investment world is a stellar advantage."

33. In addition, on March 31, 2013, Jacob sent a solicitation email in which he wrote, "By way of introduction, I am both [*sic*] a Certified Public Accountant, an Attorney-at-Law (now retired and non-practicing), and an Accredited Tax Adviser. While I must make the distinction between the public accounting practice and the performance of legal services, on a day-to-day basis there's no real difference."

34. On at least one occasion, when specifically confronted about his reasons for leaving the practice of law, Jacob lied. In an August 2013 email to his clients, following a report that he had had been disbarred, Jacob wrote:

> Yes, I quit practicing law. In mid-2002, I decided to no longer actively practice; it was becoming too time consuming, too expensive to maintain a dual-practice, and it was not enjoyable. My skills were better allocated to the financial, accounting, and tax areas, where [my wife] and I shined. In 2004, knowing I would be departing Maryland and never doing legal work there again, I resigned from the Maryland Bar – it was <u>knowing</u> and <u>voluntary</u>, it was <u>my</u> decision, and under Maryland Law it's called a "Consent to Disbarment." In short, at that time, I wanted no part of the b.s. of being a lawyer.

35. Jacob failed to disclose to clients that a court found he had engaged in

sustained misconduct, during his performance of client services that are strikingly similar to those he provided for investment advisory clients during the relevant period. As a fiduciary and as the manager of their retirement assets, such information regarding prior misconduct clearly would have been material to Jacob and IBS's clients and prospective clients.

36. In addition, Jacob provided tax advice to his investment advisory clients without disclosing to them that in March 2005, he was suspended indefinitely from practicing before the IRS based on his prior disbarment from the Maryland bar. Under the IRS suspension, Jacob was prohibited from, among other things, participating in presentations to the IRS relating to a taxpayer's rights, privileges or liabilities, including preparing documents and communicating with the IRS on behalf of a taxpayer.[1] Jacob failed to disclose this suspension to his advisory clients. Indeed, in violation of the suspension order, Jacob continued to engage in activities in which he represented advisory clients before the IRS.

Jacob Misrepresented And Failed To Disclose The Risks Associated With Both The Specific Securities He Purchased For His Clients' Accounts And His Overall Investment Strategy.

37. In approximately May 2010, after discussing with the financial advisers at Firm One, Jacob decided to purchase shares of Proshares Short S&P500 ("SH") and Proshares Short Russell2000 ("RWM") in over 25 of his clients' accounts. SH and RWM are single-inverse Exchange Traded Funds ("ETF"). SH seeks daily investment results that correspond to the inverse of the daily performance of the S&P 500 index. RWM seeks daily investment results that correspond to the inverse of the daily performance of the Russell 2000 index.

38. Prior to placing the trades in these ETFs, Jacob signed Firm One's "Client Disclosure Notice Regarding Single-Inverse ETFs," with respect to trades placed in his own accounts acknowledging that he understood the risks of holding these ETFs longer than one trading session (typically, one day), including the possible loss of all or a portion of the amount invested, and agreeing that the ETFs were to be purchased only as a hedge against a portfolio's exposure to the same index or benchmark. Jacob, however, failed to disclose to clients the warnings in the Client Disclosure Notice provided to him by Firm One.

39. Instead, Jacob immediately purchased SH and RWM in client accounts for speculation—*i.e.*, not as a hedge—as his clients did not own securities related to the S&P 500 index or the Russell 2000.

40. Jacob had most of his clients hold these positions for years, despite being informed in the Client Disclosure Notice he signed that:

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[1] *See* Treasury Department Circular 230, 31 CFR Section 10.2(a)(4).

- the performance of single-inverse ETFs over periods longer than one day can differ significantly from their reference index or benchmark;
- they are unsuitable for investors who plan to hold them for longer than one trading session unless used as part of a trading or hedging strategy; and
- the risks associated with investing in single-inverse ETFs include the possible loss of all or a portion of the amount invested.

41. When Jacob sold the positions for many of his clients in mid-2013, his clients' investments in these positions had lost nearly 50% of their original purchase price.

42. Similarly, Jacob bought and held long-term another highly volatile exchange-traded product ("ETP") in clients' accounts: the Barclays Bank PLC iPath S&P 500 VIX Short-Term Futures ETN ("VXX"). The pricing supplement to the VXX prospectus explains that VXX was designed to provide exposure to stock market volatility through futures contracts on the CBOE Volatility Index ("VIX"), which do not necessarily track the performance of the VIX and therefore may not benefit from increases in the level of the VIX. It further explains that VXX may be subject to unforeseen volatility. Barclays's investor materials state that VXX is riskier than ordinary unsecured debt securities and involves significant risks, including possible loss of principal.

43. Jacob purchased VXX in clients' accounts in March 2010, and again in the May through July 2010 time period. Contrary to representations made by Jacob in March 2010 about maintaining a short-term strategy with predictable profits, he held the VXX positions in clients' accounts for years, even though the positions steadily declined until they lost almost all of their value.

44. Again, Jacob failed to disclose the risks of VXX to clients. And, investors' losses in VXX totaled more than $630,000 as of January 2014.

45. On March 23, 2010, in response to a client's expression that he was "a little concerned with this VXX purchase" and noting that "[i]t seems to continue to nosedive," Jacob stated:

> It's a long-term play on long-term volatility. On the decline, it drops linearly downward. When it recovers it recovers geometrically upward.

Each of these assertions was false.

46. Jacob was informed that an investment in VXX was speculative. However, Jacob failed to disclose this fact to his clients. Instead, Jacob misrepresented,

from 2011 through 2014, that VXX acted like "an insurance policy" in their portfolios, which would "pay off" if the equities market went down. For example:

- On January 6, 2011, Jacob sent an email to his clients, stating, "[W]e have also 'insured' your portfolio from disaster by holding positions in index shorts (i.e., VXX); while that investment has declined substantially, the truth is we hope that insurance never pays off, but like life insurance it's there to protect you just-in-case."

- On January 20, 2011, in response to a customer's complaint that his account had declined $9,000 in 6 months, Jacob stated:

> The VXX is the culprit and remains in the accounts as the ultimate life insurance policy; sit tight for the ride, it will prove to be the right decision in the long-run.... The cash-flow from the options and income-yielding securities is doing well. Stay focused on that and be happy the ultimate insurance [VXX] is in-place.

47. Despite purchasing and holding long-term these high-risk investments (which resulted in significant losses), Jacob repeatedly made false representations to clients regarding the trading strategy he employed in the clients' accounts and the profitability of the securities held in the clients' accounts. He repeatedly misrepresented that his trading strategy was safe, involved little or no risk, and produced guaranteed, predictable profits when a number of the investments he purchased and held were high risk and volatile. For example:

- On June 18, 2010, Jacob misrepresented in an email to clients that the purchase of the ETFs discussed above was part of a strategy "so profits can be made on what's *inevitable* rather than what's *speculative*."

- On August 5, 2010, Jacob falsely assured a client that by 2016, his portfolio's value would increase by a factor of seven or eight by virtue of holding VXX, SH and RWM in his account. Specifically, Jacob stated, "When the 'market' crashes, as is inevitable, we have enough VXX, SH, and RWM to take your portfolio up by a factor of 7-8 fold—that's 7 times what it's worth right now."

- On June 6, 2012, Jacob misrepresented to a client,

> [W]e shifted the portfolio to [Firm One] with a more active but <u>risk-averse</u> management style (you can afford NO risk), leaving the bulk of the portfolio in cash and only deploying it when gains were assured (i.e., thru high-yield investments, options, and

market orders). During the period of market volatility, your portfolio did well, taking no extraordinary risk.

- On January 30, 2014, Jacob misrepresented to another client,

  [T]he portfolio is managed with caution on the upside and minimization of risk on the downside. Despite the crushing economic problems in the world, such a methodology allows us to steadily profit while the market is irrationally reaching new highs, generate income from a fixed-income strategy (which works regardless of market movement), and protect ourselves with calls, insurance, and hedges as things become more unsustainable.

48. Jacob had no reasonable basis to predict the long-term performance of these exchange traded products, which he knew or was reckless in not knowing were risky and speculative and which, if held long-term, would tend to result in losses.

Jacob Made False and Misleading Statements To Clients About the Profitability of His Investment Strategies.

49. In addition, Jacob repeatedly misrepresented that his investment strategy was profitable and minimized the significance of losses – referring to them as "holding losses" – while such losses in the clients' accounts grew steadily and significantly throughout the relevant period. Jacob knew, was reckless in not knowing, or should have known that his statements were false and misleading because, among other things, he had direct access to his clients' account statements and kept track of the profits and losses in each of his clients' accounts. For example:

- On March 15, 2010, Jacob sent an email to all his clients, falsely stating,

  [W]e don't purchase any investment without knowing how, when, and at what profit it will be sold.... One thing is certain – one-hundred-percent of our buy/sell/Call Premium trades have been at a profit and, since embarking on this strategy (and, for many relocating your money out West), no account has lost money.

  Notably, as of February 28, 2010, the month-end prior to this email, approximately 20 client households held unrealized losses in accounts.

- On January 27, 2013, Jacob represented to a client, "The investment results are in positive territory, the accounts are yielding a healthy

annual cash-flow, and every sale effected has generated total gains of between 16-28%." This statement was misleading because, as of December 31, 2012, this client had unrealized losses totaling over $49,000 in three ETPs held in two accounts with total assets of nearly $308,000.

- Almost a year later, on January 10, 2014, Jacob similarly told this client, "The investment results are in positive territory, the accounts are yielding a healthy annual cash-flow, and every sale effected has generated profits." This was misleading in that as of December 31, 2013, this client had unrealized losses in one ETP of about $33,000 and realized losses of over $16,000 after the July 25, 2013 sale of the other two ETPs.

- On November 5 and 6, 2013, Jacob again falsely assured clients that:

> While we are sitting on several 'holding [unrealized] losses', they are income-oriented which tends to decline sharply during times of market upswings. However, our goal therewith is to secure a steady, long-term source of continual new cash-flow, even accepting wide value fluctuations, since there is, literally, nothing to invest in which will directly track the market's overall, but manipulated, increases.... [B]ecause the holding [unrealized] losses are comprised of long-term holds (e.g., silver, mining, energy, and financials – who's long term prognosis is solid), we are not very concerned.

Jacob Provided False Information to Firm Two in Order to Purchase Securities in Clients' Accounts.

50. In 2012, Jacob provided false information to Firm Two, so that he could continue to trade in his clients' accounts.

51. Shortly after the accounts were transferred from Firm One to Firm Two, Firm Two employees discussed that Jacob may be acting as an unregistered investment adviser and communicated to Jacob that he needed to provide a legal opinion that he was in compliance with each state where the clients were located. Firm Two told Jacob that if he did not provide the legal opinion, Firm Two would not permit Jacob, who had trading authorization on the accounts, to purchase any securities in his clients' accounts.

52. In July 2012, Jacob provided to Firm Two a letter he drafted, falsely describing the services he and IBS provided. The letter included the following false statements:

- Jacob (and IBS) did not provide investment advice for compensation;

- the investment-related services Jacob and IBS performed were billed on the same basis as fees for all other services;
- Jacob and IBS did not select specific investments;
- Jacob and IBS did not decide the timing of buys and sells;
- Jacob and IBS did not make decisions regarding the general portfolio structure or the specific composition of the investment portfolios;
- Jacob and IBS did not publish an investment newsletter; and,
- Jacob and IBS did not hold themselves out to the public as an investment adviser.

In fact, as described elsewhere herein, Jacob and IBS provided all of these services and held themselves out as investment advisers.

53. Jacob also submitted to Firm Two an attorney opinion letter, which was based on the false assertions he made in the July 2012 letter. Jacob's counsel stated that, assuming Jacob's description of the services Jacob and IBS provided to clients was accurate, Jacob did not fit within the definition of "investment adviser." After Firm Two received the legal opinion, Jacob was permitted to place orders to purchase securities in clients' accounts and he continued receiving advisory fees for managing the accounts.

Jacob Misrepresented To Clients That He Was Not Required To Register As An Investment Adviser.

54. In an August 14, 2013 email from Jacob to his clients, Jacob falsely claimed that he was not required to register as an investment adviser with any state, despite being required to register as an investment adviser under the laws of Montana, Georgia, and Maryland. Specifically, Jacob stated:

> We did NOT have to hold any sort of "securities license" or "registration" to do this. . . .This was well-researched before we embarked on this path in early-2009 and was validated by an independent lawyer. In fact, [Firm Two's] Legal Compliance Department verified this, in painstaking detail, when we moved accounts there, hence some of the delay getting things firmly established. If you would like a copy, let me know.

55. Jacob failed to disclose the material fact that the "independent" lawyer who "validated" this conclusion relied solely on the letter from Jacob to Firm Two, in which Jacob falsely described his and IBS's services.

56. Jacob also failed to disclose to the advisory clients that he and IBS were required to be registered as investment advisers in several states.

D. TOLLING AGREEMENT

57. Respondents entered into tolling agreements in which they agreed to toll any applicable statute of limitations period up to and including March 10, 2015, through October 5, 2015.

E. VIOLATIONS

58. As a result of the conduct described above, IBS and Jacob willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Section 10(b) of the Exchange Act makes it unlawful for any person to use or employ, in connection with the purchase or sale of any security any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe. Rule 10b-5 under the Exchange Act makes it unlawful for any person, directly or indirectly, (a) to employ any device scheme, or artifice to defraud, (b) to make any untrue statement of material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

59. As a result of the conduct described above, IBS and Jacob willfully violated Sections 206(1) and 206(2) of the Advisers Act. Section 206(1) of the Advisers Act prohibits any investment adviser from employing any device, scheme, or artifice to defraud any client or prospective client, and Section 206(2) of the Advisers Act prohibits any investment adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against IBS pursuant to Section 203(e) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act;

C. What, if any, remedial action is appropriate in the public interest against Jacob pursuant to Section 203(f) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9 of the Investment Company Act; and

E. Whether, pursuant to Section 21C of the Exchange Act and Section 203(k) of the Advisers Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act, whether Respondents should be ordered to pay a civil penalty pursuant to Section 21B(a) of the Exchange Act, Section 203(i) of the Advisers Act, and whether Respondents should be ordered to pay disgorgement pursuant to Sections 21B(e) and 21C(e) of the Exchange Act, Section 203 of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall each file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If either of the Respondents fails to file the directed answer, or fails to appear at a hearing after being duly notified, that Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents as provided for in the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually

related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76080 / October 6, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4217 / October 6, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16884

In the Matter of **THOMAS J. PALERMO,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Thomas J. Palermo ("Palermo" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Palermo was a registered representative associated with a dually-registered broker-dealer and investment adviser between 2010 and August 2015. Palermo is 48 years old and a resident of Parkland, Florida.

2. On October 1, 2015, a final judgment was entered by consent against Palermo, permanently enjoining him from future violations of Sections 10(b) and 14(e) of the Exchange Act and Rules 10b-5 and 14e-3 thereunder in the civil action entitled Securities and Exchange Commission v. Thomas J. Palermo, et al., Civil Action Number 3:15-cv-07118, in the United States District Court for the District of New Jersey.

3. The Commission's complaint alleged that Palermo committed insider trading by trading in the securities of Pharmasset, Inc. ("Pharmasset") based on material, nonpublic information in advance of the November 21, 2011 public announcement that Pharmasset and Gilead Sciences, Inc. ("Gilead") had entered an agreement for Gilead to acquire Pharmasset. The complaint alleged that, on November 8, 2011, Palermo learned from a friend who was a lawyer for a member of Pharmasset's board of directors that Pharmasset was engaged in advanced negotiations involving a sale of the company and that a sale appeared imminent. Based on that information, Palermo purchased Pharmasset equities and options, and profited by $124,528 when the sale was announced.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, that Respondent Palermo be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

Pursuant to Section 15(b)(6) of the Exchange Act, Respondent Palermo be, and hereby is barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a

customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76090 / October 7, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16886

In the Matter of **OneSource Technologies, Inc., Packitgreen Holdings Corp., and Raytec Corp.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents OneSource Technologies, Inc., Packitgreen Holdings Corp., and Raytec Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. OneSource Technologies, Inc. (CIK No. 1118421) is a void Delaware corporation located in Scottsdale, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). OneSource Technologies, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2005. As of December 3, 2014, the company's stock (symbol "OSRC") was traded on the over-the-counter markets. The stock was previously suspended by the Commission on May 14, 2012, pursuant to Exchange Act Section 12(k).

2. Packitgreen Holdings Corp. ("Packitgreen") (CIK No. 1364798) is a revoked Nevada corporation located in Boise, Idaho with a class of securities registered with the

Commission pursuant to Exchange Act Section 12(g). Packitgreen is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2009, which reported a net loss of $123,587 for the prior nine months.

3. Raytec Corp. ("Raytec") (CIK No. 1305522) is a permanently revoked Nevada corporation located in Lake Oswego, Oregon with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Raytec is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on May 18, 2005.

B. DELINQUENT PERIODIC FILINGS

4. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

5. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

6. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Commissioner Piwowar
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4219 / October 7, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16887

In the Matter of Blackstone Management Partners L.L.C., Blackstone Management Partners III L.L.C., and Blackstone Management Partners IV L.L.C., Respondents.	ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Blackstone Management Partners L.L.C., Blackstone Management Partners III L.L.C., and Blackstone Management Partners IV L.L.C. (collectively, "Blackstone" or "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds[1] that:

SUMMARY

1. These proceedings arise from inadequate disclosures that involved two distinct breaches of fiduciary duty by private equity fund advisers Blackstone Management Partners L.L.C., Blackstone Management Partners III L.L.C., and Blackstone Management Partners IV L.L.C. (collectively, "Blackstone"). First, from at least 2010 through March 2015, upon either the private sale of a portfolio company or an initial public offering ("IPO"), Blackstone terminated certain portfolio company monitoring agreements and accelerated the payment of future monitoring fees as set forth in the agreements. Although Blackstone disclosed that it may receive monitoring fees from portfolio companies held by the funds it advised, and disclosed the amount of monitoring fees that had been accelerated following the acceleration, Blackstone failed to disclose to its funds, and to the funds' limited partners prior to their commitment of capital, that it may accelerate future monitoring fees upon termination of the monitoring agreements. Second, in late 2007, Blackstone negotiated a single legal services arrangement with its primary outside law firm (the "Law Firm") on behalf of itself and the funds. For the majority of legal services performed by the Law Firm beginning in 2008 and continuing through early 2011, Blackstone received a discount that was substantially greater than the discount received by the funds. The disparate legal fee discounts were not disclosed to the funds or the funds' limited partners until August 2012. Because of its conflict of interest as the recipient of the accelerated monitoring fees and the beneficiary of the disparate legal fee discounts, Blackstone could not effectively consent to either of these practices on behalf of the funds it advised. As a result, Blackstone breached its fiduciary duty to the funds in violation of Section 206(2) of the Advisers Act and also violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

2. Blackstone separately violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder by failing to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act arising from the undisclosed receipt of fees and conflicts of interest.

RESPONDENTS

3. **Blackstone Management Partners L.L.C. ("BMP")** is a Delaware limited liability company with its principal place of business in New York, New York. BMP is a private equity fund adviser that has been registered with the Commission as an investment adviser since October 2005. BMP manages Blackstone Capital Partners V.

4. **Blackstone Management Partners III L.L.C. ("BMP III")** is a Delaware limited liability company that maintained its principal place of business in New York, New York. BMP III

[1] The findings herein are made pursuant to Respondents' Offer and are not binding on any other person or entity in this or any other proceeding.

was a private equity fund adviser that was registered with the Commission as an investment adviser from August 1997 through March 2014.[2] BMP III managed Blackstone Capital Partners III.

5. **Blackstone Management Partners IV L.L.C. ("BMP IV")** is a Delaware limited liability company with its principal place of business in New York, New York. BMP IV is a private equity fund adviser that has been registered with the Commission as an investment adviser since September 2001. BMP IV manages Blackstone Capital Partners IV.

OTHER RELEVANT ENTITIES

6. **Blackstone Capital Partners III Merchant Banking Fund L.P., along with a parallel fund (collectively, "Blackstone Capital Partners III")**, is a Delaware limited partnership and private investment fund formed in 1997 to make private equity investments. As of March 2014, Blackstone Capital Partners III had exited all of its portfolio company positions and distributed all remaining assets to its limited partners.

7. **Blackstone Capital Partners IV L.P. ("Blackstone Capital Partners IV")** is a Delaware limited partnership and private investment fund formed in 2001 to make private equity investments.

8. **Blackstone Capital Partners V L.P., along with parallel funds (collectively, "Blackstone Capital Partners V")**, is a Delaware limited partnership and private investment fund formed in 2005 to make private equity investments.

FACTS

A. Background

9. BMP and BMP IV are New York-based private equity fund advisers and BMP III is a former private equity fund adviser (BMP, BMP III, and BMP IV collectively, "Blackstone"). The Blackstone Group L.P. (NYSE: BX), a publicly traded company since 2007, is Blackstone's parent company and has approximately $330 billion in assets under management.

10. Blackstone has advised multiple private equity funds, including Blackstone Capital Partners III, Blackstone Capital Partners IV, and Blackstone Capital Partners V (collectively, the "Funds"), each of which was or is governed by a limited partnership agreement ("LPA") setting forth the rights and obligations of its limited partners, including their obligations to pay advisory and other fees and expenses to Blackstone pursuant to a separate management agreement between each fund and the relevant Blackstone adviser. As is typical in the industry, among other fees and expenses, Blackstone generally charges the limited partners in its Funds an annual advisory or "management fee" equivalent to 1.5% of their capital under management.

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[2] BMP III withdrew its registration with the Commission in March 2014, after Blackstone Capital Partners III – the fund it advised – exited all of its portfolio company positions and distributed all of its remaining assets to its limited partners.

11. Each Fund's LPA established a Limited Partnership Advisory Committee ("LPAC") consisting of a number of limited partners. The functions of the LPAC include, among other things, the review and approval or disapproval of any potential conflicts of interest in any transaction or relationship (including those relating to the receipt of certain fees).

B. Acceleration of Monitoring Fees

12. Each Blackstone-advised fund owns multiple portfolio companies. Blackstone typically enters into monitoring agreements with each portfolio company that is owned by a Blackstone-advised fund. Pursuant to the terms of the monitoring agreements, Blackstone charges each portfolio company an annual fee in exchange for rendering certain consulting and advisory services to the portfolio company concerning its financial and business affairs. The monitoring fees paid by each fund-owned portfolio company to Blackstone are in addition to the annual management fee paid by the Funds' limited partners to Blackstone. However, a certain percentage of the monitoring fees the portfolio companies pay to Blackstone are used to offset a portion of the annual management fees that the Funds' limited partners would otherwise pay to Blackstone. The offset percentage, which was 50 percent for BCP III and is also 50 percent for BCP IV and BCP V, is set forth in each fund's LPA or investment advisory agreement.

13. Blackstone's practice of entering into monitoring agreements with portfolio companies and collecting monitoring fees is disclosed and authorized in various pre-commitment fund documents, including private placement memoranda, LPAs, and investment advisory agreements. For example, one fund's LPA states, "The Limited Partners recognize and consent that [Blackstone] may receive financial advisory fees, monitoring fees, [and] divestment fees. . . ."

14. Prior to 2012, Blackstone monitoring agreements commonly provided for ten years of monitoring services and fees. Some of these agreements contained so-called "evergreen" provisions that automatically extended the life of the agreement for an additional term. The monitoring agreements between Blackstone and the portfolio companies also provided for acceleration of monitoring fees to be triggered by certain events. For example, upon either the private sale or IPO of a portfolio company, the monitoring agreements allowed Blackstone to terminate the monitoring agreement and accelerate the remaining years of monitoring fees, in some cases including additional renewal periods, and receive present value lump sum "termination payments." While a portion of these accelerated monitoring payments reduced management fees otherwise payable by limited partners, the net amount of the payments also reduced the value of the Funds' assets (i.e., the portfolio companies making the accelerated monitoring payments) when sold or taken public, thereby reducing the amounts available for distribution to limited partners.

15. In some instances, Blackstone terminated the monitoring agreement and accelerated monitoring fee payments even though the relevant Blackstone-advised fund had completely exited the portfolio company, meaning that Blackstone would no longer be providing monitoring services to the portfolio company. In most instances, Blackstone terminated the monitoring agreement upon a portfolio company IPO and accelerated monitoring fee payments while maintaining some ownership stake in the company. In connection with most IPOs, Blackstone continued to provide consultancy and advisory services to the publicly traded portfolio company until the fund

completely exited its investment. However, in a few instances, Blackstone accelerated monitoring fees beyond the period of time during which it held an investment in the company. The timing of the exits following the IPOs ranged from approximately one-and-a-half years to several years.

16. While Blackstone disclosed its ability to collect monitoring fees to the Funds and to the Funds' limited partners prior to their commitment of capital, it did not disclose to the Funds, the Funds' LPAC, or the Funds' limited partners its practice of accelerating monitoring fees until after Blackstone had taken accelerated fees. The disclosures were made in distribution notices, quarterly management fee reports, and, in the case of IPOs, Form S-1 filings. By the time these disclosures were made, the limited partners had already committed capital to the Funds and the accelerated fees had already been paid. The LPAC of each Fund could have objected and arbitrated over the accelerated monitoring fees after they had been taken, but never did. Finally, because of its conflict of interest as the recipient of the accelerated monitoring fees, Blackstone could not effectively consent to the practice on behalf of the Funds.

C. Disparate Legal Fee Discounts

17. From at least late 2007 through early 2011, the Law Firm performed a substantial volume of legal work for Blackstone and the Funds. During this period, the Funds generated significantly more legal fees than Blackstone.

18. In late 2007, Blackstone negotiated a single legal services arrangement with the Law Firm on behalf of itself and the Funds whereby Blackstone benefited by receiving a discount from the Law Firm that was substantially greater than the discount received by the Funds.

19. Blackstone did not disclose the disparate legal fee discounts the Law Firm provided from 2008 through early 2011 to the Funds, the Funds' LPAC, or the Funds' limited partners. Moreover, because of its conflict of interest as the beneficiary of the disparate legal fee discounts, Blackstone could not effectively consent to the undisclosed practice on behalf of the Funds.

20. As the result of an early-2011 internal Blackstone audit, Blackstone voluntarily ended the disparate legal fee arrangement with the Law Firm and adopted a new task-based legal services arrangement pursuant to which Blackstone and the Funds received the same discounts. In August 2012, Blackstone disclosed to all of its Funds' limited partners the disparate legal fee discounts that had been in place from late 2007 through early 2011 and stated that the rate differential generally reflected the different mix of work performed by the Law Firm for the Funds and Blackstone.

D. Blackstone Failed to Adopt and Implement Policies and Procedures Reasonably Designed to Prevent Violations of the Advisers Act and its Rules

21. While registered as investment advisers, BMP, BMP III, and BMP IV were subject to the Advisers Act rules, including the requirement to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules.

22. From at least January 2010 through March 2015, while BMP, BMP III, and BMP IV were registered with the Commission as investment advisers, they failed adequately to disclose their practice of receiving accelerated monitoring fees.

23. From January 2008 through early 2011, while BMP, BMP III, and BMP IV were registered with the Commission as investment advisers, they received a discount on the majority of their legal fees that was substantially greater than the discount received by the Funds and they failed adequately to disclose the disparate legal fee discounts.

24. Despite the practice of receiving accelerated monitoring fees and receiving a more favorable legal fee discount than the Funds, BMP, BMP III, and BMP IV did not adopt or implement any written policies or procedures reasonably designed to prevent violations of the Advisers Act or its rules arising from the undisclosed receipt of fees or conflicts of interest.

VIOLATIONS

25. Section 206(2) of the Advisers Act prohibits investment advisers from directly or indirectly engaging "in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client." A violation of Section 206(2) of the Advisers Act may rest on a finding of simple negligence. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)). Proof of *scienter* is not required to establish a violation of Section 206(2) of the Advisers Act. *Id.* As a result of the conduct described above, BMP, BMP III, and BMP IV violated Section 206(2) of the Advisers Act.

26. Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder make it unlawful for any investment adviser to a pooled investment vehicle to "[m]ake any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle" or "engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle." As a result of the conduct described above, BMP, BMP III, and BMP IV violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

27. Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder require registered investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules. As a result of the conduct described above, BMP, BMP III, and BMP IV violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

BLACKSTONE'S COOPERATION AND REMEDIAL EFFORTS

28. In determining to accept Blackstone's Offer, the Commission considered remedial acts taken by Blackstone prior to contact from Commission staff and cooperation afforded the Commission staff after Blackstone was contacted. In early 2011, Blackstone voluntarily ended its disparate legal fee arrangement with the Law Firm. In 2012, Blackstone disclosed to all limited partners, without any resulting complaints, that historical discounts offered to Blackstone exceeded discounts provided to the Funds.

29. For all funds formed after 2012, Blackstone has disclosed in the PPMs that monitoring agreements may contain acceleration provisions that trigger lump sum payments. In addition, as it disclosed to its LPACs in June 2014, since 2012, Blackstone has not entered into any monitoring agreements that have terms beyond ten years, self-renew or contain "evergreen" provisions. Blackstone has, since 2010, also not taken advantage of any evergreen provisions in existing agreements when collecting a lump sum payment. In 2012, Blackstone enhanced the disclosures it makes after taking accelerated monitoring payments by explicitly identifying termination payments in reports distributed to limited partners and setting forth in detail the assumptions underlying the calculation of such payments. In 2014, prior to the SEC investigation, Blackstone changed its business practices and further disclosed that it will not accelerate monitoring fee payments when it completely exits a portfolio company through private sale and will not accelerate more than three years (equal to the approximate average post-IPO length of time before Blackstone has made full exits) of remaining monitoring fee payments in the event of an IPO.

30. Throughout the staff's investigation, Blackstone voluntarily and promptly provided documents and information to the staff. Blackstone met with the staff on multiple occasions and provided detailed factual summaries of relevant information. Blackstone was extremely prompt and responsive in addressing staff inquiries.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offer.

Accordingly, pursuant to Section 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondents BMP, BMP III, and BMP IV cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 thereunder.

B. Respondents BMP, BMP III, and BMP IV shall pay, jointly and severally, disgorgement and prejudgment interest as follows:

i. Respondents shall pay a total of $28,911,756 consisting of disgorgement of $26,225,203 and prejudgment interest of $2,686,553 (collectively, the

"Disgorgement Fund") to compensate the Funds and limited partners therein that invested in private equity transactions from 2010 to March 2015 that resulted in payment of undisclosed accelerated monitoring fees;

ii. Within ten (10) days of the entry of this Order, Respondents shall deposit the full amount of the Disgorgement Fund into an escrow account acceptable to the Commission staff and shall provide the Commission staff with evidence of such deposit in a form acceptable to the Commission staff. If timely deposit of the Disgorgement Fund is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600;

iii. Respondents shall be responsible for administering the Disgorgement Fund. When possible, Respondents shall distribute the amount of the Disgorgement Fund to the applicable funds or limited partners as a credit against or other effective reduction of certain fees or other amounts that the funds would otherwise be obligated to pay to Blackstone or that Blackstone would otherwise be entitled to receive. Within 30 days of the entry of this Order, Blackstone shall submit a proposed distribution to the staff for review and approval. The proposed distribution will include the names of the applicable funds or limited partners and their respective payment amounts and a description of the methodology used to determine the exact amount of payment or credit for each fund or limited partner that will receive a distribution. The distribution of the Disgorgement Fund shall be made in the next two fiscal quarters immediately following the entry of this Order but no later than within 270 days of the date of the Order, based on the methodology set forth in the proposed distribution and as reviewed and not objected to by the staff. If Respondents do not distribute any portion of the Disgorgement Fund for any reason, including factors beyond Respondents' control, Respondents shall transfer any such undistributed funds to the Commission for transmittal to the United States Treasury. Any such payment shall be made in accordance with Section IV.C below;

iv. Respondents agree to be responsible for all tax compliance responsibilities associated with distribution of the Disgorgement Fund and may retain any professional services necessary. The costs and expenses of any such professional services shall be borne by Respondents and shall not be paid out of the Disgorgement Fund; and

v. Within 270 days after the date of the entry of the Order, Respondents shall submit to the Commission staff a final accounting and certification of the disposition of the Disgorgement Fund not unacceptable to the

staff, which shall be in a format to be provided by the Commission staff. The final accounting and certification shall include: (i) the amount paid or credited to each fund or limited partner; (ii) the date of each payment or credit; (iii) the check number or other identifier of money transferred or credited to the fund or limited partner; and (iv) any amounts not distributed to be forwarded to the Commission for transfer to the United States Treasury. Respondents shall submit the final accounting and certification, together with proof and supporting documentation of such payments and credits in a form acceptable to Commission staff, under a cover letter that identifies BMP, BMP III, and BMP IV as the Respondents in these proceedings and the file number of these proceedings to Anthony S. Kelly, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5010. Any and all supporting documentation for the accounting and certification shall be provided to the Commission staff upon request. Once the Commission approves the final accounting, Respondents shall pay any amounts that have not been distributed to the Commission for transmittal to the United States Treasury.

C. Respondents BMP, BMP III, and BMP IV shall pay, jointly and severally, within ten (10) days of the entry of this Order, a civil monetary penalty in the amount of $10,000,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Section 21F(g)(3) of the Securities Exchange Act of 1934. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payment by check or money order must be accompanied by a cover letter identifying BMP, BMP III, and BMP IV as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Anthony S. Kelly, Assistant Director, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5010.

D. Respondents acknowledge that the Commission is not imposing a civil penalty in excess of $10,000,000 based upon their cooperation in a Commission investigation and related enforcement action. If at any time following the entry of the Order, the Division of Enforcement ("Division") obtains information indicating that Respondents knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding, the Division may, at its sole discretion and with prior notice to the Respondents, petition the Commission to reopen this matter and seek an order directing that the Respondents pay an additional civil penalty. Respondents may contest by way of defense in any resulting administrative proceeding whether it knowingly provided materially false or misleading information, but may not: (1) contest the findings in the Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76096 / October 7, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31865 / October 7, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16888

In the Matter of **PHILLIP CORY ROBERTS, and BAY PEAK, LLC,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Phillip Cory Roberts ("Roberts") and Bay Peak, LLC ("Bay Peak").

II.

After an investigation, the Division of Enforcement alleges that:

SUMMARY

Phillip Cory Roberts created Bay Peak, LLC in 2005 to acquire domestic shell companies for reverse merger transactions with China-based operating companies and to engage in transactions to finance those business combinations and the resulting issuers. Since at least 2007, Roberts and Bay Peak have participated in no less than nine corporate financings or reverse mergers involving Chinese operating companies. Since the formation of Bay Peak in 2005, neither Roberts nor Bay Peak has been registered with the Commission in any capacity.

In a typical deal, Roberts and Bay Peak located a Chinese company seeking financing in the U.S. markets and negotiated to reverse merge the company's operating

entity into one of the shells acquired by Bay Peak and Roberts for that purpose. In the process, Roberts and Bay Peak met with the operating company's management to sell Bay Peak's shells and services. Roberts and Bay Peak then would work to raise capital through private placements, warrant financings, initial public offerings ("IPOs"), or direct investment. Roberts and Bay Peak participated in key steps of the financing process on behalf of the parties to the deals by, among other things, directly soliciting investors and hiring agents to solicit investors; communicating with warrant holders on behalf of the entities; drafting and editing private placement memoranda and SEC registration statements; participating in discussions about how to structure financings; and providing direct financing.

As a result of Roberts' and Bay Peak's regular participation in such activities as part of their business, each acted as an unregistered broker in violation of Section 15(a)(1) of the Exchange Act.

RESPONDENTS

1. **Phillip Cory Roberts**, age 50, is a United States citizen who resides in Mill Valley, California. Roberts was registered as an associated person of Salomon Smith Barney Inc. from 1996 to 1999, during which time he passed the Series 7, 63, and 65 examinations. According to the Central Registration Depository, maintained by the Financial Industry Regulatory Authority, his broker-dealer license has not been active since 1999. At all relevant times, Roberts was the managing member of Bay Peak and exercised control over the entity's activities, but was not registered with the Commission.

2. **Bay Peak, LLC ("Bay Peak")** is a limited liability company that was established in 2005 in the State of California. During the relevant time period, Bay Peak marketed itself as "a privately held investment firm" that sourced, developed, and executed investment opportunities globally, including by managing public listings of operating companies through merger transactions with shell companies. Bay Peak has never been registered with the Commission in any capacity.

RELATED PARTIES

3. **Fuqi International, Inc. ("Fuqi")** is a company with operations based in China. In November 2006, Fuqi and a shell company controlled by Bay Peak completed a reverse merger. On December 29, 2006, Fuqi filed an Exchange Act Form 10-12G to register its common stock pursuant to Section 12(g) of the Exchange Act. On October 23, 2007, Fuqi's Securities Act Form S-1 registration statement for its initial public offering of common stock became effective along with its Exchange Act Form 8-A/12B registering its common stock pursuant to Section 12(b) of the Exchange Act, and Fuqi's common stock began trading on the NASDAQ Global Market. On June 3, 2011, NASDAQ filed a Form 25 delisting Fuqi's common stock as of June 13, 2011, and deregistering the common stock from Section 12(b). Thereafter, Fuqi's common stock reverted to its previous Section 12(g) registration. On July 1, 2013, Fuqi consented to the entry of an order revoking Fuqi's Exchange Act Section 12 registration.

4. **Trunkbow International Holdings Limited ("Trunkbow")** is a company with operations based in China. In February 2010, Trunkbow and a shell company controlled by Bay Peak completed a reverse merger. On June 4, 2010, Trunkbow filed an Exchange Act Form 10-12G to register its common stock pursuant to Section 12(g) of the Exchange Act. On February 2, 2011, Trunkbow's Securities Act Form S-1 registration statement for its initial public offering of common stock became effective along with its Exchange Act Form 8-A/12B registering its common stock pursuant to Section 12(b) of the Exchange Act, and Trunkbow's common stock began trading on the NASDAQ Global Market. On April 14, 2014, NASDAQ filed a Form 25 delisting Trunkbow's common stock as of April 24, 2014, and deregistering the common stock from Section 12(b). Thereafter, Trunkbow's common stock reverted to its previous Section 12(g) registration. On April 24, 2014, Trunkbow filed a Form 15-12G terminating Trunkbow's Exchange Act Section 12 registration. Roberts, in his capacity as a director of the company, signed Trunkbow's Form S-1 and Forms S-1/A dated: October 14, 2010; November 16, 2010; December 15, 2010; January 6, 2011; January 14, 2011; and February 2, 2011. Roberts resigned as a member of Trunkbow's Board of Directors on March 30, 2011.

5. **Asia Leechdom Holding Corporation ("Asia Leechdom")** is a Nevada corporation with operations based in China through its indirect subsidiary, Tianjin BOAI Pharmaceuticals, Co. Ltd. (BOAI). On May 28, 2010, a Bay Peak shell company, Bay Peak 6 Acquisition Corp., and Asia Leechdom completed a reverse merger. Roberts, who had been a director of the shell company, remained a director after the merger. On February 14, 2011, Asia Leechdom filed a Form 10-12G to register its common stock pursuant to Section 12(g) of the Exchange Act. Roberts signed the Form 10-12G. On December 29, 2011, Asia Leechdom filed a Form 15-12G terminating its Section 12 registration.

FACTS

6. Roberts created Bay Peak in 2005 for the purpose of engaging in reverse merger transactions with China-based operating companies.

7. Bay Peak and Roberts solicited and structured the transactions between shell companies controlled by Roberts and Chinese companies and actively participated in efforts to finance those business combinations. They also raised capital for some of the resulting issuers through additional securities offerings. Since at least 2007, Roberts and Bay Peak have participated in no less than nine corporate financings or reverse mergers involving China-based operating companies, including transactions involving Fuqi, Trunkbow, and Asia Leechdom. In addition, Roberts, on behalf of Bay Peak, signed financial advisory agreements in connection with possible financings for at least 13 other Chinese companies. The Financial Advisory Agreements typically included some or all of the following services: (i) assist the Company in evaluating the manner of effectuating a going public transaction; (ii) providing services in preparation for a "Going Public Transaction," including website, PowerPoint and due diligence package creation; (iii) negotiating investment terms with the lead underwriter; and (iv) assisting the Company in capital-raising activities through introductions to potential investors (which may or may not be affiliates of Bay Peak). Compensation was often in the form of an "Advisory Fee"

calculated as a percentage of the gross proceeds raised from a financing as well as reimbursement of expenses.

8. Since the formation of Bay Peak in 2005, neither Roberts nor Bay Peak has been registered with the Commission in any capacity.

A. Roberts' and Bay Peak's Description of its Services and Shells

9. Roberts and Bay Peak marketed their services and shells for use in transactions through a website on which they held themselves out as "manag[ing] the Initial Public Listing process from pre-transaction origination to the development of financing alternatives," including "deal origination," "financing," and "going public." On that site, they claimed "a proven track record of success in international investment banking and investment management" and listed ten "successful" deals they had managed on behalf of Chinese companies seeking to enter the U.S. securities markets. The website also included press releases describing Bay Peak's successful financings and reverse mergers and testimonials from issuers praising Bay Peak and Roberts for their role in the companies' corporate financings and IPOs.

10. Roberts also distributed other materials that described the services that Bay Peak could provide to "Target Companies." These documents stated, "Bay Peak is the principal owner of publicly held US bankruptcy shells that we use to transact mergers and acquisitions with profitable operating companies. We establish a new Initial Public Listing for the operating company on the AMEX, NASDAQ or OTC.BB. Our Initial Public Listing process is specifically tailored for efficiency in raising capital. To complete an initial public listing, the operating company executes a merger transaction with one of the BayPeak Acquisition Companies (BPAC) *simultaneously* [italics in original] with a capital raise. The capital raise is executed through a free-trading warrant that enables the operating company to determine the valuations and timing of the capital it needs. . . . BayPeak manages the process from pre-transaction origination to the development of financing alternatives. We will supply all of the relevant transaction documentation necessary for a successful execution of the listing process."

11. Roberts further described Bay Peak's business in a February 2006 email, "My company, BayPeak LLC, assists Asian based companies to raise capital and attain a public listing on a US stock market." Roberts elaborated in an October 2007 email, stating, "I control 16 bankruptcy shell companies that I use to do reverse merger transactions with Asia based companies. We close the merger transaction simultaneous with a capital raise."

12. Roberts sent an email to a China-based target company in which he referred the company to Bay Peak's website and said, "...[Bay Peak owns] 15 shell companies that I use for reverse merger transactions with Chinese companies. We also directly invest in each transaction.... We . . . invested $3M USD into the company and then raise approximately $75M USD in an IPO. I am currently engaged with 8 other Chinese companies to execute similar transactions as I did with FUQI." Roberts attached to his email a PowerPoint presentation titled "Discussion materials for: Target

Company." The presentation stated, in part, "BayPeak manages the process from pre-transaction origination to the development of financing alternatives. We provide investment valuation analysis and a guaranteed minimum capital raise and maximum dilution upon the closing of the [Alternative Public Listing process] .... Bay Peak llc provides an Institutional quality shell company structured for quick and easy merger transactions. They provide a focused value proposition to the operating company, the investors and the investment banks that assist them."

13. Typically, using business contacts and Chinese-speaking employees of Bay Peak, Roberts and Bay Peak would locate a Chinese company seeking financing in the U.S. markets and negotiate to reverse merge the company's operating entity into one of the shells acquired by Bay Peak and Roberts for that purpose.

14. The reverse merger transaction was Bay Peak's mechanism to convert a privately-held operating company to a publicly-held one and thereby facilitate listing of the public company's shares on a U.S. exchange. Listing and public trading would enable the company to raise capital more easily. The shells controlled by Bay Peak and Roberts typically had warrant structures that could be used by the companies resulting from the reverse mergers to raise capital through a call of the warrants. If the pre-existing warrant holders elected to exercise their warrants, they would then become shareholders in the new companies.

15. The Chinese operating companies would also typically employ Bay Peak to provide additional services in connection with the reverse merger transactions and subsequent efforts to raise capital through private placements, warrant financings, or IPOs.

16. Some of the services that Bay Peak and Roberts regularly provided on behalf of its clients included explaining different options by which the companies could raise capital; participating in discussions about how to structure financings; communicating with warrant holders on behalf of issuers; soliciting investors on behalf of issuers to purchase the issuers' equity securities and hiring agents to solicit investors to purchase the securities of Bay Peak's issuer clients; drafting and editing private placement memoranda and SEC registration statements; introducing the companies to other investment banks; and providing direct short-term financing for services the issuers needed to complete the transactions.

Soliciting Investors

17. Prior to the reverse merger transactions, Roberts and Bay Peak often entered into financial advisory agreements with client companies that contained provisions stating that Bay Peak would assist the companies in capital-raising activities and would be compensated for, among other things, introductions to potential investors.

18. For example, in April 2008, Roberts entered into an agreement on behalf of Bay Peak to provide a Chinese energy company ("Company 1") with "financial advisory and consulting services related to . . . one or more offerings of equity securities of the Company [,] . . . a going public transaction between the Company and a public shell

domiciled in the United States . . . [, and] a restructuring plan . . . ." Pursuant to the agreement, Bay Peak agreed to act on a "best efforts basis" to provide services including "assist[ing] the Company with a private Financing of a minimum $12 million dollars from the sale of shares of capital stock of the Company . . . through (a) introductions to potential investors, placement agents or underwriters (it is understood that BayPeak is not an 'investment banking' firm or 'broker-dealer), as permitted by applicable law, and/or (b) conversion or exercise of warrants or other convertible securities issued by the shell company."

19. The agreement's disclaimer that Bay Peak was not an investment banking firm or broker-dealer notwithstanding, Roberts and Bay Peak directly solicited potential investors on behalf of Company 1.

20. On October 28, 2008, Roberts, identifying himself as managing member of Bay Peak, emailed the managing partner of a private equity firm, stating, "Thanks for taking the time to meet up last Friday. I wanted to follow up on our conversations about taking a look at [a] specific opportunity to determine if you may have some interest in participating. I have attached a [PowerPoint] for [Company 1] which is one of my deals that we will start looking for a small equity round of financing soon . . . ."

21. Roberts often solicited institutional investors to invest in the companies involved in Bay Peak's reverse merger transactions.

22. On May 7, 2008, Roberts emailed two PowerPoint presentations containing information about a Chinese nutritional supplement company ("Company 2") and another Chinese energy company ("Company 3") to an employee of an institutional investment firm with the message: "attached is some basic information in a [PowerPoint] for a couple of deals that I am doing. Let me know if you may have some interest, would love to talk to you about them." On May 14, 2008, another employee of the investment firm emailed Roberts, "Thank you for organizing the conference call for [Company 3] . . . . After consideration we decided to pass [on Company 2]. Thank you for sharing this opportunity with us." Roberts responded, "Could you let me know what you thought of the [Company 2] project, and what was the determining factor in your decision to pas[s]? It will help me better understand the projects that you may have an interest in. I expect to have at least 3 more ready in the next two months." The investment firm employee responded to Roberts's question, explaining the reasons that "we don't think it is a good time to invest in [Company 2]."

23. Roberts had previously entered into agreements on behalf of Bay Peak to receive transaction-based compensation in the form of equity and a finders fee for providing Companies 2 and 3 with assistance with capital-raising activities, among other services.

24. Similarly, Roberts and Bay Peak represented that they had entered into a consulting agreement with a brewery with operations in China ("Company 4") that provided that Bay Peak would assist the company in capital-raising activities. Roberts subsequently emailed a potential investor on June 23, 2011, "remember the Chinese Beer

company I told you about? any interest in taking a look. Need to raise minimum $4 million but up to $10 million. Have an engagement signed. Done some DD [due diligence]. Terms are good and the economics are great . . . [ellipsis in original] especially if I can negotiate one more thing in the deal." The potential investor expressed interest. A few days later, Roberts emailed the investor again, and they made arrangements to meet in person.

25. A Bay Peak contract employee also solicited another potential investor on behalf of Company 4. In August 2011, the Bay Peak employee emailed Roberts to inform him that a Chinese investment fund "is interested to put in $10M-$20M. We supposed to have a conference today with its senior Vice President . . . to further discuss [Company 4]."

26. Company 4 subsequently terminated its agreement with Bay Peak. In October 2011, the Bay Peak contract employee emailed Roberts that "4 US legal attorneys have reviewed it saying that we wouldn't win the lawsuit if we go after [Company 4]. Also, they will ask SEC to investigate Baypeak for illegal fundraising activities because we don't have the license."

27. Bay Peak and Roberts communicated with potential investors to solicit them as a regular part of their business. In an October 2010 email to the Bay Peak contract employee, Roberts stated, "I need to create a password protected data room so that I can share documents with investors." Roberts sent the employee a link to an example of such a data room and told the employee, "this is a dataroom for a deal that I am working on with someone else. this is a virtual data room which is hosted by a company. I want to create one with the same functionality on my Bay Peak website. We will have multiple deals so I want to make sure that the data room can give different password protection to each deal."

28. Roberts and Bay Peak also participated in seminars at which they communicated with investors in order to, among other things, solicit transactions. One of Roberts's investment partners emailed Roberts before a scheduled investor seminar: "We are proposing two meetings – one in the morning just for Warrantholders . . . . Then another meeting in the afternoon for new investors . . . ." Roberts agreed to attend the seminar. A flyer for a March 24, 2010 seminar advertised "An Invitation to Meet Our China Connection Cory Roberts" and stated that attendees would learn about "Opportunities for you, as a Stock and/or Warrant Holder."

29. In addition to direct solicitations, Roberts and Bay Peak communicated with investors in partnership with third parties. For example, an analyst report named Roberts as a "Key Partner" of Ground Floor Capital ("GFC"), a firm affiliated with an investor with whom Roberts had previously worked, and stated that GFC had "partnered with BayPeak . . . [t]o work to allow high growth Chinese companies to become listed in the United States by way of a reverse merger. GFC and BayPeak are currently seeking investors to help finalize a reverse merger and listing . . . ."

30. On at least two occasions, Bay Peak entered into consulting agreements with third parties "to research and identify" investors and investment funds that may be

potential investors for Bay Peak clients. Bay Peak was to pay these consultants a "consultation" or "success" fee based on a percentage of the funds raised.

31. These consultants later introduced two potential investors to Bay Peak in connection with the Asia Leechdom deal.

Roberts' and Bay Peak's Solicitation Activity in Concert with Investment Banks

32. Although a registered investment bank was also often involved in the financing transactions in which Roberts and Bay Peak participated, Roberts and Bay Peak acted as unregistered brokers in connection with those deals.

33. For example, in September 2007, an employee of an investment bank engaged by Fuqi emailed Roberts, telling him "you owe me a list of potential investors . . . ." On the same day, Roberts contacted more than a dozen individuals affiliated with hedge funds and investment firms to personally invite them to attend an IPO road show for Fuqi.

34. In another February 2010 email, Roberts informed an employee of the investment bank that was engaged as part of a financing transaction for Trunkbow that an investor that Roberts had previously contacted about investing in Trunkbow "was passing" and added that he was "Trying to bring in a couple of other guys." The investment bank employee told Roberts, "Get me what ever you can."

Structuring Transactions

35. Roberts also advised issuers about the desirability of structuring securities transactions in particular ways. For example, Roberts participated in the structuring of Trunkbow's financing transactions by convincing the investment bank to use a warrant structure that had the potential to maximize the number of shareholders, thereby meeting minimum shareholder requirements for Trunkbow's listing on NASDAQ.

36. With a number of companies, Roberts and Bay Peak entered into financial advisory agreements that provided that Bay Peak would advise and assist the companies in structuring and effecting securities transactions. As one example, in addition to the agreements discussed in connection with the representative engagements below, in December 2007, Bay Peak's agreement with Company 3 stated that Bay Peak would "assist the Company in evaluating the manner of effectuating a going public transaction with a public shell company … [and] use best-efforts to complete the Going Public Transaction."

37. Similarly, in April 2007, Roberts and Bay Peak received a signed agreement from another company with operations in China ("Company 5") that provided that Bay Peak would provide "advice and assistance in connection with: a. Introducing potential investors to the Financing [and] b. Reviewing financial information and assisting in negotiations of the financial terms and structure of the Financing."

Providing Pre-Transaction Financing

38. Roberts and his investor group often advanced money to Bay Peak's client companies to cover transaction-related expenses. Bay Peak advertised that it would provide up to $1 million for transaction financing as "development loans" for payment of pre-transaction legal expenses, US GAAP audits, and "work capital."

39. This pre-transaction financing allowed the issuers to, among other things, hire professionals to create audit reports, draft private placement memoranda, and draft and file registration statements with the Commission.

40. Bay Peak also advertised that it would provide convertible bridge financing of up to $3 million to facilitate private placements and that Bay Peak and affiliated investment funds (Roberts' and Bay Peak's investor partner group) would invest up to $20 million in pre-IPO financing.

41. Roberts and Bay Peak, by their participation in reverse merger transactions and corporate financings, engaged in a business of regularly effecting securities transactions in the accounts of solicited investors, their investment partners, and Bay Peak's client companies.

Compensation

42. In return for their efforts and the use of a Bay Peak-controlled shell company, Roberts and Bay Peak typically received negotiated compensation in the form of shares, advisory and consulting fees, and bonus payments.

43. In connection with the corporate financings or reverse mergers in which they participated since 2007, Roberts and Bay Peak received at least $1,800,000 in advisory fees, of which at least $1,600,000 was in transaction-related compensation based on the success of their client companies' capital-raising activities.

44. Roberts and Bay Peak also received shares as part of a retained ownership interest in the issuers following the transactions. Upon completion of the Fuqi, Asia Leechdom, and Trunkbow reverse mergers, discussed in more detail below, Roberts held at least 840,000, 2,541,535, and 1,352,332 shares, respectively. As a result of other reverse mergers, Roberts held 1,182,939 shares in a Chinese tour operator and 1,014,799 shares in a Chinese fashion sportswear company.

45. Some of the shares Roberts and Bay Peak received were compensation for assisting issuers to complete securities transactions. For example, Roberts and Bay Peak received 675,317 shares of common stock as consideration for their services in connection with the Asia Leechdom financings.

46. Roberts or Bay Peak later sold all or a portion of their ownership stakes, including securities received as compensation or obtained otherwise, and thereby received total proceeds of at least $7 million.

B. Representative Engagements

Fuqi

47. Fuqi was the first transaction negotiated and structured by Roberts and Bay Peak using a Bay Peak-controlled shell for a reverse merger. In November 2006, Fuqi and a Bay Peak shell executed a negotiated share exchange agreement to effect the reverse merger.

48. Roberts initiated his and Bay Peak's participation in the Fuqi transaction by conducting due diligence on Fuqi and meeting with the company's management to explain how Bay Peak could manage a capital raise through a warrant financing and an IPO in the U.S. markets. In one email, Roberts wrote, "Fuqi still has 2 series of warrants outstanding. Those warrants should be put into a Unit and used to raise the capital and help build the market."

49. Roberts and Bay Peak also assumed certain expenses associated with the reverse merger between Fuqi and the Bay Peak-controlled shell including legal fees for opinion letters, the drafting of merger documents, and the preparation of a Form 10 filed with the Commission.

50. On May 2, 2007, Roberts, on behalf of Bay Peak, entered into an advisory agreement with Fuqi that provided that it would pay Bay Peak an advisory fee of $10,000 and a "bonus fee of six percent (6%) of the gross proceeds of the Financing if the Company successfully raises more than Two Million Dollars ($2,000,000) from the [warrant] Call." The "Financing" was defined in the agreement as "the capital raising event resulting solely from the exercise of the Company's outstanding Series C Plan Warrants and Series E Plan Warrants following the Company's completion of the call for redemption of such warrants." In return, Roberts, on behalf of Bay Peak, agreed to provide "advice to the extent requested by the Company in connection with the Financing."

51. Roberts and Bay Peak participated in setting the exercise price for warrants and provided advice to Fuqi and the investment bank on the timing of the warrant call. Roberts also strategized with Fuqi on the process of making a warrant call prior to the company's IPO.

52. On July 2, 2007, Fuqi filed a Form S-1 with the SEC. In it, the company stated that it had "entered into a letter agreement with Bay Peak to assist us in the potential exercise of outstanding Series C Plan Warrants and Series E Plan Warrants . . . ." In return for their services in connection with the warrant call, Roberts and Bay Peak were compensated in the form of a "'bonus fee' of 6% of the gross proceeds from the exercise of the Warrants (approximately $178,000)." Bay Peak also received an "advisory fee" of $10,000 and was reimbursed for expenses of $10,000.

53. Furthermore, Roberts and Bay Peak participated in discussions with the lead underwriter in the deal to analyze financing options and potential structures to raise capital. He described his role to one potential institutional investor in Fuqi as follows: "the investment bank, the company and I all agreed to do an IPO. Since we made this

determination, we decided to only raise a small bridge financing. . . . My investor [sic] own the warrants that are associated with my shells and look to invest a minimum of $3 to $5mm in each of the companies that we execute a merger with. If the company needs to raise more than $10mm we bring in 3rd party funds to participate along with us."

54. Roberts and Bay Peak continued to provide services to Fuqi in connection with the company's subsequent IPO. In September 2007, Roberts sent emails that he signed as "Managing Member" of Bay Peak to more than a dozen individuals affiliated with hedge funds and investment firms to invite them to attend an IPO road show for Fuqi. In several of the emails, Roberts wrote, "I have one of my portfolio companies getting ready to do an IPO road show. . . . I wanted to see if you may be interested." Fuqi completed an IPO in October 2007, and began trading on NASDAQ.

55. Roberts and Bay Peak used the success of the Fuqi deal to solicit others for additional deals. In one email to a potential investor on October 24, 2007, Roberts wrote, "my china deal is up and trading. . . . [ellipse in original] FUQI thought you may be interested. I have five more deals that I am working on, could use some help! Could use some money to invest in these deals!!!!!!!!!!"

56. Roberts later described Bay Peak's involvement with Fuqi in an email in which he stated, "We close the merger transaction simultaneous with a capital raise. The first transaction I did with one of these shells is listed on NASDAQ under ticker FUQI. We directly invested $3M USD into the company and then did a full registered public offering for $67M USD."

57. Bay Peak also featured its participation in the Fuqi deal on its website. In November 2010, Roberts emailed the CFO of Fuqi, "I have been revising my Website and wanted to see if I could put a quote in from you. :) is it ok with you for me to put this in? I hope it's true!!!" The quote, which Roberts told Fuqi's CFO that he (Roberts) had drafted, stated, "Baypeak was our first foreign investor and assisted us in our IPO. Cory continues to be a valued shareholder and friend." Fuqi's CFO responded, "It is fine to quote these facts." The quote, attributed to Fuqi's CFO, was placed on Bay Peak's website.

Trunkbow

58. In February 2010, Roberts and Bay Peak participated in a reverse merger between a Bay Peak-controlled shell and Trunkbow. Concurrent with the reverse merger transaction, Trunkbow engaged in a simultaneous call of warrants and a private placement.

59. Roberts and Bay Peak were involved in structuring Trunkbow's reverse merger transaction and its concurrent capital raise.

60. According to a term sheet between a Bay Peak-controlled shell company and Trunkbow, which was signed by Roberts on behalf of the shell company, Trunkbow would receive bridge financing of $2 million from Bay Peak and/or affiliated persons in connection with the contemplated reverse merger transaction. Roberts and Bay Peak would arrange for an investor group to exercise outstanding warrants in the shell company

for an aggregate exercise price of $4 to $8 million, with the price per share determined by a negotiated formula. In exchange for these commitments, after the reverse merger transaction was completed, Bay Peak and the minority shareholders in the shell would own 5% of the issued and outstanding shares of the merged company.

61. Roberts and Bay Peak participated in the structuring of Trunkbow's financing transactions by advocating for a process that had the potential to maximize the number of shareholders and therefore help Trunkbow satisfy NASDAQ's minimum shareholder requirements for listing. The lead investment bank participating in the transaction initially planned to create three separate offerings for Trunkbow. Roberts objected, writing to the bank's Managing Head of China Investment Banking, "This will not list up on NASDAQ now. We will be stuck with doing a registered offering. What is the motivation behind executing this through 3 separate offerings?" After a discussion with Roberts, the warrant structure for which Roberts advocated was adopted.

62. Roberts described his and Bay Peak's involvement with Trunkbow in a November 29, 2009 email to a potential investor, "Just signed up a very exciting deal! I am providing a $2M bridge to the company on Monday and then they are doing a $15M raise. We are coming in with around $5M and [an investment bank] is engaged to raise the rest... [ellipsis in original] which looks like it is pretty much completed. Would love for you to take a look and see if you are interested. The Company is called Trunkbow...." The potential investor requested additional information, and, in response, Roberts forwarded "the latest investor presentation" and commented, "attached a presentation but I don't think that it is very good . . . [ellipsis in original] really misses the real value proposition and competitive advantages." Roberts and the prospective investor then discussed arrangements to speak further by telephone.

63. In an email to another potential investor in December 2009, Roberts wrote, "I just signed up a new deal which I have been working in coordination with . . . the investment bank which completed the FUQI IPO for me[]. I have attached the company presentation and the terms to the financing. I just bridged the company $2M this week. I am excited about this one -- they have a huge opportunity and the valuations are right. There is a large strategic [sic] that has committed and other investors outside of my group that has [sic] committed $20M -- but I have the right to invest $4M to $8M with my guys. We are putting in $4M and have another group coming in for $2M so there is $2M left in our allocation. (I am limiting the total capital raise to $20M)[.] Let's talk about this one when you have some time."

64. Roberts and Bay Peak continued to assist Trunkbow in raising additional capital after the bridge loan agreement was in place. He did this by contacting warrant holders in connection with Trunkbow's warrant call and other investors in connection with Trunkbow's private placement.

65. In his capacity as managing member of Bay Peak, Roberts met with the CEO and CFO of an investor that ultimately invested in Trunkbow. During that meeting, Roberts discussed Trunkbow with the potential investor and explained why Bay Peak had chosen to participate in a merger transaction with the company.

66. Roberts also provided feedback to the lead investment bank regarding "information he would like to see" in Trunkbow's private placement memorandum that was used to solicit investors. Once prepared, Roberts and Bay Peak also distributed the document to several potential investors.

67. Roberts and Bay Peak created a document with a "bayPeak llc" header on each page that described Trunkbow's business, financials, and financing plans. The document stated that, "Trunkbow has entered into a Share Exchange Agreement to complete a reverse merger transaction with bayPeak 5 Acquisition Corp 'BPAC 5' [a shell company provided by Bay Peak] upon a minimum financing of $10 million. Investors may purchase common stock in Trunkbow through the exercise of an existing warrant which, once called by the company, entitles each holder to convert one warrant into one share of common stock. Through this offering, we are seeking to raise up to $25 million in proceeds for issuance of 37% of our total equity post closing." The final page of the document stated, "For more information please contact Cory Roberts" or another person with a "baypeak.com" email address.

68. Similar documents were created for at least two other deals, including Asia Leechdom, discussed below.

69. In a January 6, 2010 email, Roberts followed up with the potential investor he contacted in November 2009 about investing in Trunkbow. Roberts wrote, "Things are progressing quickly on all of these deals I am working on. I have attached our internal executive summary for both Trunkbow and BOAI. Let me know if you have an interest. We will have a PPM [private placement memorandum] on Trunkbow by the end of this week . . . ."

70. Roberts continued to discuss the opportunity to invest in Trunkbow with the prospective investor in a January 19, 2010 email. Roberts wrote, "I attached a financial model. . . . Let's talk soon if you are interested because this is over subscribed at this point. I am pushing to get more of the offering and should be able to since we are leading and providing the shell. They will most likely cut some of the Chinese investors back to make room."

71. In a February 2, 2010 email, Roberts, as managing member of Bay Peak, contacted another potential investor in Trunkbow, writing, "Just wanted to give you a heads up on a deal I am closing this week. Would love for you to participate. Let me know if you have an interest, the PPM [private placement memorandum] is attached. We are the lead investor with $6M on top of this $20M that is being completed with [investment bank] as the banker."

72. Roberts contacted another prospective investor in a February 4, 2010 email with the subject "Trunkbow PPM." In the email, Roberts wrote, "This is the offering document. Let me know if you want to do a little bit." On February 16, the potential investor wrote back, "thinking of doing 100k." Roberts responded the same day, "I forgot I sent that to you. We closed with $22.5M last week." The potential investor replied, "So I

guess I missed it. I wish I'd known the deadline. Damn." Roberts wrote back the next day, "There will be others."

73. In another email Roberts sent on February 2, 2010, he told an employee of the lead investment bank, "I brought in 37 investors and for $66,400. [W]hich almost pays for all my expenses. fyi – still trying to bring this one guy in." A few days later, on February 8, Roberts contacted the lead investment bank in an email with the subject "new investor" and asked that the bank send the investor required forms to finalize his investment in Trunkbow.

74. Roberts also assisted Trunkbow in conducting an IPO in February 2011. Two months before the IPO, Roberts told an investment bank that he had "several" investors for whom he wanted to set up accounts and about whom he wanted to discuss allocation amounts.

75. In December 2010, Roberts sent an email to his investor group asking whether they could "stir up some broker/retail interest" if Trunkbow added a stop in Vancouver for its IPO road show.

76. After the merger transaction, Bay Peak owned approximately 5% of the issued and outstanding shares of Trunkbow, which amounted to 1,352,332 shares of stock and 100,000 warrants.

77. Roberts resigned from Trunkbow's board of directors on March 31, 2011, shortly after the IPO was completed.

78. The CEO of Trunkbow is quoted on Bay Peak's website as saying, "Bay Peak provided our bridge financing and led our initial investment round and provided us with assistance and guidance for a successful listing onto NASDAQ. We are happy to have Cory still serving on our Board."

Asia Leechdom

79. On May 28, 2010, another Bay Peak shell company completed a reverse merger with Asia Leechdom, the 100% owner of BOAI. Subsequently, on or about June 1, 2010, Bay Peak posted on its website, at the direction of Roberts, a press release announcing the merger and the raising of $8,000,000 on behalf of the company through the exercise of warrants.

80. Roberts described Bay Peak's engagement with BOAI in a December 1, 2009 email as follows, "I signed up another company named BOAI Pharmaceuticals this past week as well. It tried to go out and raise money earlier this year but was unsuccessful . . . [ellipsis in original] I think that their positioning was all wrong. The company is audited and ready to move forward, so we are doing a financing."

81. In a December 9, 2009 email to one of his investor partners with the subject "BOAI," Roberts wrote, "Let's discuss how we want to move this financing forward. The SEA [Share Exchange Agreement] closes contingent upon a $10M capital raise but they

will close this with as little as $5M if we can close before March 1st. Can work a small fee into this for another group we bring in to complete the transaction. Let's try to figure this one out."

82. In the months leading up to the reverse merger, Roberts directly solicited investors on behalf of BOAI/Asia Leechdom.

83. On December 17, 2009, Roberts emailed a prospective investor, "I wanted to follow up with you about BOAI. . . . I would like to know if your investment group still has an interest in investing along side our investment and how much they are interested in investing?" On December 28, 2009, the prospective investor emailed Roberts, "Would you please send me the latest business plan of Boai?" On December 30, 2009, Roberts sent the potential investor a document that he described as "our internal executive summary." In a subsequent email, Roberts described the document as "the BOAI executive summary that we are using to discuss the opportunity with investors." The document contained a "bayPeak llc" header on each page and concluded with the statement, "For more information please contact Cory Roberts" or another person with a "baypeak.com" email address.

84. Roberts emailed his investor partner on March 18, 2010, "my guy says he is in for $1M . . . . I think I may have another small hedge fund in for $1M but have to work on him some more. . . . I have 2 other guys I will send them info. after I call them tomorrow . . . [ellipsis in original] they could come in for $1M each as well but may be a long shot." The partner responded, "Good job teammate!"

85. On March 29, 2010, Roberts sent an email with the subject "BOAI deal" to the same potential investor to whom Roberts had sent an "internal executive summary for both Trunkbow and BOAI" by email on January 6, 2010 (described in paragraph 69, above). In the March 29 email Roberts wrote, "I don't think I ever sent you final info on this deal. You should take a look at it. let me know."

86. In addition to directly soliciting investors, Roberts facilitated communications between several prospective investors and company management. In one February 1, 2010 email, an employee of a potential institutional investor wrote to Roberts, "Thanks for the time today to discuss BOAI and your structure. . . . If [BOAI's chairman] is available on Thursday or Friday, I think it would be worth a visit." Roberts responded that another employee of the institutional investor had "connected with my guys in BJ [Beijing] and will visit the company this Sat." The potential investor replied, "Great. Thanks for the setting this up."

87. In another February 11, 2010 email, Roberts provided detailed information about BOAI/Asia Leechdom in response to questions described as "[p]oints of focus for one investor who is deciding on how much to commit."

88. In February 2010, Roberts was asked to arrange a private call between a prospective Chinese-speaking investor and the company's chairman. Roberts agreed to set up the call, but refused to allow the investor to speak to the chairman without Roberts or

one of his Chinese-speaking partners on the phone. In a February 26, 2010 email, Roberts wrote, "I am sure we can get a call set up with . . . the Chairman of BOAI for Monday at 3:30. However, I will not provide free access to anyone without either myself on the call or one of my team members. Since the call will be held in Chinese then I will have one of my partners on the call." Roberts later added, "if he refuses to have one of my partners on the call while he speaks to the Chairman then I don't want his money."

89. Like in Trunkbow, Roberts circulated a document that described a "Private Offering" for the "China BOAI Financing." The document had a "bayPeak llc" header on each page and stated, "Through this offering, we are seeking to raise a minimum of $10 million in proceeds for issuance of 10% of our total equity post closing." The final page of the document stated, "For more information please contact Cory Roberts" or another person with a "baypeak.com" email address. Roberts sent the document to at least two potential investors.

90. On July 1, 2010, Roberts, on behalf of Bay Peak, entered into a negotiated agreement with Asia Leechdom to provide advisory services in exchange for $8,000 per month and "8% of the gross proceeds the Company receives from any Financing completed during the term of this Agreement." In return, Roberts and Bay Peak agreed to advise the company on "the manner of effectuating a going public transaction."

91. On or about July 26, 2010, Bay Peak posted on its website, at the direction of Roberts, a press release announcing that Asia Leechdom Holdings had completed a second tranche of warrant financing for approximately $3 million, increasing the amount raised to approximately $10.8 million. According to the press release, Asia Leechdom would "seek to list on a senior exchange in the United States" and had engaged Bay Peak to "advise on the listing process."

92. In November 2011, Roberts and Bay Peak entered into consulting agreements with two Chinese citizens for them to solicit investors in Asia Leechdom. Bay Peak agreed to pay the consultants a fee of 2% of the gross proceeds received from any potential investor.

93. On February 11, 2011, Asia Leechdom filed a Form 10-12G, signed by Roberts as a director. The Form 10-12G stated that, "As consideration for its services as financial advisor in connection with the May 2010 and June 2010 financing, at the closing of such financing we also paid Bay Peak, LLC, the company's financial advisor, $935,000 in cash and issued them 675,317 shares of our Common Stock valued at $2.51 per share." According to the terms of the financial advisory agreement between Asia Leechdom and Bay Peak, this payment was transaction-based compensation based on the amount of money raised from the warrant call.

94. The Chairwoman of BOAI (the 100% owner of Asia Leechdom) was quoted on Bay Peak's website as saying, "We have been very pleased in working so closely with Bay Peak to complete our financing needs and our US listing. They really work hard for us."

VIOLATIONS

95. Section 15(a)(1) of the Exchange Act prohibits any broker that is a natural person not associated with a broker or dealer from using the mails or any other means of interstate commerce to "effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security," unless he or she is registered with the Commission as a broker in accordance with Section 15(b) of the Act. As a result of the conduct described above, Roberts willfully violated Section 15(a)(1) of the Exchange Act by failing to register as a broker.

96. Section 15(a)(1) of the Exchange Act prohibits any broker that is not a natural person from using the mails or any other means of interstate commerce to "effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security," unless that broker in registered with the Commission in accordance with Section 15(b) of the Act. As a result of the conduct described above, Bay Peak willfully violated Section 15(a)(1) by failing to register as a broker.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b), (d), and (e) of the Investment Company Act including, but not limited to, disgorgement and civil penalties; and

D. Whether, pursuant Section 21C of the Exchange Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Section 15(a)(1) of the Exchange Act, whether Respondents should be ordered to pay a civil penalty pursuant to Section 21B(a) of the Exchange Act, and whether Respondents should be ordered to pay disgorgement pursuant to Sections 21B(e) and 21C(e) of the Exchange Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an

Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310.

This Order shall be served forthwith upon Respondents as provided for in the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76089 / October 7, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16885

In the Matter of OSK Capital I Corp., OSK Capital III Corp., PowerNomics Enterprise Corp., and ReDirect, Inc., Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents OSK Capital I Corp., OSK Capital III Corp., PowerNomics Enterprise Corp., and ReDirect, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. OSK Capital I Corp. ("OSK Capital I") (CIK No. 1092391) is a permanently revoked Nevada corporation located in Denver, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). OSK Capital I is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB/A for the period ended February 29, 2000, which reported a net loss of $63,978 from the company's February 25, 1999 inception to February 29, 2000.

2. OSK Capital III Corp. ("OSK Capital III") (CIK No. 1107565) is a Nevada corporation located in Atlanta, Georgia with a class of securities registered with the

Commission pursuant to Exchange Act Section 12(g). OSK Capital III is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2005, which reported a net loss of $1,175 for the prior nine months.

3. PowerNomics Enterprise Corp. ("PowerNomics") (CIK No. 1116684) is a void Delaware corporation located in Chalfont, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PowerNomics is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended January 31, 2001, which reported a net loss of $95,426 for the prior three months.

4. ReDirect, Inc. ("ReDirect") (CIK No. 1466551) is a forfeited Delaware corporation located in Philadelphia, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ReDirect is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on July 14, 2009, which reported a net loss of $20,640 for the year ended December 31, 2008.

B. DELINQUENT PERIODIC FILINGS

5. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

6. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

7. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76109 / October 8, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4221 / October 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16890

In the Matter of WOLVERINE TRADING, LLC and WOLVERINE ASSET MANAGEMENT, LLC, Respondents.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Wolverine Trading, LLC ("WT") and Wolverine Asset Management, LLC ("WAM") (together, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds[1] that:

SUMMARY

1. These proceedings arise out of WT's and WAM's failure to establish, maintain, or enforce written policies and procedures reasonably designed, taking into consideration the nature of their businesses, to prevent the misuse of material, nonpublic information, which came to light as a result of breaches of information barriers by the two affiliated entities from late-February to late-March 2012, relating to an exchange-traded note ("ETN") known as TVIX.

2. On February 21, Credit Suisse AG ("CSAG"), TVIX's issuer, announced a temporary suspension of new issuances of TVIX. For the next month, TVIX experienced a dislocation of its trading price from its indicative value, resulting in the development of a significant premium. During the course of the trading day on March 22, however, TVIX's trading price dropped sharply, and with that, the premium between trading price and indicative value decreased. After the market close that day, CSAG announced a reopening of issuances of TVIX on a limited basis.

3. During this period and thereafter, WT shared information about TVIX with WAM, including information relating to its trading positions, activities, and strategies, while WAM shared with WT its intent to enter into a swap and to request the creation of TVIX notes, including the number of notes it sought to create and eventually received. This information sharing violated existing written policies and procedures. In addition, WT and WAM personnel met to discuss issues relating to TVIX numerous times and participated in negotiations and conference calls together, all of which breached the information barriers between the two entities.

4. This information sharing also exposed inadequacies in WT's and WAM's written policies and procedures, which included various vague provisions and did not provide adequate guidance, monitoring, or surveillance of potential information sharing.

5. WT and WAM failed to enforce their written policies and procedures—most notably, those relating to information barriers—and the various ambiguities and other weaknesses in those policies and procedures rendered them not reasonably designed to prevent the misuse of material, nonpublic information. Accordingly, WT violated Section 15(g) of the Exchange Act, and WAM violated Section 204A of the Advisers Act.

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[1] The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

RESPONDENTS

6. WT is an Illinois limited liability company with its principal place of business in Chicago, Illinois. It is a wholly owned subsidiary of Wolverine Holdings, L.P. ("Wolverine Holdings") and an affiliate of WAM. WT has been registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act since 1994, originally known as Wolverine Trading, L.P. and as of 2003 known as WT. As of July 23, 2015, WT was a member of twelve securities exchanges, on which it traded for its own account.

7. WAM is an Illinois limited liability company with its principal place of business in Chicago, Illinois. It is a wholly owned subsidiary of Wolverine Holdings and an affiliate of WT. WAM has been registered with the Commission as an investment adviser pursuant to Section 203(c) of the Advisers Act since August 2011. As of March 27, 2015, WAM had regulatory assets under management of over $6.9 billion, providing discretionary advisory services to seven accounts.

OTHER RELEVANT ENTITIES

8. Wolverine Holdings is an Illinois limited partnership that serves as the holding company for WT, WAM, and their affiliates. During the relevant time period, Wolverine Holdings had ten partners; today, Wolverine Holdings has eleven partners ("Partners"). Two of the Partners are controlling shareholders of Wolverine Trading Partners, Inc. ("WTP"), the General Partner of Wolverine Holdings.

9. CSAG is a corporation incorporated and domiciled in Switzerland and headquartered in Zurich, Switzerland. Credit Suisse Securities (USA) LLC ("CSSU"), a CSAG affiliate, is a Delaware limited liability company with its principal place of business in New York, New York and a registered broker-dealer and investment adviser with the Commission. CSAG, acting through its Nassau Branch, is the issuer of the VelocityShares Daily 2x VIX Short Term ETN linked to the S&P 500 VIX Short-Term Futures Index due December 4, 2030, an ETN which, during the relevant time period, was listed on the New York Stock Exchange Arca ("NYSE Arca") with the exchange ticker TVIX ("TVIX").

10. Velocity Shares, LLC ("VelocityShares") is a Delaware limited liability company with its principal place of business in Darien, Connecticut. VLS Securities LLC ("VLS"), a VelocityShares subsidiary, is a Delaware limited liability company with its principal place of business in Darien, Connecticut and a registered broker-dealer with the Commission.

BACKGROUND

Suspension and Subsequent Reopening of Issuances of TVIX

11. TVIX is an ETN issued by CSAG.[2] According to its pricing supplement, TVIX is intended to provide investors with returns based on a multiple of the performance of the S&P 500 VIX Short-Term Futures Index ER ("Index"), and the Index is intended "to provide investors with exposure to one or more maturities of futures contracts on the CBOE Volatility Index . . . [("VIX")], which reflect implied volatility of the S&P 500 Index at various points along the volatility forward curve."

12. Any market participant could purchase TVIX on a securities exchange; however, only certain market participants were authorized to request the creation of TVIX notes, which were priced at TVIX's indicative value[3] plus an additional cost. These market participants entered into a "VelocityShares Redemption and Creation Agreement" with VLS ("VLS Agreement"). Referred to in the VLS Agreement as "Market Makers," these market participants were authorized to submit creation or redemption requests to VLS, which then aggregated, organized, and submitted those requests to CSSU on behalf of those Market Makers. WT entered into a VLS Agreement as of November 24, 2010; to date, WAM has not entered into a VLS Agreement.

13. After the market close on February 21, 2012, CSAG announced in a press release the temporary suspension of new issuances of TVIX due to "internal limits on [its] size" ("February 21 Press Release"). As a result, Market Makers were restricted from requesting the creation of TVIX notes, though not from redeeming notes. Later in the February 21 Press Release, CSAG noted the possibility that the suspension "may cause an imbalance of supply and demand in the secondary market," which may lead to trading at "a premium or discount in relation to . . . indicative value."

14. Over the next month, a persistent premium between TVIX's trading price and indicative value developed. For example, from February 22 to March 9, the closing premium ranged from approximately four to twenty percent, and from March 12 to March 21, the closing premium remained above twenty percent and increased day-over-day, with the exception of March

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2 ETNs generally are unsecured debt securities issued by public companies (most often, bank holding companies or investment banks), which typically can provide exposure to certain benchmarks or strategies and are traded on securities exchanges.

3 The indicative value of an ETN reflects the intrinsic value of that ETN, as defined in the prospectus. TVIX's indicative value ticker is TVIXIV.

14, reaching a closing high of 89.4% on March 21. As of March 20, NYSE Arca placed TVIX on its Regulation SHO threshold securities list.[4]

15. From February 22 to March 22 ("Creation Suspension Period"), CSSU considered alternatives that would enable the reopening of new issuances. Over the course of the day on March 22, the trading price of TVIX dropped significantly from an opening price of $14.78 to a closing price of $10.20, which affected the closing premium such that it collapsed to 30.2%. After the market close, CSAG announced in a press release its plan to reopen new issuances of TVIX on a "limited basis" ("March 22 Press Release"). In addition to issuing TVIX into its affiliates' inventory for securities lending, CSAG stated that beginning as soon as March 28, it may issue TVIX "to be sold solely to authorized market makers," though it "may condition its acceptance of a market maker's offer to purchase [TVIX] on its agreeing to sell to Credit Suisse specified hedging instruments consistent with Credit Suisse's hedging strategy, including but not limited to swaps."

16. On March 28, three market participants other than CSSU submitted individual creation requests for TVIX to VLS. Total return swaps were traded with Credit Suisse International ("CSI"), the relevant CSAG affiliate that served as swap counterparty.

WT's and WAM's Trading in TVIX from February 21 to March 22, 2012

17. On February 21, 2012, WT had a long end-of-day position in TVIX. During the Creation Suspension Period and thereafter, WT maintained short end-of-day positions in TVIX. WT's end-of-day short position in TVIX increased almost every day during the Creation Suspension Period, with a few exceptions, eventually resulting in a short end-of-day position of over 2.4 million TVIX notes on March 22.

18. Prior to the Creation Suspension Period, WAM had never taken a trading position in TVIX. Beginning on February 22, WAM established a short position in TVIX, which increased almost every day, with limited exceptions, until March 13, when WAM believed that it could no longer add to its short position due to its belief that it needed to obtain a locate, which it could not do. From March 13 to March 22, WAM maintained a short end-of-day position of over 800,000 TVIX notes.

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[4] Regulation SHO applies to short sales of "equity securities" as the term is defined in Section 3(a)(11) of the Exchange Act and Rule 3a11-1 thereunder. Because TVIX is not an "equity security" under the Exchange Act, it should not have been placed on the NYSE Arca Regulation SHO threshold securities list.

WT's and WAM's Information Sharing Regarding TVIX

a. WT's and WAM's Information Sharing During Creation Suspension Period

i. *WT's TVIX Position and Strategy*

19. On the morning of February 22, 2012, the day after the suspension of new issuances of TVIX, the principal trader on the WT desk responsible for market making in TVIX ("WT Trader") sent an e-mail to a Partner inquiring whether his desk could undertake a similar trading strategy in TVIX as it had years before in relation to another exchange-traded product ("ETP#2")—*i.e.*, essentially whether WT could establish and hold a short position in TVIX, which could potentially result in surpassing risk parameters, but which could allow WT to profit eventually from any premium that developed as a result of the suspension. This Partner was the Chief Executive Officer ("CEO") and Chief Investment Officer ("CIO") of WAM and had ultimate responsibility for WAM's investment decisions, and he was a Founder and Co-Managing Partner of Wolverine Holdings and one of the controlling shareholders of WTP ("WTP Partner").

20. After market close on February 22, another WT trader sent a daily positional profit-and-loss e-mail to, among others, the "Partners" listserv, which included the WTP Partner. An e-mail from the WT Trader to that same group followed in which he provided WT's approximate end-of-day position in TVIX and his intention to "trade the premium back and forth" and not to "establish a long term position until we get more clarity on when TVIX could open for creations again." Later that evening, the WTP Partner responded, "Keep me up on the spread and we can discuss sizing."

21. That same evening, the WTP Partner forwarded an e-mail that he had received from a third party regarding TVIX to a WAM portfolio manager ("WAM PM") with the following note: "Something I forgot to mention today. Basket desk informed me about this today. Something similar to [ETP#2] may be happening here. Got pushed to a pretty big premium today. Let's look at it closer tomorrow. Worth starting to put some on and get into the trade." The term "basket desk" refers to the WT Trader's desk.

22. The WAM PM responded to the WTP Partner that he had already established a short position in TVIX earlier that day, provided positional information, and indicated that they could discuss tomorrow. The next day, the WAM PM increased the size of WAM's short position in TVIX from 41,000 to 316,000 notes.

23. Over the course of the Creation Suspension Period, the WT Trader continued to send e-mails to the WTP Partner providing specific information regarding the size of WT's position in TVIX and WT's trading strategy. For example, at certain points during the Creation Suspension Period, the WT Trader informed the WTP Partner of WT's position, the then-current TVIX premium, and how much the WT Trader proposed to add or to reduce his short position if the premium moved within certain ranges. The WTP Partner typically responded with his reaction to this information; for example, in response to one of these snapshots, the WTP Partner responded that he was "good with the levels." According to the WT Trader, if the WTP Partner had not

responded that he was comfortable with the "levels," he would have sought guidance from the WTP Partner relating to what his "levels" should be.

24. Meanwhile, during the Creation Suspension Period, the WAM PM provided daily updates on his TVIX position to various WAM personnel, including to the WTP Partner. The WTP Partner and WAM PM discussed WAM's TVIX position over e-mail and on the trading floor, where the WAM PM sat in close proximity to the WTP Partner. According to the WAM PM, if the WTP Partner had not agreed with WAM's position in TVIX, the WAM PM would have inquired as to whether the WTP Partner wanted him to shrink his short position in TVIX, and, if so, the WAM PM would have done so immediately.

ii. *Meetings Between WT Trader and WAM PM*

25. Despite the physical separation between WT and WAM, the WT Trader and the WAM PM met several times during the Creation Suspension Period specifically to discuss TVIX. These meetings would sometimes occur in a conference room in the common area between WT's and WAM's trading floors. The WTP Partner was aware that the WT Trader and the WAM PM discussed TVIX during the Creation Suspension Period.

iii. *Information Relating to Potential Swaps*

26. On the morning of February 22, 2012, the WT Trader reached out to CSSU, seeking information and guidance regarding the February 21 Press Release and the expected timing of any reopening of new issuances. Specifically, the WT Trader e-mailed a CSSU Director in Equity Derivatives Product Investor Solutions ("CSSU Director"), who was tasked with managing CSSU's ETN platform. Later that day and then again the next day, the WT Trader contacted CSSU, including the CSSU Director, proposing entry into a swap in exchange for creation of TVIX notes.

27. On March 2, the WT Trader again contacted the CSSU Director regarding, among other things, the potential entry into a swap. Following a telephone call, the WT Trader sent an e-mail to the CSSU Director, introducing the Chief Operating Officer of WAM ("WAM COO") as WT's "[s]wap contact" for purposes of "get[ting] the paper work rolling with the ISDA on the trading side."

28. The term "ISDA" refers to International Swaps and Derivatives Association documentation, which counterparties enter into as a predicate to executing over-the-counter derivative transactions, including swaps. The relevant entity for which an ISDA was to be negotiated was Wolverine Alternative Investments, LLC ("WAI"), another subsidiary of Wolverine Holdings. During the Creation Suspension Period, WT was the only Market Maker that was engaged in active discussions with CSSU regarding an ISDA. Wolverine Convertible Arbitrage Fund Trading Ltd. ("WCAF")—one of WAM's pooled investment vehicle clients—had previously entered into an ISDA with CSI.

29. Over the balance of the Creation Suspension Period, the CSSU Director and the WT Trader had conversations relating to, among other things, the potential use of swaps in connection

with the reopening of new issuances of TVIX, which included the WAM PM in addition to the WAM COO. The WAM PM participated in at least eight telephone calls with the WT Trader and the CSSU Director. As a result of these conversations, the WAM PM relayed to the WTP Partner and other WAM personnel, for example, that on March 19, "[s]wap talks are ongoing yet painfully slow," whereas on March 20, "[s]wap talks were productive today, sounds like action should come soon (barring any currently unforeseen setbacks)." Additionally, in an e-mail exchange with the WAM PM during mid-afternoon on March 22, as the premium between TVIX's market price and indicative value was collapsing, the WAM COO informed the WAM PM that he had spoken with the WT Trader and CSSU and that he was expecting to receive the WAI ISDA the next day, noting that it "[s]ounds like they are keen to move that quickly now," which he supposed "could have been perceived by someone else as meaningful."

b. Swap Execution and Request for TVIX Creation by WAM on March 28, 2012

30. After the March 22 Press Release, the WT Trader contacted the CSSU Director to express interest in requesting the creation of TVIX notes, along with entering into a swap. That evening, the WT Trader corresponded with the WAM COO regarding the impact of the March 22 Press Release on the timing of completion of the WAI ISDA. He also communicated with the WTP Partner regarding his initial view as to the dollar amount of notes that should be requested, as well as on how to trade TVIX, and related instruments, in light of the March 22 Press Release. The next morning, the WAM PM and the WTP Partner also discussed the WAM PM's thoughts on requesting creation of TVIX notes, as well as how he was trading TVIX following the March 22 Press Release.

31. On March 23, 2012, the CSSU Director circulated a draft swap term sheet to certain Market Makers, including WT. The CSSU Director indicated that they were soliciting indications of interest from Market Makers and asked that any Market Maker that wanted to request the creation of TVIX notes provide the number or dollar amount of notes that they desired. WAM did not receive this draft term sheet directly from the CSSU Director.

32. From March 23 to March 27, correspondence between the WT Trader and the WTP Partner, on the one hand, and between the WAM PM and the WTP Partner, on the other hand, continued regarding the return profile associated with creation of TVIX notes and execution of a swap. These individual exchanges included specific information such as current TVIX positions, the dollar amount of TVIX notes to be requested, terms of the swap including duration and initial margin, and the dollar amount of VIX futures to be used to hedge the swap. In addition, on at least one occasion, the WT Trader and the WAM PM discussed the return profile associated with creation of TVIX notes and execution of a swap.

33. On the morning of March 27, the WT Trader provided the CSSU Director with an indication of interest on behalf of both WT and WAM. That afternoon, the CSSU Director provided the WT Trader with an approved allocation of TVIX notes—which was significantly lower than the indication of interest—along with the initial margin and duration of the swap. That evening, the WT Trader e-mailed the WTP Partner to tell him that he "took the fill."

34. During the course of the morning of March 28, the exact identity of the entity that was to be the designated swap counterparty vacillated between WCAF and WAI following telephone calls between the WT Trader and the CSSU Director. The WAI ISDA, however, was not completed by March 28, and the WT Trader indicated to the CSSU Director that WCAF would be the swap counterparty.

35. In the early afternoon, the WAM PM submitted a creation request to VLS on behalf of "Wolverine." Shortly thereafter, the CSSU Director sent the WAM PM and the WT Trader, among others, the final swap term sheet, requesting that the WAM PM confirm the terms on behalf of WCAF and instructing that the WT Trader must submit the creation request to VLS, noting that "[o]n the creation leg, we can only face the same entity authorized as MM for these with Velocity." In response to the CSSU Director, the WAM PM confirmed the swap on behalf of WCAF and replied that they would "coordinate" with VLS regarding the creation request. Despite the CSSU Director's instruction, WAM, not WT, submitted the order to create TVIX notes. As a result, WAM earned greater profits because it covered its short position in TVIX with those notes, which were priced close to the then indicative value at $6.8924, whereas any other non-Market Maker would have had to cover its short position at TVIX's market price, which continued to reflect a greater premium over indicative value. The closing price of TVIX on March 28 was $7.20.

c. Additional Correspondence Regarding WT's TVIX Position and Strategy

36. Even after the Creation Suspension Period and the March 28 note creation and swap execution, WT personnel still updated the WTP Partner and sought his guidance on WT's position and strategy regarding TVIX. These discussions continued until at least mid-April 2012.

Written Policies and Procedures to Prevent Misuse of Material, Nonpublic Information

a. Information Barrier Procedures

37. The "Information Barrier Procedures," which were applicable across WT, WAM, and their affiliates ("Wolverine Entities"), set forth in their introduction that they "establish the manner in which [the Wolverine Entities] will conduct business as separate and distinct organizations free from conflicts of interest and prevent the improper use or dissemination of material non-public information."

38. The Information Barrier Procedures highlighted the "functional and physical separation" among the Wolverine Entities and required that personnel of the Wolverine Entities maintain the confidentiality of trading positions, activities, and strategies. Instructions were given regarding the "responsibility" of any "officer or employee of an entity [that] obtains inappropriate information about another entity's trades, positions or strategies," including "inform[ing] the Compliance Department," "maintain[ing] . . . the confidentiality of such information," and "refrain[ing] . . . from engaging in any trading or other activities that make improper use of such information."

39. The Information Barrier Procedures also designated "Supervisors" that were "responsible for the maintenance and surveillance" of the Information Barrier Procedures for each Wolverine Entity or individual trading desk within certain Wolverine Entities ("Information Barrier Supervisors"), including by "actively monitor[ing] the information barriers by ensuring that personnel from other entities are not spending time in space occupied by another entity." At the time of the events described herein, the WT Trader and the WTP Partner were Information Barrier Supervisors for the WT Trader's desk and for WAM, respectively.

40. The Information Barrier Procedures devoted a section to "Individuals 'Above the Wall,'" designated as "[c]ertain individuals responsible for performing various accounting, back office, compliance, risk monitoring and systems-related functions . . . [that] may have position or trading knowledge pertaining to more than one entity or business unit." The individuals designated as "above the wall" included the risk manager for the Wolverine Entities (who is also a Partner, a Founder and Co-Managing Partner of Wolverine Holdings, and the other controlling shareholder of WTP), the Chief Financial Officer, the Chief Legal Counsel, the WT risk management group, and compliance department personnel.

41. At the time of the events described herein, the only individuals explicitly designated in the Information Barrier Procedures as being "above the wall" were those highlighted in the "Individuals 'Above the Wall'" section. A freestanding paragraph in the introduction of the Information Barrier Procedures, however, stated that "[s]enior management of the entities who are not active in the day-to-day trading activities and/or day-to-day management of specific trading activities will be responsible for and may participate in general managerial oversight," defined as "includ[ing], but . . . not limited to market strategy, revenue and profit targets and objectives, establishment of risk parameters, overall trading philosophy, staffing, resources and other administrative and general managerial matters."

42. The Information Barrier policies were periodically revised after the events described herein. In connection with an August 2012 revision, the Information Barrier Procedures were updated to include a new section entitled "Other Access 'Above the Wall,'" which added the Partners, including the WTP Partner, to those individuals explicitly identified as "above the wall" for certain purposes. Upfront, the section noted that the Partners "may be 'walled off' from seeing the specific trading activity/positions" of Wolverine Entities for which they did not perform day-to-day responsibilities. It continued, however, that despite these limitations, the Partners may see "specific information in relation to the corporate organizational structure in general, as well as information related to the profits and losses of the entities, potential strategies, targets and objectives, risk parameters, overall trading philosophy, staffing, resources and other administrative and general managerial matters." The revised Information Barrier Procedures also referenced "[o]ther senior management of the entities who are not active in the day-to-day trading activities and/or day-to-day management of specific trading activities," who "may participate in general managerial oversight and may view information similar" to that accessible to the Partners.

b. Other Relevant Policies and Procedures

43. The "Insider Trading Policies and Procedures," which were also applicable across all of the Wolverine Entities, stated upfront that all personnel of the Wolverine Entities "must attest to their understanding and acceptance of the [Wolverine Entities'] written procedures as they relate to insider trading and the misuse of material, non-public information." The Insider Trading Policies and Procedures then provided context regarding the meanings of certain terms, discussed restricted lists, and included instructions for personnel when they believed they were in possession of material, nonpublic information.

44. WAM's "Code of Ethics" also devoted a section to the "Prohibition Against Insider Trading." Like the Insider Trading Policies and Procedures, the Code of Ethics provided context for the meaning of certain terms, and instructions for steps to take if personnel believed they had access to material, nonpublic information. It also advised that "[n]on-public information does not change to public information solely by selective dissemination" and that "[e]mployees must be aware that even where there is no expectation of confidentiality, a person may become an insider upon receiving Material Non-Public Information." On the topic of "Selective Disclosure," the Code of Ethics restricted the sharing of nonpublic information regarding "investment strategies, trading, and Client holdings" with third parties, "except as is necessary to implement investment decisions and conduct other legitimate business," adding that "[e]mployees must never disclose proposed or pending trades or other sensitive information to any third party without the prior approval of the [Chief Compliance Officer]."

<u>WT's and WAM's Written Policies and Procedures Are Not Reasonably Designed to Prevent Misuse of Material, Nonpublic Information</u>

45. WT and WAM did not adequately enforce their written policies and procedures in connection with their information sharing relating to TVIX. WT's trading positions, activities, and strategies were shared with WAM through the conversations between the WT Trader and the WTP Partner, who was WAM's CEO and CIO. In addition, WAM shared with WT its interest in entering into a swap and requesting the creation of TVIX notes, including the quantity of TVIX notes WAM sought to create and eventually received, evidenced by the WT Trader's providing for both WT and WAM an indication of interest with respect to the dollar amount of TVIX notes requested and subsequent taking of the "fill," and his relaying the identity of the ultimate swap counterparty, WCAF, to CSSU.

46. The meetings between the WT Trader and the WAM PM, as described in paragraph 25, were contrary to the physical separation that the written policies and procedures required be maintained between the two entities. Exacerbating the issue was the presence of an Information Barrier Supervisor himself in these meetings (the WT Trader) and the knowledge of another Information Barrier Supervisor that the WT Trader and the WAM PM had met (the WTP Partner). The functional separation of WT and WAM was also undermined by, among other things, the collective telephone calls with CSSU, the communication of a cumulative swap indication of interest, and the request for creation of notes by WAM. The blending of WT and WAM provided information and opportunity that other market participants did not have. The participation of WAM

personnel in the WAI ISDA negotiation and the CSSU telephone calls provided WAM with insight into the potential use of swaps in connection with the reopening of new issuances of TVIX. The WT Trader's communication of a cumulative swap indication of interest followed by WAM's submission of an order to create TVIX notes—despite contrary instructions from CSSU—provided WAM with an opportunity that no other non-Market Maker received at that time.

47. To the extent that any of this sharing of information was permitted under the written policies and procedures, such policies and procedures were not reasonably designed to prevent the misuse of material, nonpublic information. As a result of the communications between the WT Trader and the WTP Partner—who was WAM's CEO and CIO—WAM became aware of the trading positions, activities, and strategy of WT, a Market Maker with a significant and increasing short position. Rather than immediately reaching out to the WTP Partner, the WT Trader could have consulted with a Partner that had day-to-day responsibilities over his desk or the risk manager of the Wolverine Entities, who was "above the wall" and had the same titles and authority as the WTP Partner, as well as day-to-day responsibilities with respect to WT. And, although the Information Barrier Procedures operative at the time mentioned that certain "senior management . . . will be responsible for and may participate in general managerial oversight," including "establishment of risk parameters," this provision was too vague and unclear in its applicability to be relied upon to justify the information sharing.

48. Although subsequent revisions to the Information Barrier Procedures explicitly designated the Partners and "other senior management" as being given "Other Access 'Above the Wall,'" the Information Barrier Procedures still lacked a framework to monitor this sharing of information and to surveil afterwards to determine whether recipients were misusing any material, nonpublic information. Moreover, the purposes for which Partners were granted access above the wall were vague and broad—*e.g.*, "potential strategies," "targets and objectives," "risk parameters," and "overall trading philosophy"—and an undefined category of "other senior management" was entitled to the same access. That a Partner or "other senior management" may have had such open access "above the wall" created a risk of misuse, given such individuals' abilities to guide trading positions and strategies, as the WT Trader and WAM PM both acknowledged with respect to their independent conversations with the WTP Partner regarding TVIX.

49. If the breaches of physical and functional separation between WT and WAM were permissible in any respect, the written policies and procedures did not have any means to ensure that personnel not share or misuse any material, nonpublic information during such interactions. The meetings between the WT Trader and WAM PM, as well as the presence of WAM personnel during the various conversations with CSSU, occurred without safeguards to mitigate or to react to the risks present through cross-affiliate sharing of information.

VIOLATIONS

50. As a result of the conduct described above, WT willfully[5] violated Section 15(g) of the Exchange Act, which requires every registered broker or dealer to "establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of such broker's or dealer's business, to prevent the misuse in violation of . . . [the Exchange Act] or the rules or regulations thereunder, of material, nonpublic information by such broker or dealer or any person associated with such broker or dealer."

51. As a result of the conduct described above, WAM willfully violated Section 204A of the Advisers Act, which requires every registered investment adviser to "establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of such investment adviser's business, to prevent the misuse in violation of . . . [the Advisers Act or the Exchange Act] or the rules or regulations thereunder, of material, nonpublic information by such investment adviser or any person associated with such investment adviser."

REMEDIAL EFFORTS

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by WT and WAM.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents WT's and WAM's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent WT cease and desist from committing or causing any violations and any future violations of Section 15(g) of the Exchange Act.

B. Respondent WAM cease and desist from committing or causing any violations and any future violations of Section 204A of the Advisers Act.

C. Respondents WT and WAM are censured.

D. Respondent WAM shall, within fourteen (14) days of the entry of this Order, pay disgorgement of $364,145.80 and prejudgment interest of $39,158.47 to the Securities and

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[5] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying WAM as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Steven G. Rawlings, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY 10281.

E. Respondent WT shall, within fourteen (14) days of the entry of this Order, pay a civil money penalty in the amount of $375,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying WT as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Steven G. Rawlings, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY 10281.

F. Respondent WAM shall, within fourteen (14) days of the entry of this Order, pay a civil money penalty in the amount of $375,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
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Payments by check or money order must be accompanied by a cover letter identifying WAM as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Steven G. Rawlings, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY 10281.

G. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalties, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of

any award of compensatory damages by the amount of any part of Respondents' payments of civil penalties in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalties imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9959 / October 8, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76104 / October 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16889

In the Matter of

BRIARGATE TRADING, LLC

and

ERIC OSCHER,

Respondents.

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Briargate Trading, LLC ("Briargate") and Eric Oscher ("Oscher," collectively "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings

herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V., Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-And-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds[1] that:

Summary

1. Briargate, an unregistered proprietary trading firm based in New York, New York, and Oscher, one of its principals, utilized a market manipulation strategy known as "spoofing" as one of its trading strategies. In a spoofing scheme, a trader places non-bona fide orders — spoofs — that the trader does not intend to have executed, on one side of the market. The non-bona fide buy or sell orders create a false appearance of buy or sell interest in the security, which often results in a price change. The trader who placed the non-bona fide orders then places bona fide orders on the opposite side of the market for the same stock, in an attempt to take advantage of any price change resulting from the false appearance of buy or sell interest. Immediately after the bona fide orders are executed, the trader cancels the open, non-bona fide orders.

2. Respondents' spoofing scheme focused on trading in securities that were listed on the New York Stock Exchange ("NYSE"). From October 2011 through September 2012 (the "Relevant Period"), Oscher used his Briargate account to place a series of large, non-bona fide orders on the NYSE prior to the opening of trading on the NYSE. Once news of Briargate's non-bona fide orders was disseminated to the market, this information impacted the market's perception of the demand for the stock and often the price of the stock. Next, Briargate also sent orders in the same security — but on the opposite side of the market — to other exchanges that opened before the NYSE. Then prior to the NYSE opening, Oscher cancelled the non-bona fide NYSE orders and Briargate profitably unwound the positions it had acquired on other exchanges. Through this conduct, Respondents derived approximately $525,000 in profits during the Relevant Period.

3. Through this conduct, Briargate and Oscher violated Section 17(a)(1) and 17(a)(3) of the Securities Act and Sections 9(a)(2) and 10(b) of the Exchange Act and Rule 10b-5 thereunder.

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[1] The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

Respondents

4. Briargate is a Delaware limited liability company located in New York, New York. Since its founding in 2009, it has utilized various market arbitrage trading strategies, including strategies related to the NYSE opening auction. Briargate had approximately five employees during the Relevant Period.

5. Oscher, age 47, is a resident of New York, New York. From 1999 to 2007, Oscher worked as a specialist on the NYSE. In early 2009, Oscher co-founded Briargate. During the Relevant Period, Oscher was a 50 percent owner of Briargate.

Facts

6. Oscher used his Briargate account to place non bona-fide orders on the NYSE prior to the open of trading, which occurs at approximately 9:30 a.m. ET (the "open"). Before the open, based on the existing orders for each stock, an opening imbalance of buy or sell orders could occur (or disappear) as market participants placed buy or sell orders.

7. Approximately one hour before the open, the NYSE released the first of a series of messages called the Order Imbalance Message ("Imbalance Message") to paying subscribers to the NYSE's Order Imbalance data feed. At specified intervals before the open and throughout the trading day, the NYSE's Order Imbalance data feed disseminated real-time information concerning buy and sell imbalances in NYSE listed securities based on the anticipated opening price of the securities. The Imbalance Message included the side of the imbalance (buy or sell), the imbalance quantity (indicative of interest for which there was currently no contra at the reference price, which was the previous day's closing price), and beginning at 9:28 a.m., an indicative opening price (the price at which all the interest eligible to trade in the open of that security could be executed in full). Sophisticated market participants used this information to estimate the likelihood of an imbalance at a certain opening price. The NYSE updated the Imbalance Message based on all electronic interest eligible to trade in the open of that security. The NYSE relayed this information every five minutes between 8:30 a.m. and 9 a.m., every minute from 9 a.m. to 9:20 a.m., and every 15 seconds from 9:20 a.m. until the open or until 9:35 a.m. (whichever came first).

8. Certain traders monitored the Imbalance Message to identify the demand for a stock, not only on the NYSE, but also as the stock traded on other exchanges before the NYSE open. For example, when an Imbalance Message showed a buy imbalance for a stock, meaning traders were seeking to buy more shares than were offered for sale at the open, traders often expected that the stock's opening price on the NYSE will rise (relative to the reference price) to reflect the excess buyer demand, and that the stock's price will rise on other exchanges. Conversely, when there was a sell imbalance, meaning there were more shares for sale than sought by buyers at the open, traders often expected a lower opening price on the NYSE, and a decrease in the stock's trading price on other exchanges. The Imbalance Message thus impacted the perceived demand for the stock on the NYSE and the price of the stock on other exchanges.

9. Beginning in 2009, Briargate employed an inter-market arbitrage trading strategy related to the NYSE open as one of its principal trading strategies. Briargate personnel sought to predict the opening price for NYSE-listed securities. Briargate identified trading opportunities due to differences between the price of a security in pre-market trading in markets away from the NYSE and the price at which Briargate estimated the same security would open on the NYSE.

10. Briargate's inter-market arbitrage trading strategy depended in part on its ability to predict the opening price of a security on the NYSE. Beginning in 2009, Briargate believed there were instances where other market participants placed what Briargate believed were non-bona fide orders that were then canceled during pre-market trading. As a result, Briargate began to doubt the integrity of the information in the Imbalance Message.

11. After identifying these concerns about other market participants' conduct, Briargate complained to the NYSE that other market participants were engaging in manipulative conduct involving large cancelled orders. For example, in the spring of 2011, Briargate complained to the NYSE that the data feeds provided by the NYSE were "susceptible to manipulation where parties look to gain advantage by entering non bona fide orders to entice others to trade." As detailed below, subsequent to making these complaints, Oscher used his Briargate account to place large, non-bona fide orders.

Briargate's Spoof Orders

12. Starting in October 2011, Oscher began using his Briargate account to place non-bona fide orders for 10,000 shares or more on the NYSE prior to the open. Oscher's non-bona fide orders impacted the Imbalance Messages by either increasing or decreasing the buy or sell imbalance. Because Oscher placed the non-bona fide orders on the NYSE and then cancelled them prior to the open in that stock, they were not subject to market risk. Briargate also acquired positions in the same stocks by trading on other exchanges, where the price had changed following Oscher's non-bona fide orders. Once Oscher cancelled the non-bona fide orders, Briargate consistently unwound the position it had acquired on other exchanges.

13. During the Relevant Period, Respondents took a series of steps each time they used non-bona fide orders to carry out their spoofing scheme. The following description illustrates the steps Briargate and Oscher took:

- **The Imbalance Messages Begin:** At 8:30 a.m., the NYSE sent the first Imbalance Message for stocks expected to open with an imbalance (buy or sell). The NYSE continued to send Imbalance Messages with increasing frequency until the open of each stock; by 9:20 a.m., Imbalance Messages were sent every 15 seconds.

- **The Entry of the Non-Bona Fide Orders:** Between 8:30 a.m. and the NYSE open, Oscher typically placed non-bona fide orders on the NYSE in securities that the Imbalance Messages identified as having large order imbalances. Oscher's non-bona fide orders were reflected in the next Imbalance Message

for that stock. Oscher's non-bona fide orders often impacted the price of the stock on other exchanges. For example, for a NYSE-listed stock with a sell imbalance, Oscher's non-bona fide buy orders reduced the sell imbalance and increased the price of that stock on other exchanges.

- **Briargate Obtains Positions on Other Exchanges:** After Oscher placed spoof orders for a stock on the NYSE (but before cancelling them); Briargate also traded the same stock on the opposite side of the market on other exchanges. For example, if Oscher placed a non-bona fide buy order, Briargate generally sold the same stock short on other exchanges. Doing so often allowed Briargate and Oscher to take advantage of any price change on other exchanges following Oscher's non-bona fide orders on the NYSE.

- **The Cancellation of the Non-Bona Fide Orders:** Next, Oscher cancelled the non-bona fide orders on the NYSE prior to the open. This had the effect of changing the imbalance minutes before the stock opened on the NYSE and typically reversed the effect the non-bona fide orders had on the stock's price.

- **Briargate Unwinds its Position on Other Exchanges:** To complete the spoofing scheme, Briargate's last step was to liquidate its position in that same stock on other exchanges. Briargate was typically flat by the end of the stock's opening auction on the NYSE.

14. During the Relevant Period, Respondents engaged in manipulative trading by following this trading pattern. For example, on March 20, 2012, Respondents traded in the NYSE listed security, "Security A." That day, the NYSE sent an Imbalance Message showing a persistent sell imbalance in Security A. Between 9:22 a.m. and 9:26 a.m., the Security A Imbalance Message reflected a sell imbalance of over 370,000 shares. The best bid for Security A's stock on other exchanges during that time was between $21.02 and $21.06. Starting at approximately 9:26 a.m., Oscher placed 10 large, non-bona fide buy orders in Security A on the NYSE for a total of 400,000 shares. Oscher's 400,000 Security A orders weakened the sell imbalance, after which the best bid and offer available for Security A on other exchanges increased. Starting at 9:27 a.m., Respondents began accumulating a short position in Security A of 43,400 shares at an average price of $21.16 on other exchanges. At 9:29 a.m., Oscher cancelled all his non-bona fide Security A buy orders on the NYSE. Once Oscher cancelled the non-bona fide orders to buy 400,000 shares, the Security A sell imbalance increased and the best bid and offer available for Security A on other exchanges dropped. Just five seconds after cancelling the non-bona fide orders of 400,000 shares, Briargate began purchasing Security A shares to cover its short position in Security A on other exchanges, and at the NYSE open, with an average buy price of $20.99. In total, Respondents obtained a profit of $7,233 from trading 43,400 Security A shares.

15. During the Relevant Period, Oscher placed and cancelled non-bona fide orders in 242 instances with an average aggregate size of approximately 200,000 shares. These orders impacted the Imbalance Message that other traders received through their NYSE data feeds. Unlike other traders that viewed the Imbalance Message, Respondents knew that the changes in the

Imbalance Message resulting from their non-bona fide orders were artificial. In nearly every instance that Oscher placed non-bona fide orders in the NYSE pre-market, Respondents placed profitable trades in the same stocks, but on the opposite side of the market, from their non-bona fide orders. In total, Respondents derived approximately $525,000 in profits from trading stocks in which they placed non-bona fide orders during the Relevant Period.

Respondents' Trading Was Manipulative

16. Respondents benefited from non-bona fide orders that brought about an artificial change in the NYSE Imbalance Messages, and in the prices of the same securities on other exchanges. Respondents profited from this manipulative trading by sending orders on the opposite side of the market, which were executed on the other exchanges or the NYSE. Respondents traded in these stocks across multiple Briargate accounts.

17. Oscher did not intend to execute the non-bona fide orders he placed during the NYSE pre-market trading. Respondents had no legitimate economic purpose to engage in trading involving non-bona fide orders.

18. Respondents knew that these orders affected the Imbalance Message and impacted the same stock's best bid and best offer on other exchanges. Despite this knowledge, Respondents took advantage of the artificial change in the Imbalance Message to trade the same securities at artificial prices on the opposite side of the market on other exchanges and on the NYSE.

Violations

19. As a result of the conduct described above, Briargate and Oscher violated Section 9(a)(2) of the Exchange Act, which makes it unlawful "to effect, alone or with one or more other persons, a series of transactions in any security . . . creating actual or apparent active trading in such security, or raising or depressing the price of such security, for the purpose of inducing the purchase or sale of such security by others."

20. As a result of the conduct described above, Briargate and Oscher violated Section 17(a)(1) and 17(a)(3) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder which make it unlawful, in the offer or sale of securities and in connection with a purchase or sale of securities, to: (1) employ any device, scheme or artifice to defraud; (2) make material misstatements of fact or omit to state material facts; or (3) engage in any act or practice that operates as a fraud or deceit.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, and for the protection of investors to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Section 8A of the Securities Act and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Briargate and Respondent Oscher cease and desist from committing or causing any violations and any future violations of Section 17(a)(1) and 17(a)(3) of the Securities Act, Sections 9(a)(2) and 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondents shall, jointly and severally, within 10 days of the entry of this Order, pay disgorgement, which represents profits gained as a result of the conduct described herein of $525,000 and prejudgment interest of $37,842.32 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

(1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Briargate and Oscher as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Charles D. Riely, Division of Enforcement, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY 10281.

C. Respondent Briargate shall pay a civil money penalty in the amount of $350,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment shall be made in the following four installments: $87,500 due within 90 days of the entry of this Order, $87,500 due within 180 days of the entry of this Order, $87,500 due within 270 days of the entry of this Order, and $87,500 due within 360 days of the entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to

31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Respondent Briargate may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent Briargate may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent Briargate may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

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Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Briargate as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Charles D. Riely, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY, 10281.

D. Respondent Oscher shall pay a civil money penalty in the amount of $150,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment shall be made in the following four installments: $37,500 due within 90 days of the entry of this Order, $37,500 due within 180 days of the entry of this Order, $37,500 due within 270 days of the entry of this Order, and $37,500 due within 360 days of the entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Respondent Oscher may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent Oscher may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent Oscher may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

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Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Oscher as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Charles D. Riely, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY, 10281.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent Oscher, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent Oscher under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent Oscher of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

Commissioner Stein
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9960 / October 9, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76125 / October 9, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3714 / October 9, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16213

In the Matter of

DAVID G. DERRICK, Sr.,

Respondent.

ORDER MAKING FINDINGS AND IMPOSING SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

On October 24, 2014, the Securities and Exchange Commission ("Commission") issued the Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 against David G. Derrick, Sr. ("Derrick" or "Respondent").

II.

Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or in which the Commission is a party, and without admitting or denying the findings contained in the Order, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondent consents to the entry of this Order Making Findings and Imposing Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 as set forth below.

III.

On the basis of this Order and the Offer of Respondent, the Commission finds[1] that:

A. RESPONDENT

1. David G. Derrick, Sr. ("Derrick") served as Chairman of the Board and Chief Executive Officer ("CEO") of SecureAlert, Inc. (now known as Track Group) from February 2001 until June 30, 2011. Derrick, 62 years old, is a resident of Farmington, Utah.

B. OTHER RELEVANT ENTITY AND INDIVIDUAL

2. SecureAlert, Inc., now known as Track Group and formerly known as RemoteMDx, Inc. ("SecureAlert"), incorporated in Utah in 1995, markets and sells tracking technology devices in the area of adult probation and parole. SecureAlert's principal place of business is in Sandy, Utah. SecureAlert's common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act and trades on the OTC Bulletin Board. SecureAlert files periodic reports, including Forms 10-K and 10-Q, with the Commission pursuant to Section 13(a) of the Exchange Act and related rules thereunder.

3. James J. Dalton, Jr. ("Dalton") served as a Director of SecureAlert from 2001 to November 2, 2009 and was President from August 2003 to June 19, 2008. Dalton, 72 years old, is a resident of Park City, Utah.

C. BACKGROUND

4. In 2007, SecureAlert sold its product through a distributorship system, whereby distributors were given specific territories in which to market SecureAlert product. SecureAlert had been struggling for years and was making a substantial effort to boost sales and revenues.

Undisclosed Personal Guarantees by Derrick and Dalton

5. On September 20, 2007, just prior to the end of the fiscal year on September 30, 2007, SecureAlert entered into an Exclusive Distribution Agreement ("Distribution Agreement") with a large investor ("Distributor"). The Distribution Agreement called for Distributor to purchase 2,000 devices at $500 each for a total of $1 million, with payment due in six months.

6. Derrick negotiated the Distribution Agreement on behalf of SecureAlert. Prior to executing the agreement, Distributor informed Derrick and Dalton that he would not pay for any product and would not subject himself to liability for purchasing product if he was unable to sell it. Dalton does not recall that either Derrick or Distributor told him whether Distributor had sold any SecureAlert product to end user customers but Distributor told Derrick or Dalton that Distibutor was engaging in significant efforts to leverage his business and personal connections to, among other things, establish a sales infrastructure to sell SecureAlert product. Derrick, Dalton and

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Distributor knew this was a new technology application and that the possibility of product failure existed.

7. Distributor further informed Derrick that he did not need any product at the time because he did not yet have customers. Derrick insisted that Distributor accept shipment of the 2,000 units from SecureAlert, and Derrick and Dalton agreed that Distributor would not have to pay for product that Distributor was not able to sell. To document this, the Distribution Agreement gave Distributor a right of return and reimbursement for any unused units in the event the contract was terminated for any reason.

8. To further protect himself from liability, Distributor also required Derrick and Dalton to personally guarantee that they would pay for any unused units under the Distribution Agreement if Distributor was not satisfied with the devices or the business arrangement for any reason. Derrick and Dalton signed a letter dated September 20, 2007 to that effect. Derrick and Dalton did not disclose the personal guarantee to other Board members or employees of SecureAlert, nor did they disclose it to SecureAlert's independent auditor or outside securities counsel. Distributor accepted the 2,000 units but did not pay for any product at the time.

9. On December 13, 2007, near the end of the following quarter, Derrick and Dalton requested a purchase order from Distributor to purchase an additional 2,000 devices from SecureAlert at $500 each for a total of $1 million, with payment due in six months. Dalton does not recall Derrick or Distributor at the time of the second purchase order, telling Dalton that Distributor had not yet sold any of the first 2,000 units or any additional devices that would be requested by a purchase order. Distributor informed Derrick he did not need any more devices, but Derrick insisted on the purchase order and that Distributor accept shipment of the devices. Derrick and Dalton again agreed to provide a personal guarantee that they would pay for any unused units. Derrick and Dalton did not disclose this agreement to other Board members or employees of SecureAlert, nor did they disclose it to SecureAlert's independent auditor or outside securities counsel. Distributor accepted the second 2,000 units but did not pay for any product at the time.

10. Derrick and Dalton knew or were reckless in not knowing that the personal guarantees were material related-party agreements that should have been disclosed and should have been considered in SecureAlert's financial statements.

11. SecureAlert filed its Form 10-KSB for the fiscal year ended September 30, 2007 ("2007 Form 10-KSB") on January 15, 2008. The financial statements reported $1 million in revenue for the September 20, 2007 transaction with Distributor. The $1 million was also recorded as an accounts receivable due in six months, on or around March 20, 2007. Derrick signed certifications for the 2007 Form 10-KSB as CEO. The 2007 Form 10-KSB did not disclose the personal guarantee and did not consider the personal guarantee in its accounting treatment of the $1 million purported sale in September 2007.

12. The $1 million in reported revenue for the September 2007 transaction represented 29% of product revenues and 12% of total revenues for fiscal year 2007 and represented a gross profit of $254,000. SecureAlert reported a gross loss of $404,000 for the year. Without gross

profits from the $1 million "sale" to Distributor at year-end, the gross loss would have been 63% greater.

13. SecureAlert filed its Form 10-QSB for the period ended December 31, 2007 ("December 31, 2007 Form 10-QSB") on February 14, 2008. The December 31, 2007 Form 10-QSB reported $1 million in revenue for the December 2007 transaction with Distributor. The $1 million was also recorded as an accounts receivable due in six months, on or around June 13, 2008. Derrick signed certifications for the December 31, 2007 Form 10-QSB. The December 31, 2007 Form 10-QSB did not disclose the personal guarantee that Distributor would not be liable for unsold product and did not consider this personal guarantee in its accounting treatment of the $1 million purported sale in December 2007.

14. On March 13, 2008, staff in the Commission's Division of Corporation Finance ("Corp Fin Staff") issued a comment letter ("March 13 Comment Letter") with regard to SecureAlert's 2007 Form 10-KSB and its December 31, 2007 Form 10-QSB. The March 13 Comment Letter included a question as to why the year-end accounts receivable balance was more than half of SecureAlert's revenue for the year.

Undisclosed Personal Financing of Transactions by Derrick and Dalton

15. Soon after receiving Corp Fin Staff's comment letter, payment for the first $1 million purported sale to Distributor became due, on or around March 20, 2008. In the meantime, Distributor had learned that many of the devices shipped to him were defective or damaged. Distributor had not sold any devices at that point, and he refused to pay for defective devices or devices he had not sold. Derrick attempted to arrange financing to pay the accounts receivable due, in an apparent attempt to conceal the fact that revenue should not have been recognized in the transaction. In this way, SecureAlert's accounting records would reflect the $1 million accounts receivable as fully paid at or around the due date.

16. Derrick reached out to a third party financing entity ("Third Party"), with which he had previously done business. Third Party agreed to make the payment for the accounts receivable to SecureAlert. However, Third Party would not provide funding because of the risk, so Derrick and Dalton provided their own personal funds, through their entity, to finance the transaction.

17. The Third Party transaction was documented with a promissory note dated March 26, 2008, in which Distributor promised to pay Third Party $1 million plus interest by March 31, 2009. Distributor signed the promissory note, but Derrick and Distributor agreed that the transaction was executed on paper only and that Distributor had no obligation to pay $1 million to Third Party. Derrick and Distributor also agreed that Distributor would not be liable for any interest due under the note. Dalton was made aware of the agreement between Derrick and Distributor. Derrick and Dalton did not disclose to Distributor that they provided the $1 million in funds to Third Party.

18. Derrick and Dalton sent $1 million of their personal funds to Third Party on March 31, 2008. Third Party, in turn, sent the funds to SecureAlert to satisfy the $1 million accounts receivable due in March 2008.

19. The accounts receivable for the December 2007 $1 million purported sale to Distributor became due on or around June 13, 2008. Again, Distributor had not yet sold any devices, so he refused to pay for devices that were defective or unsold. Derrick again approached Third Party, which agreed to make the second payment for the accounts receivable to SecureAlert if Derrick and Dalton again provided the funds.

20. The second Third Party transaction was documented with a promissory note dated September 16, 2008, in which Distributor promised to pay Third Party $1 million plus interest by September 16, 2009. Distributor signed the promissory note, but again Derrick and Distributor agreed that this transaction was executed on paper only and that Distributor had no obligation to pay the $1 million to Third Party. Derrick and Distributor also agreed that Distributor would not be liable for any interest due under the note. Dalton was made aware of the agreements. Derrick and Dalton did not disclose to Distributor that they provided the second $1 million in funds to Third Party.

21. Derrick and Dalton sent $1 million of their personal funds to Third Party on September 12, 2008. This time, Third Party wired the money to Distributor, who in turn forwarded $1 million to SecureAlert on September 25, 2008, just prior to the end of fiscal year 2008. The $1 million was used to pay the $1 million accounts receivable due in June 2008.

22. Derrick and Dalton did not disclose their personal financing of the Third Party transactions to other Board members or employees of SecureAlert, nor did they disclose it to SecureAlert's independent auditor or outside securities counsel.

Comment Process with Corp Fin Staff

23. From March to June 2008, SecureAlert engaged in the comment process with Corp Fin Staff. On April 28, 2008, SecureAlert filed a response to the staff's March 13, 2008 comment letter, and discussed SecureAlert's revenue recognition policies. The letter was signed by Derrick and represented that SecureAlert only recognized revenue if the following conditions were met: persuasive evidence of an arrangement exists, ***title passes to the customer and the customer cannot return the devices,*** prices are fixed or determinable, and collection is reasonably assured.

24. SecureAlert also made the following separate representations about revenue recognition in its April 28, 2008 response: (1) "Distributors do not have general rights of return;" (2) "Generally, title and risk of loss pass to the buyer upon delivery of the devices;" (3) "The distributors do not have general rights of return for these devices."

25. The statements related to revenue recognition were false in the case of Distributor because Derrick and Dalton had made assurances to Distributor that he would not be liable for any unsold devices and that Distributor could return devices at any time for any reason.

26. In the April 28, 2008 response and a response to additional staff comments filed on May 14, 2008, SecureAlert represented that it had collected 100% of the accounts receivable due from Distributor for the first $1 million purported sale. The responses did not disclose that

Distributor did not pay the receivable. The responses did not disclose that Derrick and Dalton actually paid the receivable with their own personal funds through a third party. The responses did not disclose that Derrick and Dalton had agreements with Distributor that he was not liable to pay for any devices he did not sell.

27. During the comment process, SecureAlert reviewed the Distribution Agreement. SecureAlert, in consultation with its independent auditor and outside securities counsel, determined that the provision in the Distribution Agreement allowing Distributor a right to return product did not allow for revenue to be recognized. Therefore, SecureAlert informed Corp Fin Staff that it would restate the $1 million initially recorded as revenue from the purported sale in September 2007 to "deferred revenue."

28. On May 6, 2008, SecureAlert filed a Form 8-K announcing a restatement of the financial statements, including the deferral of the $1 million in revenue from the September 2007 contract with Gonzalez. The Form 8-K contained no disclosure of the personal guarantees or the personal financing of the $1 million "sale."

29. To avoid future issues with revenue recognition, SecureAlert amended the Distribution Agreement in April 2008 ("Amended Distribution Agreement") to remove Distributor's unilateral right to return product. SecureAlert determined that under the Amended Distribution Agreement, revenue from sales to Distributor could be recognized immediately if they met the required revenue recognition conditions, including that title passes to the customer and the customer cannot return devices. Based on this determination, SecureAlert concluded it did not need to restate revenue from the December 2007 purported sale to Distributor. Derrick and Dalton did not disclose their side agreement that Distributor could return unused or unsold product for any reason and that Distributor would not be liable for any product it did not use.

SecureAlert Files Materially Misstated Periodic Reports with the Commission

30. On June 18, 2008, SecureAlert filed an amended Form 10-QSB/A for the period ended December 31, 2007 ("December 2007 Form 10-QSB/A"). The $1 million in revenue for the second purported sale to Distributor in December 2007 was not restated and remained in the financials as revenue. Derrick signed certifications as CEO for the December 2007 Form 10-QSB/A.

31. On June 19, 2008, SecureAlert filed an amended Form 10-KSB/A ("2007 Form 10-KSB/A"). The 2007 Form 10-KSB/A restated the $1 million revenue from the first purported sale in September 2007 as "deferred revenue." The Distribution Agreement was attached as an exhibit to the filing; however, the personal guarantee and the personal financing arrangements were not disclosed. Derrick signed certifications as CEO for the 2007 Forms 10-KSB/A and 10-QSB/A.

32. On August 15, 2008, SecureAlert filed its Form 10-Q for the period ended June 30, 2008 ("June 2008 Form 10-Q"). Because of the Amended Distribution Agreement, SecureAlert determined it could now recognize revenue from the September 2007 $1 million purported sale to Distributor. Derrick signed certifications as CEO for the June 2008 Form 10-Q.

33. On December 26, 2008, SecureAlert filed its Form 10-K for the fiscal year ended September 30, 2008 ("2008 Form 10-K). The entire $2 million for the September and December 2007 purported sales was reported as revenue in the year-end financial statements. The $2 million in reported revenue made up 78% of SecureAlert's product revenues and 16% of all revenues for fiscal year 2008. Derrick signed certifications as CEO for the 2008 Form 10-K.

34. The materially misstated financial statements continued to be reported in SecureAlert's filings through the end of fiscal year 2009. The filings included Forms 10-Q for the periods ended December 31, 2008, March 31, 2009, and June 30, 2009. The Form 10-K for the fiscal year ended September 30, 2009 ("2009 Form 10-K") was the last report to contain the misstated financial statements and was filed on January 13, 2010. Derrick signed certifications as CEO for each of the quarterly reports filed during fiscal year 2009 and the 2009 Form 10-K.

35. Derrick made misrepresentations to SecureAlert's independent auditor during the yearly audit and quarterly review periods for each of the relevant periods. For each period, he signed a management representation letter to the auditor, representing, among other things, that: financial statements were fairly presented in conformity with GAAP along with all related disclosures, that he had no knowledge of any fraud or suspected fraud, and that all related party transactions had been properly recorded or disclosed. These representations were false in light of the undisclosed personal guarantees and personal related-party financing of transactions.

Assignment of Third Party Promissory Notes to Derrick and Dalton Entity

36. By June 2009, SecureAlert and its distributors continued to struggle. There were still problems with technology and defective units and Distributor had sold little, if any, of the $2 million in product purportedly sold to him in September and December 2007. The $2 million owed to Third Party had not been paid. The first $1 million was three months overdue, and Derrick knew that Distributor would not pay. Although Third Party had not provided any funds for the transactions, Third Party desired to remove the large, stale accounts receivables from Third Party's balance sheet. Therefore, Derrick devised a plan to arrange additional transactions, which served to cover up the personal financing arrangements and the personal guarantees.

37. In June 2009, Derrick formed an entity called JBD Management, LLC ("JBD"). JBD was owned by Derrick (47.5%), Dalton (47.5%) and Third Party (5%). Derrick arranged for Third Party to assign its interest in the March 2008 $1 million promissory note and the September 2008 $1 million promissory note to JBD. The assignment involved a series of transactions and documents executed in July 2009. Interest due on the notes had previously been paid to Third Party by Derrick and Dalton.

38. The end result was that, on paper, Distributor appeared to owe $2 million to JBD. Derrick and Dalton did not disclose that Distributor was not obligated to pay the $2 million to JBD, nor did they disclose that funds for the Third Party transactions had been personally provided by Derrick and Dalton.

39. In addition, Derrick and Dalton executed and signed a second undisclosed side agreement, dated July 13, 2009, to personally guarantee the re-purchase of any unused product in Distributor's possession by December 31, 2010. This personal guarantee apparently documented

the agreement that Distributor would not be liable for the 2,000 units purportedly sold to him in December 2007, and he would not have to make payments on the financing arrangement, which were to come due in September 2009, if Distributor did not need or sell devices. Derrick and Dalton did not disclose this personal guarantee to other Board members or employees of SecureAlert, nor did they disclose it to SecureAlert's independent auditor or outside securities counsel.

40. During the relevant period, Derrick and Dalton solicited investments in SecureAlert and obtained money or property, including money for the sale of SecureAlert stock, by means of the material misstatements and omissions contained in the company's financial statements and the non-disclosure of their personal guarantees and material related-party transactions. During that time period, SecureAlert was engaged in offering and selling its securities in private offerings and via Forms S-8. SecureAlert issued 23,927,219 shares of common stock to a number of private parties for prices ranging from $0.20 to $1.00 and a total of $8,307,914.00. In addition, on August 26, 2008 and March 9, 2009, SecureAlert filed Forms S-8 to register shares for sales or awards of stock to employees. The August 26, 2008 Form S-8 incorporated by reference SecureAlert's materially false financial statements found in SecureAlert's 2007 Form 10-KSB. The March 9, 2009 Form S-8 incorporated by reference SecureAlert's materially false financial statements found in SecureAlert's 2008 Form 10-K. Derrick's and Dalton's actions also constituted a transaction, practice, or course of business which operated as a fraud or deceit in the offer or sale of SecureAlert securities.

Internal Control Deficiencies

41. During the relevant period, Derrick and Dalton knowingly failed to implement a system of internal accounting controls for SecureAlert and directly or indirectly caused to be falsified SecureAlert's books, records, and accounts.

42. Through their conduct, Derrick and Dalton caused SecureAlert's books and records to be inaccurate and caused SecureAlert to fail to devise or maintain a system of sufficient internal accounting controls.

Discovery of Undisclosed Personal Guarantees and Personal Financing

43. In or around spring of 2011, Distributor and Derrick discussed the issue of obligation under the Third Party transactions. For the first time, Derrick admitted to Distributor that he and Dalton had provided the financing for the Third Party transactions. Over the next several months, Distributor had discussions with the Board regarding the situation. The Board ultimately asked for Derrick's resignation, which he provided on June 30, 2011.

44. After Derrick left SecureAlert, the Board authorized an internal investigation into Derrick's business dealings, including transactions with Distributor and Third Party. SecureAlert and Derrick jointly self-reported the possible violations. Later, the results of the internal investigation were provided to Commission Enforcement Staff. After initiation of the internal investigation, SecureAlert implemented a number of internal control procedures to prevent future violations of the federal securities laws.

<u>Reclassification of Revenues</u>

45. After learning of the personal guarantees and personal financing arrangements by Derrick and Dalton, SecureAlert, with the help of its independent auditor, concluded it should reclassify the $2 million for the Distributor transactions as capital contributions. SecureAlert determined that the transactions should be treated as capital contributions because JBD was ultimately issued stock for the $2 million that Derrick and Dalton paid to finance the transactions. This was pursuant to the assignment of the Third Party notes to JBD and subsequent transactions involving SecureAlert and Distributor.

46. The reclassification was made in the second quarter of fiscal year 2012 and reported in SecureAlert's Form 10-Q for the period ended March 31, 2012, which was filed on May 17, 2012. For that period, SecureAlert's 2008 statement of operations was no longer presented in its filings. As a result, the reclassification was made directly between SecureAlert's accumulated deficit and additional paid-in capital. At the time, SecureAlert's balance sheet reflected $249 million in additional paid-in capital and an accumulated deficit of $234 million.

47. As a result of the conduct described above, Derrick violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities.

48. As a result of the conduct described above, Derrick violated Exchange Act Rule 13a-14, which requires the principal executive officer to sign and certify annual and quarterly reports.

49. As a result of the conduct described above, Derrick violated Section 13(b)(5) of the Exchange Act, which prohibits any person from knowingly circumventing or failing to implement a system of internal accounting controls and Rule 13b2-1 thereunder, which prohibits the direct or indirect falsification of an issuer's books, records, or accounts.

50. As a result of the conduct described above, Derrick violated Exchange Act Rule 13b2-2, which prohibits directors or officers of an issuer to make or cause to made materially false or misleading statements or omissions to an accountant in connection with any audit, review, or examination of the financial statements of the issuer.

51. As a result of the conduct described above, Derrick caused violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder, which require the filing of annual and quarterly reports that do not contain material misstatements or omissions.

52. As a result of the conduct described above, Derrick caused violations of Section 13(b)(2)(A) of the Exchange Act, which requires Section 12 registrants to make and keep books, records, and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer and Section 13(b)(2)(B) of the Exchange Act, which requires Section 12 registrants to devise and maintain a system of sufficient internal accounting controls.

IV.

On the basis of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent's offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Derrick shall cease and desist from committing or causing violations, and any future violations, of Section 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A) and (B), and 13(b)(5) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-13, 13a-14, 13b2-1, and 13b2-2 thereunder;

B. Derrick be, and hereby is, prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act [15 U.S.C. § 78l] or that is required to file reports pursuant to Section 15(d) of the Exchange Act [15 U.S.C. § 78o(d)]; and

C. Derrick shall pay civil penalties of $232,500 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury subject to Exchange Act Section 21F(g)(3). Payment shall be made in the following installments: Within 14 days of the entry of the Order, Derrick shall make a first payment of $130,000. Derrick shall pay the remaining amount of $102,500 no later than February 28, 2016. If any payment is not made by the date the payment is required by the Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying David G. Derrick, Sr. as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Karen

Martinez, Regional Director, Salt Lake Regional Office, Securities and Exchange Commission, 351 South West Temple, Suite 6.100, Salt Lake City, Utah 84101.

Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

Service List

Rule 141 of the Commission's Rules of Practice provides that the Secretary, or another duly authorized officer of the Commission, shall serve a copy of the Order Making Findings and Imposing Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order") on the Respondent and his legal agent.

The attached Order has been sent to the following parties and other persons entitled to notice:

Honorable Jason S. Patil
Administrative Law Judge
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-2557

Daniel J. Wadley, Esq.
Salt Lake Regional Office
Securities and Exchange Commission
351 S. West Temple, Suite 6.100
Salt Lake City, UT 84101

David G. Derrick, Sr.
c/o Erik A. Christiansen, Esq.
Parsons, Behle & Latimer
One Utah Center
201 South Main Street
Suite 1800
Salt Lake City, UT 84111

Erik A. Christiansen, Esq.
Parsons, Behle & Latimer
One Utah Center
201 South Main Street
Suite 1800
Salt Lake City, UT 84111
Counsel for Respondent

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4225 / October 13, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16892

In the Matter of

JAMES T. BUDDEN and
ALEXANDER W. BUDDEN,

Respondents.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against James T. Budden ("J. Budden") and Alexander W. Budden ("A. Budden") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents each have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds[1] that:

SUMMARY

Respondents failed reasonably to supervise Douglas E. Cowgill ("Cowgill"), the former Chief Compliance Officer ("CCO") of Professional Investment Management, Inc. ("PIM"), an investment adviser registered with the Commission, within the meaning of Sections 203(e)(6) and 203(f) of the Advisers Act, with a view to preventing and detecting Cowgill's violations of the federal securities laws. Cowgill violated several antifraud provisions of the federal securities laws by misappropriating more than $840,000 in client assets. Respondents also caused[2] PIM to violate Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder (the "Compliance Rule"). J. Budden further caused PIM to violate Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder (the "Custody Rule").

RESPONDENTS

1. **James T. Budden**, age 73, is a former 50.2% shareholder of PIM. J. Budden was the President and a Director of PIM from approximately 1973 through approximately July 22, 2013, the date he sold all of his interest in PIM to Cowgill. While associated with PIM, J. Budden supervised several employees, including Cowgill. J. Budden resides in Columbus, Ohio.

2. **Alexander W. Budden**, age 68, is a former 48.7% shareholder of PIM. A. Budden was the Vice President and Secretary and a Director of PIM from approximately April 1981 through approximately July 22, 2013, the date he sold all of his interest in PIM to Cowgill. While associated with PIM, A. Budden supervised several employees, including Cowgill. A. Budden resides in Cleveland, Ohio.

OTHER RELEVANT PARTIES

3. **Professional Investment Management, Inc.** is an Ohio corporation with its principal place of business in Columbus, Ohio. At all times relevant to this proceeding, PIM was owned by J. Budden (50.2%), A. Budden (48.7%), and Cowgill (1.1%). PIM was registered with the Commission as an investment adviser from 1978 through September 30, 2013. PIM re-registered with the Commission on June 24, 2014. PIM provides third-party administration services and investment advisory services to approximately fifteen retirement plan clients (which consist of approximately 325 participants who, in turn, own approximately 425 individual retirement accounts that PIM advises), and also provides investment advisory services to

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[1] The findings herein are made pursuant to each Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

[2] "Negligence is sufficient to establish 'causing' liability . . ., at least in cases in which a person is alleged to 'cause' a primarily violation that does not require scienter." *KPMG Peat Marwick, LLP*, Rel. No. 43862, 2001 WL 47245, *19 (Jan. 19, 2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002).

approximately twenty-five individual clients for their own (non-retirement plan) accounts. PIM has approximately $120 million of regulatory assets under management, and has custody of client assets through three omnibus accounts. PIM has been operating under the control of a court-appointed receiver since on or about May 15, 2014.

4. **Douglas E. Cowgill**, age 60, began working for PIM in July 1981. Cowgill became the sole owner and President of PIM on or about July 22, 2013, when he purchased all of Respondents' interest in PIM. Cowgill remained the President of PIM until on or about May 15, 2014, when a court-appointed receiver took control of PIM. Cowgill resides in Columbus, Ohio.

5. The Commission filed suit against Cowgill and PIM in the United States District Court for the Southern District of Ohio on April 29, 2014 in *Securities and Exchange Commission v. Douglas E. Cowgill, et al.*, Case No. 2:14-CV-396, alleging that Cowgill and PIM violated the antifraud provisions of the U.S. securities laws by hiding a shortfall of more than $700,000 in client assets by sending false account statements to clients, and that PIM violated, and Cowgill aided and abetted and caused PIM's violations of, the registration provisions of the Advisers Act, and the Custody Rule. The Commission filed an Amended Complaint on August 7, 2014 that included additional counts against Cowgill and PIM. On August 21, 2014, the Court entered a Judgment by Consent against Cowgill as to all counts asserted in the Amended Complaint and permanently restrained and enjoined Cowgill from violating and/or aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, Sections 203(a), 204(a), 206(1), (2), and (4), and 207 of the Advisers Act, and Rules 204-2, 206(4)-2, and 206(4)-7 thereunder.

6. On September 8, 2014, the Commission entered an order barring Cowgill from associating with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

7. On July 2, 2015, a Grand Jury sitting in the United States District Court for the Southern District of Ohio indicted Cowgill in *United States v. Cowgill*, Case No. 2:15-CR-160, on thirteen counts of wire fraud, five counts of engaging in monetary transactions in property derived from specified unlawful activity, two counts of theft or embezzlement from an employee benefit plan counts, and one count of perjury. Each of these counts stemmed from the conduct alleged in the Commission's civil lawsuit against Cowgill. Cowgill's criminal matter is ongoing.

FACTS

Failure to Supervise Cowgill

8. At all times from July 1981 through approximately July 22, 2013, Cowgill reported to Respondents and Respondents were Cowgill's supervisors. For instance, Respondents promoted Cowgill from Accounting Clerk to Vice President and Treasurer in 1983, and designated Cowgill as PIM's CCO on or about September 28, 2004.

9. As explained above, the United States District Court for the Southern District of Ohio entered an order on August 21, 2014 in *Securities and Exchange Commission v. Douglas E. Cowgill, et al.* that permanently restrained and enjoined Cowgill from violating and/or aiding and abetting violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Sections 203(a), 204(a), 206(1), (2), and (4), and 207 of the Advisers Act, and Rules 204-2, 206(4)-2, and 206(4)-7 thereunder.

10. Respondents failed to adopt or implement any policies or procedures regarding their supervision of Cowgill. In fact, Respondents merely assumed, without ever confirming, that Cowgill performed his responsibilities in compliance with the federal securities laws.[3]

Violations of the Compliance Rule

11. After Respondents designated Cowgill as PIM's CCO, they never provided any funding, training, or resources to support Cowgill in the CCO role.

12. Respondents, as the majority owners of PIM and as required by the Compliance Rule, participated in annual compliance reviews with Cowgill in 2004, 2006, and 2007.[4] Respondents knew or should have known that Cowgill stopped performing compliance reviews after 2007, but took no steps to ensure that Cowgill or anyone else at PIM resumed conducting compliance reviews at least annually after 2007.

13. Respondents took no steps to ensure that PIM was complying with the federal securities laws after 2007, and did nothing after 2007 to ensure that Cowgill carried out his responsibilities as PIM's CCO.

14. Respondents did not ensure that PIM established policies or procedures to prevent client assets from being misappropriated via checks or wire transfers or to ensure that client statements were reviewed for accuracy. No such policies or procedures were ever established at PIM. During the period 2008 through 2013, Cowgill secretly wrote numerous checks and initiated numerous wire transfers from PIM's client asset-holding bank account and sent false account statements to PIM's clients to hide his misappropriation of client assets.

Violations of the Custody Rule

15. At all relevant times, PIM maintained client funds in an omnibus checking account held on an agency basis at Custodian 1, and client securities in two omnibus accounts held on an agency basis at Custodian 2 and Custodian 3. All client funds were initially deposited into the omnibus checking account held at Custodian 1. PIM then transferred these client funds for investment to various firms, including Custodians 2 and 3. PIM had custody of all of the client

[3] "Liability for failure to supervise may be imposed when a supervisor fails 'to learn of improprieties when diligent application of supervisory procedures would have uncovered them.'" *In the Matter of Stephen Jay Mermelstein*, Advisers Act Rel. No. 2961 (Dec. 14, 2009).

[4] PIM did not conduct an annual compliance review in 2005.

assets held at Custodian 1, 2, and 3 because it had the authority to obtain possession of these assets.

16. Each year from 1999 to 2009, J. Budden had, as required by the Custody Rule, engaged an independent accountant on behalf of PIM to conduct annual surprise examinations to verify all client assets of which PIM had custody and required the accountant to file Form ADV-E with the Commission within a prescribed amount of time. J. Budden delegated that responsibility to Cowgill during the summer of 2009 after J. Budden had engaged the accountant in May 2009 to perform the 2009 annual surprise examination. J. Budden continued to supervise Cowgill during this time period, but did not follow up with Cowgill to ensure that Cowgill had fulfilled this responsibility.

17. J. Budden knew from past experience that, in order to comply with the Custody Rule, PIM was obligated to, among other things, require the accountant to file Form ADV-E with the Commission. Cowgill failed to require PIM's accountant to file Form ADV-E with the Commission in connection with the 2009 surprise examination, and J. Budden did nothing to ensure that that Cowgill had done so. J. Budden did nothing to confirm that Form ADV-E had been filed with the Commission or that PIM had complied with the Custody Rule in 2009. PIM violated the Custody Rule in 2009 by failing to ensure that the accounting firm filed with the Commission Form ADV-E.

18. Cowgill engaged these same accountants in 2010 and again in 2011 to perform annual surprise examinations in accordance with the Custody Rule. Cowgill did not cooperate with the accounting firm, and, ultimately, the accounting firm did not complete either of these annual surprise examinations. J. Budden did nothing to confirm that these annual surprise examinations had been completed, that Form ADV-E had been filed with the Commission in connection with either of these annual surprise examinations, or that PIM had complied with the Custody Rule in 2010 and 2011. PIM violated the Custody Rule in 2010 and 2011 by failing to have annual surprise examinations completed in each of those years.

19. Cowgill did not engage any accountants in 2012 to perform an annual surprise examination in accordance with the Custody Rule. J. Budden did nothing to confirm that Cowgill had engaged an accountant to complete the annual surprise examination in 2012, that the annual surprise examination had been completed, that Form ADV-E had been filed with the Commission in connection with the annual surprise examination, or that PIM had complied with the Custody Rule in 2012. PIM violated the Custody Rule in 2012 by failing to have an annual surprise examination completed that year.

20. In 2013, J. Budden realized that he had not seen any accountants at PIM for "some time," and sought to learn the status of PIM's compliance with the Custody Rule. Respondents spoke with the principal of the accounting firm that historically had completed annual surprise examinations for PIM. Respondents learned that the accounting firm was terminating its relationship with PIM because, among other reasons, Cowgill had not sufficiently cooperated with the accounting firm in 2010 and 2011 to enable it to complete the annual surprise exams during those two years as required by the Custody Rule. Respondents further learned that Cowgill had not engaged the accounting firm to perform any work on behalf of PIM since 2011.

21. In July 2013, Respondents spoke with an attorney to determine how to address PIM's delinquent ADV-E filings.

22. However, neither Respondent took any disciplinary action against Cowgill.

23. Instead, on July 22, 2013, each Respondent executed a stock purchase agreement in which they each agreed to sell all of their interest in PIM to Cowgill.

24. Respondents both knew at the time of the sale that PIM was not in compliance with the federal securities laws, including specifically, the Compliance Rule and the Custody Rule.

25. As a result of the conduct described above, Respondents failed reasonably to supervise Cowgill within the meaning of Section 203(e)(6) of the Advisers Act, with a view to preventing and detecting Cowgill's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 203(a), 204(a), 206(1), (2), and (4), and 207 of the Advisers Act and Rules 204-2, 206(4)-2, and 206(4)-7 thereunder.

26. As a result of the conduct described above, Respondents caused PIM's violation of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which require, among other things, that a registered investment adviser adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and the rules thereunder by the adviser and its supervised persons, and review, no less frequently than annually, the adequacy of such policies and procedures.

27. As a result of the conduct described above, J. Budden caused PIM's violation of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder, which require, among other things, that a registered investment adviser have client assets over which it has custody verified by an independent public accountant at least once a year without prior notice to the investment adviser and that the investment adviser require the accountant to file Form ADV-E with the Commission within a prescribed amount of time.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in each Respondent's Offer.

Accordingly, pursuant to Sections 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

Respondent J. Budden

A. Respondent J. Budden cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rules 206(4)-2 and 206(4)-7 thereunder.

B. Respondent J. Budden be, and hereby is:

> barred from association in a supervisory or compliance capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization

with the right to apply for reentry after three (3) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

C. Any reapplication for association by Respondent J. Budden will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Respondent J. Budden, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent J. Budden shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $125,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondent J. Budden may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent J. Budden may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent J. Budden may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Respondent J. Budden as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Paul Montoya, Assistant Director, Division of Enforcement, Securities and Exchange Commission, Chicago Regional Office, 175 West Jackson Boulevard, Suite 900, Chicago, IL 60604-2908.

Respondent A. Budden

E. Respondent A. Budden cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder.

F. Respondent A. Budden be, and hereby is:

barred from association in a supervisory or compliance capacity with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization

with the right to apply for reentry after two (2) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

G. Any reapplication for association by Respondent A. Budden will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Respondent A. Budden, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

H. Respondent A. Budden shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $75,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondent A. Budden may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent A. Budden may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent A. Budden may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Respondent A. Budden as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Paul Montoya, Assistant Director, Division of Enforcement, Securities and Exchange Commission, Chicago Regional Office, 175 West Jackson Boulevard, Suite 900, Chicago, IL 60604-2908.

I. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the penalties referenced in paragraphs IV.D and IV.H, above. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against any Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. § 523, the findings in this Order are true and admitted by Respondents, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondents under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondents of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary

SECURITIES AND EXCHANGE COMMISSION
Release No. 34-76129

October 13, 2015

Order Granting Temporary, Limited, and Conditional Exemption of Kroll Bond Rating Agency, Inc. from the Conflict of Interest Prohibition in Rule 17g-5(c)(1) of the Securities Exchange Act of 1934

I. Introduction

Rule 17g-5(c)(1) of the Securities Exchange Act of 1934 ("Exchange Act") prohibits a nationally recognized statistical rating organization ("NRSRO") from issuing or maintaining a credit rating solicited by a person that, in the most recently ended fiscal year, provided the NRSRO with net revenue equaling or exceeding 10% of the total net revenue of the NRSRO for the fiscal year. In adopting this rule, the Securities and Exchange Commission ("Commission") stated that a person soliciting a credit rating who was the source of 10% or more of the total net revenue of the NRSRO would be in a position to exercise substantial influence on the NRSRO, which in turn would make it difficult for the NRSRO to remain impartial given the impact on the NRSRO's income if the person withdrew its business.[1] Section 36 of the Exchange Act authorizes the Commission to exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of the Exchange Act or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

II. Exemption Request of Kroll Bond Rating Agency, Inc.

Kroll Bond Rating Agency, Inc. ("KBRA"), formerly known as LACE Financial Corp. ("LACE"), is a credit rating agency registered with the Commission as an NRSRO under section 15E of the Exchange Act for the classes of credit ratings described in clauses (i) through (v) of

[1] Release No. 34-55857 (June 5, 2007), 72 FR 33564, 33598 (June 18, 2007).

section 3(a)(62)(A) of the Exchange Act. The Commission has previously granted KBRA two temporary exemptions from Rule 17g-5(c)(1): (1) until January 1, 2013, in connection with its entering the market for rating structured finance products ("First KBRA Order");[2] and (2) until January 1, 2015, to allow KBRA to continue to diversify its business beyond commercial mortgage-backed securities ("CMBS") ratings ("Second KBRA Order").[3] The Commission also previously granted a temporary exemption from Rule 17g-5(c)(1) to LACE in connection with its initial registration as an NRSRO ("LACE Order" and, collectively with the First KBRA Order and Second KBRA Order, "Previous Exemptive Orders").[4]

KBRA has informed the Commission that while its revenues have been derived increasingly from a diversified group of issuers beyond the CMBS market, factors outside of KBRA's control have continued to limit its ability to grow its business in certain sectors. Specifically, KBRA states that the number of CMBS issuers in the market is limited, and that business development in other rating areas has been affected by market conditions and barriers to entry. Accordingly, KBRA has requested an extension of its exemption from Rule 17g-5(c)(1), until January 1, 2017, to enable the continued growth of its business and, thereby, foster competition in the credit rating industry.

III. Discussion

The Commission, when adopting Rule 17g-5(c)(1), noted that it intended to monitor how the prohibition operates in practice, particularly with respect to asset-backed securities, and

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[2] Release No. 34-65339 (Sept. 14, 2011), 76 FR 58319, 58321 (Sept. 20, 2011).

[3] Release No. 34-71220 (Dec. 31, 2013).

[4] Release No. 34-57301 (Feb. 11, 2008), 73 FR 8720 (Feb. 14, 2008).

whether exemptions may be appropriate.[5] The Commission noted several factors in granting the Previous Exemptive Orders, including that the exemptions would further the primary purpose of the Credit Rating Agency Reform Act of 2006 ("Rating Agency Act") to "improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating agency industry."[6] Citing the same factors, the Commission has issued similar orders granting temporary exemptions from the requirements of Rule 17g-5(c)(1) to Realpoint LLC, in connection with its registration as an NRSRO,[7] and to Morningstar Credit Ratings, LLC, the successor to Realpoint LLC.[8]

KBRA has informed Commission staff that in the current fiscal year, KBRA may receive more than 10% of its total net revenue from one or more clients that paid it to rate asset-backed securities. In the request that is subject to this Order, KBRA states that it expects to have more diversified revenue sources over time and that a temporary extension of the exemption from Rule 17g-5(c)(1) would enable the continued growth of its business so that eventually it will be able to operate without an exemption.

The Commission believes that a temporary, limited, and conditional exemption allowing KBRA to continue to diversify its business beyond CMBS ratings is consistent with the Commission's goal, as established by the Rating Agency Act, of improving ratings quality by fostering accountability, transparency, and competition in the credit rating agency industry and is necessary or appropriate in the public interest and consistent with the protection of investors. In

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5 Release No. 34-55857, 72 FR 33598.

6 Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850, Rating Agency Act, S. Report No. 109-326, 109th Cong., 2d Sess. (Sept. 6, 2006).

7 Release No. 34-58001 (June 23, 2008), 73 FR 36362 (June 26, 2008).

8 Release No. 34-66514 (Mar. 5, 2012), 77 FR 14580 (Mar. 12, 2012); Release No. 34-71219 (Dec. 31, 2013).

order to maintain this exemption, KBRA will be required to comply with the following conditions: (1) KBRA shall review, update, maintain, comply with, and document policies, procedures, and internal controls specifically designed to address the conflict of interest created by exceeding the 10% threshold, including that KBRA's Designated Compliance Officer ("DCO") shall: (a) conduct and document, on at least a quarterly basis, a review of a sample of rating files from its 2015, 2016, and 2017 fiscal years for credit ratings solicited by the applicable client or clients that provided KBRA with 10% or more of its total net revenue, and take other steps acceptable to the Commission's examination staff, to verify that ratings of any such clients were not influenced by commercial concerns and that KBRA adhered to such policies, procedures, and internal controls; and (b) deliver quarterly written reports about these efforts to KBRA's Chief Executive Officer ("CEO") and board of directors; (2) within 5 business days after the end of each quarter beginning with the last quarter of its 2015 fiscal year and through the end of its 2017 fiscal year, KBRA's CEO shall file with the Commission a certification that all credit ratings issued through the end of each such quarter on deals for any client or clients that provided KBRA with 10% or more of its total net revenue sufficiently adhered to its policies, procedures, and internal controls to address the conflict of interest created by exceeding the 10% threshold, that the DCO took appropriate measures, including rating file reviews, to confirm this adherence, and that identifies the credit ratings issued for any such clients during such quarter; (3) KBRA shall appropriately address the Commission staff's findings and recommendations in the 2015 annual section 15E(p)(3) examination and any other examinations conducted by Commission staff during 2015, 2016, or 2017; (4) net revenue received by KBRA from a single client may not exceed 19.5% of KBRA's total net revenue for either the fiscal year ending December 31, 2015 or the fiscal year ending December 31, 2016; (5)

KBRA shall publicly disclose, as applicable, in Exhibit 6 to Form NRSRO that it received 10% or more of its total net revenue in fiscal years 2015 and 2016 from a client or clients; and (6) KBRA shall retain documentation demonstrating compliance with the conditions of the exemption.

Section 15E(p)(3) of the Exchange Act, as added by section 932(a)(8) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, requires the Commission's Office of Credit Ratings ("OCR") to conduct an examination of each NRSRO at least annually. As an integrated part of the applicable annual examinations, OCR staff will examine KBRA's satisfaction of the conditions to this Order set forth in section IV below. If the conditions are not being fulfilled to the staff's satisfaction, the staff will consider whether to recommend that the Commission take additional action, administrative or otherwise.

IV. Conclusion

Accordingly, pursuant to section 36 of the Exchange Act,

IT IS HEREBY ORDERED that KBRA is exempt from the conflict of interest prohibition in Exchange Act Rule 17g-5(c)(1) until January 1, 2017 with respect to any revenue derived from issuer-paid credit ratings, provided that: (1) KBRA shall review, update, maintain, comply with, and document policies, procedures, and internal controls specifically designed to address the conflict of interest created by exceeding the 10% threshold, including that KBRA's DCO shall: (a) conduct and document, on at least a quarterly basis, a review of a sample of rating files from its 2015, 2016, and 2017 fiscal years for credit ratings solicited by the applicable client or clients that provided KBRA with 10% or more of its total net revenue, and take other steps acceptable to the Commission's examination staff, to verify that ratings of any such clients were not influenced by commercial concerns and that KBRA adhered to such

policies, procedures, and internal controls; and (b) deliver quarterly written reports about these efforts to KBRA's CEO and board of directors; (2) within 5 business days after the end of each quarter beginning with the last quarter of its 2015 fiscal year and through the end of its 2017 fiscal year, KBRA's CEO shall file with the Commission a certification that all credit ratings issued through the end of each such quarter on deals for any client or clients that provided KBRA with 10% or more of its total net revenue sufficiently adhered to its policies, procedures, and internal controls to address the conflict of interest created by exceeding the 10% threshold, that the DCO took appropriate measures, including rating file reviews, to confirm this adherence, and that identifies the credit ratings issued for any such clients during such quarter; (3) KBRA shall appropriately address the Commission staff's findings and recommendations in the 2015 annual section 15E(p)(3) examination and any other examinations conducted by Commission staff during 2015, 2016, or 2017; (4) net revenue received by KBRA from a single client shall not exceed 19.5% of KBRA's total net revenue for either the fiscal year ending December 31, 2015 or the fiscal year ending December 31, 2016; (5) KBRA shall publicly disclose, as applicable, in Exhibit 6 to Form NRSRO that it received 10% or more of its total net revenue in fiscal years 2015 and 2016 from a client or clients; and (6) KBRA shall retain documentation demonstrating compliance with the conditions of the exemption.

By the Commission.

Brent Fields
Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9961 / October 13, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16891

In the Matter of **UBS AG** **Respondent**	**ORDER INSTITUTING CEASE AND DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE AND DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") against UBS AG ("UBS" or "Respondent").

II.

In anticipation of the institution of these proceedings, UBS has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, UBS consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and UBS's Offer, the Commission finds that:

Summary

1. These proceedings involve structured notes issued by UBS which were linked to a proprietary foreign exchange ("FX") trading strategy called the V10 Currency Index with Volatility Cap ("V10" or Index). UBS offered and sold approximately $190 million of medium term notes linked to the V10 (Notes) in registered offerings under the Securities Act to

approximately 1,900 retail investors ("V10 Investors") in the United States between December 2009 and November 2010 (Relevant Period). In the wake of the financial crisis, UBS perceived that investors interested in diversifying their stock and bond portfolios were attracted to these types of structured products so long as the underlying trading strategy was transparent. UBS stated to investors that the V10 was a "transparent" and "systematic" currency trading strategy. UBS further stated that the V10 was calculated using "market prices" for the relevant underlying financial instruments.

2. UBS engaged in three types of conduct that were undisclosed to investors — taking unjustified markups, engaging in hedging trades with non-systematic spreads and trading in advance of certain hedging transactions — that negatively impacted or, in the case of trading before hedging transactions, had the potential to negatively impact, pricing inputs used to calculate the V10. In reality, the V10 was neither transparent nor systematic, market prices were not consistently used to calculate the Index, and V10 Investors were thereby misled as to certain key features of this complex financial instrument. As a result of the markups and spreads, the Index was depressed by approximately five percent causing investor losses of approximately $5.5 million.

Respondent

3. UBS is a Swiss corporation headquartered in Switzerland. UBS is one of the largest issuers of structured notes in the world. UBS issued and registered with the Commission $2.7 billion of structured notes in 2014. UBS issued the Notes.

Facts

Note Offering

4. Between December 2009 and November 2010, UBS issued approximately $190 million of Notes linked to the V10. The public offering price was approximately $10 and the underwriting discount was approximately $0.25. Most of the Notes had a three year term. UBS paid no interest on the Notes. Investors were entitled to a cash payment at maturity dependent upon the performance of the V10.

5. The V10 was a proprietary index, developed and sponsored by UBS, that measured the performance of a hypothetical algorithmic trading strategy designed to identify and exploit trends in G10 foreign exchange forward rates. G10 currencies are the US dollar (USD), Euro (EUR), Japanese yen (JPY), British pound (GBP), Swiss franc (CHF), Australian dollar (AUD), New Zealand dollar (NZD), Canadian dollar (CAD), Norwegian krone (NOK) and Swedish krona (SEK). In lower volatility environments, the trading strategy hypothetically went long the three highest yielding G10 currencies and short the three lowest yielding G10 currencies using six month forward contracts which is commonly referred to as a "carry trade." In higher volatility environments, the strategy reversed this carry trade. The occasions on which the hypothetical portfolio of forward contracts changed were known as "switch days."

6. UBS sold the Notes in a series of registered offerings with the Commission under automatic shelf registration statements including through a Prospectus dated January 13, 2009; Prospectus Supplements dated December 16, 2009 and September 21, 2010; and Free Writing

Prospectuses and Prospectus Supplements (entitled "Pricing Supplements") for eleven offerings from December 23, 2009 through November 24, 2010 (collectively Offering Documents).

Relevant Statements

7. In the wake of the financial crisis, UBS perceived that investors interested in diversifying their stock and bond portfolios were attracted to these types of structured products so long as the underlying trading strategy was transparent. In an article discussing FX-based structured products entitled "Pushing frontiers in FX" that was published in The Banker on April 1, 2010, and which referenced the V10, a senior UBS employee was quoted as saying, "[i]n the current market, investors are looking for uncorrelated and highly transparent products and since the algorithmic model is pre-defined and the rules are made available, it is a glass box rather than a black box." Similarly, in an article discussing the structured products market, entitled "Structured Products: Time to rebuild trust" that was published in The Banker on May 1, 2010, and which also referenced the V10, a senior UBS employee was quoted as saying, "[t]he overall trend has been to focus on more transparent and liquid structured products" and "[i]nvestors want pay-off formulas and fees that are easier to understand."

8. UBS stated in the "Index benefits at a glance" section of the Free Writing Prospectuses, which are part of the Offering Documents, that the V10 provided investors, "[a]ccess to a transparent and systematic currency trading strategy which has proven successful in both live and back-tested results." UBS stated in the "Risk Factors" section of the Prospectus Supplements and the "Key Risks" section of the Prospectus Supplements (entitled "Pricing Supplements") that "UBS will determine the market price of the foreign exchange forward contracts underlying the Index. The foreign exchange contracts underlying the Index are foreign exchange forward contracts traded in the over-the-counter-market with terms of up to approximately six months. The prices of such contracts used to calculate gains and losses from notional settlement of hypothetical positions will be based on the market prices at 3:00 p.m. London time (or shortly thereafter taking into consideration available prices for the number of foreign exchange forward contracts that would need to be hypothetically settled as a result of such determination), on the applicable valuation date."

Undisclosed Effects or Potential Effects of Conduct

9. UBS hedged its obligations under the Notes by purchasing and selling FX forward contracts mirroring the hypothetical positions held by the V10. On switch days UBS used prices on its hedge transactions to calculate the V10; on other days UBS used mid-market prices. UBS's hedge transactions originated in London, were routed through a Swiss intermediary and then executed by the FX spot desk in Switzerland. Pricing information flowed from the FX spot desk back through the Swiss intermediary to London where the V10 was calculated on a daily basis.

10. UBS employees in Switzerland engaged in three types of conduct that either negatively impacted, or had the potential to negatively impact, pricing inputs used to calculate the V10. First, between May and October 2010, a UBS employee acting as an intermediary added markups to hedge transactions executed on switch days, which led to prices being used to calculate the Index that were not consistent with market prices. Given the intermediary's largely

administrative function, there was little, if any, legitimate business justification for the amount of these markups. Their impact on the Index was to reduce it by approximately one percent.

11. Second, between May 2010 and December 2011, the FX spot desk at UBS added spreads, which were not adequately disclosed, to internal transactions undertaken to hedge UBS's exposure to V10 instruments on switch days. These spreads were not added systematically, but rather were determined largely at the discretion of the FX spot desk. The prices of the hedge trades (including the spreads) were used as inputs to calculate the Index. The impact of the spreads on the Index was to reduce it by approximately four percent. Some UBS employees on the FX spot desk used colorful and sometimes obscene language in electronic communications via chat rooms while executing the V10 hedge transactions.

12. Third, between May 2010 and August 2011, the FX spot desk at UBS, including the head of the desk, engaged in over two dozen trades in management trading books shortly before executing potentially market-moving, internal V10 hedging transactions, which were directionally consistent with those hedging transactions. UBS did not have in place meaningful controls or restrictions during the Relevant Period over trading ahead of internal V10 hedging transactions.

13. UBS did not disclose the existence and effect, or potential effect, of this conduct to V10 Investors in the Offering Documents or otherwise. As a result, UBS's statements that the V10 was "transparent" and "systematic" and that "market prices" were used to calculate the Index were false and misleading. UBS also made a number of incomplete statements and omissions in monthly performance reports. Beginning in May 2010 and continuing through the Relevant Period, UBS filed with the Commission as Free Writing Prospectuses monthly performance reports for the V10 (Monthly Reports). The reports stated that the V10 was up X percent or down Y percent and generally attributed changes to macroeconomic events. No reference was made to the effect, or potential effect, that the conduct described above had on the Index, some of which contributed to the depression of the value of the Index.

UBS's Negligence

14. As an issuer of securities, UBS had a duty to disclose all material information necessary to make statements contained in the Offering Documents, in light of the circumstances under which they were made, not misleading. UBS breached that duty by failing to have in place an effective policy, procedure or process to make the individuals with primary responsibility for drafting, reviewing and revising the Offering Documents and Monthly Reports aware that UBS employees in Switzerland were engaged in conduct that negatively impacted, or had the potential to negatively impact, pricing inputs used to calculate the V10. As a result, those individuals with primary responsibility for drafting, reviewing and revising the Offering Documents and Monthly Reports were not in a position to make informed disclosure decisions.

15. The Offering Documents were drafted and reviewed by UBS employees in the United States with no meaningful input from UBS employees in Switzerland. UBS employees in the United States did not know that UBS employees in Switzerland were taking unjustified markups, and engaging in internal V10 hedging trades with non-systematic spreads, which negatively impacted pricing inputs used to calculate the V10, thereby negatively impacting the

performance of the Notes. Also, UBS employees in the United States did not know that UBS employees in Switzerland were trading ahead of certain V10 hedging transactions, which had the potential to negatively impact pricing inputs used to calculate the V10. UBS employees in London with responsibility for calculating the V10 were likewise unaware of this conduct and did not have the ability to critically assess pricing information provided to them.

* * *

16. As a result of the negligent conduct and materially misleading statements and omissions described above, UBS violated Section 17(a)(2) of the Securities Act which prohibits obtaining money or property by means of misstatements and omissions in the offer or sale of securities.

17. In determining to accept the Offer, the Commission considered UBS's substantial cooperation afforded the Commission staff. UBS conducted an internal investigation, and it provided information and analysis to the Commission staff. Many of the critical witnesses were located in Europe, and UBS made arrangements for them to travel to the United States for interviews with the staff. The Commission also considered certain remedial measures UBS implemented voluntarily. These include centralizing and improving the systems and controls relating to the operations, calculation and administration of indices including the V10.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in UBS's Offer.

Accordingly, pursuant to Section 8A of the Securities Act, it is hereby ORDERED that:

A. UBS cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act.

B. UBS shall pay disgorgement and prejudgment interest as follows:

1) UBS shall pay a total of $11.5 million consisting of disgorgement of $10 million and prejudgment interest of $1.5 million. $5.5 million of the disgorgement funds shall be deposited into a segregated account and used to compensate V10 Investors for each investor's incremental losses resulting from the markups and spreads described in this Order that occurred over their investment period (Disgorgement Fund). UBS shall be responsible for administering the Disgorgement Fund. The remaining $6 million shall be paid to the Commission within ten (10) days of the entry of the Order for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 17 C.F.R. § 201.600;

2) Within sixty (60) days of the entry of the Order, UBS shall make such payments to those V10 investors who still have accounts at UBS. UBS shall use its best efforts to make such distribution payments as soon as possible to those V10

investors who held their securities through non-UBS, third party dealers. UBS must complete the distribution within ninety (90) days of the entry of this Order;

3) UBS agrees to be responsible for all tax compliance responsibilities associated with distribution of the Disgorgement Fund and may retain any professional services necessary. The costs and expenses of any such professional services shall be borne by UBS and shall not be paid out of the Disgorgement Fund;

4) Upon completion of the distribution, UBS will pay any and all remaining monies from the Disgorgement Fund that have not been distributed to the Commission for transmittal to the United States Treasury. If UBS does not distribute any portion of the Disgorgement Fund for any reason, including if UBS is unable to locate and make payment to those investors who no longer maintain accounts at UBS or who held their securities through non-UBS, third party dealers, or due to factors beyond UBS's control, UBS shall transfer any such undistributed funds to the Commission for transmittal to the United States Treasury. Any such payment shall be made in accordance with Section IV.C below;

5) Within 120 days after the date of entry of this Order, UBS shall submit to the Commission staff a final accounting and certification of the disposition of the Disgorgement Fund not unacceptable to the Commission staff. UBS shall submit proof and supporting documentation of such payment (whether in the form of cancelled checks, or otherwise) in a form acceptable to the Commission staff and under a cover letter that identifies UBS as a Respondent in these proceedings and the file number of these proceedings to Reid A. Muoio, Deputy Director, Complex Financial Instruments Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. UBS shall provide any and all supporting documentation for the accounting and certification to the Commission staff upon its request and shall cooperate with any additional requests by the Commission staff in connection with the accounting and certification; and

6) The Commission staff may extend any of the procedural dates set forth in this Subsection B for good cause shown. Deadlines for dates relating to the Disgorgement Fund shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday the next business day shall be considered to be the last day.

C. UBS shall, within ten (10) days of the entry of this Order, pay a civil monetary penalty in the amount of $8 million to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment to the Commission must be made in one of the following ways:

1) UBS may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

2) UBS may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

3) UBS may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments must be accompanied by a cover letter identifying UBS as a Respondent in these proceedings and the file number of these proceedings. Proof of payment must be sent to Reid A. Muoio, Deputy Director, Complex Financial Instruments Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St. NE, Washington, DC 20549.

By the Commission.

Brent J. Fields
Secretary

Commissioner Gallagher
Commissioner Piwowar
Dissented as to the
retroactive municipal
Advisor and NRSRO Bars

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76151 / October 14, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16364

In the Matter of **DAVID L. MARION,** **Respondent.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to accept the Offer of Settlement submitted by David L. Marion ("Marion" or "Respondent") pursuant to Rule 240(a) of the Rules of Practice of the Commission, 17 C.F.R. § 201.240(a), for the purpose of settlement of these proceedings initiated against Respondent on January 28, 2015, pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act").

II.

Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Sections III.2 and III.4., below, and consents to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. David L. Marion, age 54, is currently incarcerated at the Duluth Federal Prison Camp in Duluth, Minnesota. At one time, Marion was associated with a registered broker-dealer, but in 1991, the NASD fined him, censured him, and barred him from association with any member of the NASD in any capacity for executing transactions in accounts of customers without

20 of 41

their authorization. From at least November 2008 through at least July 2009, Marion engaged in the unregistered offer and sale of securities issued by Investment Rarities Holdings Inc. ("IR Holdings"). At the time Marion solicited investors to invest in IR Holdings' securities he was neither registered with the Commission as a broker or dealer nor associated with a registered broker-dealer.

2. On June 20, 2013, a judgment was entered by consent against Marion, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. David L. Marion, et al., Civil Action Number 1:12-CV-749, in the United States District Court for the District of Minnesota.

3. The Commission's complaint alleged the following: From at least November 2008 through at least July 2009, Marion raised approximately $1 million from at least 26 investors by selling ownership shares of IR Holdings. The offer and sales of IR Holdings' securities were not registered with the Commission. Marion, personally and through others he directed, made multiple fraudulent representations in the offer and sale of securities of IR Holdings, a company that Marion owned and controlled. Marion sold ownership shares of IR Holdings to investors, telling them that IR Holdings owned 100% of International Rarities Corporation ("IR Corp."). Marion told the investors that IR Corp. was a successful gold coin and bullion sales and trading company. He told investors that by buying a piece of IR Holdings, they would share in the profits and success of IR Corp. These representations were false. When Marion sold IR Holdings' shares to investors, he was the sole owner of IR Corp. IR Holdings had no ownership interest in IR Corp. whatsoever. Marion sold the investors shares of a worthless shell company, and he knew that it was a worthless shell company. Marion also told the investors that IR Holdings had a functioning seven member-board of directors, including three independent directors. Marion also told the investors that he would use their money to expand IR Holdings' business, including taking the company public. These representations were false. In reality, IR Holdings did not have a functioning board of directors, Marion diverted the investors' funds for his own personal use, and Marion failed to take virtually any substantive action towards taking IR Holdings public. IR Holdings issued offering documents, including a Private Placement Memorandum, to investors that repeated these misrepresentations.

4. On February 21, 2013, Marion pled guilty to one count of conspiracy to commit mail and wire fraud and one count of money laundering in violation of Title 18 United States Code, Sections 1349 and 1957, respectively, before the United States District Court for the District of Minnesota, in United States v. David Laurence Marion, No. 1:12-CR-282. On August 29, 2013, a judgment in the criminal case was entered against Marion. He was sentenced to a prison term of 60 months followed by three years of supervised release and ordered to make restitution in the amount of $3,370,748.93.

5. The counts of the criminal complaint to which Marion pled guilty alleged, inter alia, that from at least November 2008 through at least July 2009, Marion made false and fraudulent representations to investors in connection with the unregistered offer and sale of approximately $1 million in securities to approximately 26 investors. Marion obtained money and property by

means of materially false and misleading statements at a time when he was acting as a broker but was not registered with the Commission as a broker or dealer and was not associated with an entity registered with the Commission as a broker-dealer.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Marion's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Marion be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent; and

Pursuant to Section 15(b)(6) of the Exchange Act Respondent Marion be, and hereby is barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Brent J Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76145 / October 14, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16899

In the Matter of AURIGA GLOBAL INVESTORS SOCIEDAD DE VALORES S.A. Respondent.	ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER AND CIVIL PENALTY

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Auriga Global Investors SV ("Auriga" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order and Civil Penalty ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

1. These proceedings arise out of violations of Rule 105 of Regulation M of the Exchange Act by Auriga Global Investors, Sociedad de Valores, S.A., a securities company registered with the Comisión Nacional del Mercado de Valores (CNMV), the financial regulatory agency of Spain. Rule 105 prohibits selling short an equity security that is the subject of certain public offerings and purchasing the offered security from an underwriter or broker or dealer participating in the offering, if such short sale was effected during the restricted period as defined therein.

2. On eight occasions between April 2014 and June 2015, Auriga bought offering shares from an underwriter or broker or dealer participating in a follow-on public offering after having sold short the same security during the Rule 105 restricted period. These violations collectively resulted in profits of $436,940.52.

Respondent

3. Auriga Global Investors, Sociedad de Valores, S.A., ("Auriga") is a securities company registered with the Comisión Nacional del Mercado de Valores (CNMV), the financial regulatory agency of Spain. Formed in 2007, Auriga is based in Madrid, Spain and has approximately $440 million of assets under management.

Legal Framework

4. Rule 105 makes it unlawful for a person to purchase equity securities in certain public offerings from an underwriter, broker, or dealer participating in the offering if that person sold short the security that is the subject of the offering during the restricted period defined in the rule, absent an exception. 17 C.F.R. § 242.105; see Short Selling in Connection with a Public Offering, Rel. No. 34-56206, 72 Fed. Reg. 45094 (Aug. 10, 2007) (effective Oct. 9, 2007). The Rule 105 restricted period is the shorter of the period: (1) beginning five business days before the pricing of the offered securities and ending with such pricing; or (2) beginning with the initial filing of a registration statement or notification on Form 1-A or Form 1-E and ending with the pricing. 17 C.F.R. § 242.105(a)(1) and (a)(2).

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

5. The Commission adopted Rule 105 "to foster secondary and follow-on offering prices that are determined by independent market dynamics and not by potentially manipulative activity." 72 Fed. Reg. 45094. Rule 105 is prophylactic and prohibits the conduct irrespective of the short seller's intent in effecting the short sale. Id.

Auriga's Violations of Rule 105 of Regulation M

6. On January 21 and January 22, 2015, Auriga sold short a total of 75,000 shares of Horsehead Holding Corp. ("ZINC") during the restricted period at a price of $13.7795 per share. On January 22, 2015, after the market close, ZINC announced the pricing of a follow-on offering of its common stock at $12.75 per share. Auriga received an allocation of 50,000 shares in that offering. Thus, Auriga's participation in the ZINC offering resulted in total profits of $51,475.

7. On April 9 and April 10, 2014, Auriga sold short a total of 75,000 shares of Regado Bioscience, Inc. ("RGDO") during the restricted period at a price of $7.7308 per share. On April 11, 2014, RGDO announced the pricing of a follow-on offering of its common stock at $6.00 per share. Auriga received an allocation of 175,000 shares in that offering. The difference between Auriga's proceeds from the restricted period short sales of RGDO shares and the price paid for 75,000 shares received in the offering was $129,810. Thus, Auriga's participation in the RGDO offering resulted in total profits of $129,810.

8. On June 16, 2014, Auriga sold short a total of 25,000 shares of Revance Therapeutics, Inc. ("RVNC") during the restricted period at a price of $29.5863 per share. On June 18, 2014, RVNC announced the pricing of a follow-on offering of its common stock at $30.50 per share. Auriga received an allocation of 60,000 RVNC shares in that offering. Although the offering price was greater than the price at which Auriga sold short during the restricted period, Auriga improperly received a benefit of $33,596.50 by purchasing the remaining 35,000 shares in the offering at a discount from RVNC's market price. Thus, Auriga's participation in the RVNC offering resulted in total profits of $33,596.50

9. On August 12, 2014, Auriga sold short a total of 10,000 shares of Celladon Corp. ("CLDN") during the restricted period at a price of $9.7970 per share. On August 12, 2014, after the market close, CLDN announced the pricing of a follow-on offering of its common stock at $9.50 per share. Auriga received an allocation of 250,000 shares in that offering. The difference between Auriga's proceeds from the restricted period short sales of CLDN shares and the price paid for 10,000 shares received in the offering was $2,970.00. Respondent also improperly received a benefit of $11,280.00 by purchasing the remaining 240,000 shares at a discount from CLDN's market price. Thus, Auriga's participation in the CLDN offering resulted in total profits of $14,250.

10. On December 10, 2014, Auriga sold short a total of 20,000 shares of Flexion Therapeutics, Inc. ("FLXN") during the restricted period at a price of $18.3818 per share. On December 11, 2014, FLXN announced the pricing of a follow-on offering of its common stock at

$17.00 per share. Auriga received an allocation of 60,000 shares in that offering. The difference between Auriga's proceeds from the restricted period short sales of FLXN shares and the price paid for 20,000 shares received in the offering was $27,636. Respondent also improperly received a benefit of $50,208.00 by purchasing the remaining 40,000 shares at a discount from FLXN's market price. Thus, Auriga's participation in the FLXN offering resulted in total profits of $77,844.

11. On June 2, 2015, Auriga sold short a total of 40,000 shares of Catalent, Inc. ("CTLT") during the restricted period at a price of $24.4965 per share. On June 2, 2015, after the market close, CTLT announced the pricing of a follow-on offering of its common stock at $29 per share. Auriga received an allocation of 35,000 shares in that offering. Thus, Auriga's participation in the CTLT offering resulted in total profits of $17,377.50.

12. On June 4, 2015, Auriga sold short a total of 20,200 shares of Ocular Therapeutix, Inc. ("OCUL") during the restricted period at a price of $22.8776 per share. On June 4, 2015, after the market close, OCUL announced the pricing of a follow-on offering of its common stock at $22 per share. Auriga received an allocation of 125,000 shares in that offering. The difference between Auriga's proceeds from the restricted period short sales of OCUL shares and the price paid for the 20,200 shares received in the offering was $17,727.52. Thus, Auriga's participation in the OCUL offering resulted in total profits of $17,727.52.

13. On October 28, 2014, Auriga sold short a total of 19,500 shares of Regulus Therapeutics, Inc. ("RGLS") during the restricted period at a price of $17.7089 per share. On October 28, 2014, after the market close, RGLS announced the pricing of a follow-on offering of its common stock at $17 per share. Auriga received an allocation of 60,000 shares in that offering. The difference between Auriga's proceeds from the restricted period short sales of RGLS shares and the price paid for the 19,500 shares received in the offering was $13,823.55. Respondent also improperly received a benefit of $81,036.45 by purchasing the remaining 40,500 shares at a discount from RGLS's market price. Thus, Auriga's participation in the RGLS offering resulted in total profits of $94,860.

14. In total, Auriga's violation of Rule 105 resulted in profits of $436,940.52.

Violations

15. As a result of the conduct described above, Auriga violated Rule 105 of Regulation M under the Exchange Act.

Auriga's Remedial Efforts & Cooperation

16. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded to Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Auriga's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Auriga cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M of the Exchange Act;

B. Auriga shall within fourteen (14) days of the entry of this Order, pay disgorgement of $436,940.52, prejudgment interest of $2,184.70 and a civil money penalty in the amount of $179,277.28 (for a total of $618,402.50) to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made on the disgorgement amount, additional interest shall accrue pursuant to SEC Rule of Practice 600. If timely payment is not made on the civil money penalty, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payments must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;[2]

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Auriga as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Gerald W. Hodgkins, Associate Director,

[2] The minimum threshold for transmission of payment electronically is $1,000,000. For amounts below the threshold, respondents must make payments pursuant to options (2) or (3) above.

Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549.

C. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76143 / October 14, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16897

In the Matter of

J.P. MORGAN INVESTMENT MANAGEMENT INC.

Respondent.

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER AND CIVIL PENALTY

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against J.P. Morgan Investment Management Inc. ("JPMIM" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order and Civil Penalty ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

1. These proceedings arise out of violations of Rule 105 of Regulation M of the Exchange Act by JPMIM, a New York-based registered investment adviser. Rule 105 prohibits selling short an equity security that is the subject of certain public offerings and purchasing the offered security from an underwriter or broker or dealer participating in the offering, if such short sale was effected during the restricted period as defined therein.

2. On ten occasions, from October 2009 through September 2012, JPMIM bought offering shares from an underwriter or broker or dealer participating in a follow-on public offering after having sold short the same security during the restricted period. These violations collectively resulted in profits of $662,763.

Respondent

3. J.P. Morgan Investment Management Inc. is a corporation organized under the laws of Delaware with its principal office in New York, New York. JPMIM is a registered investment adviser, with approximately $1.15 trillion in assets under management. The trading described herein refers to trading on behalf of certain client accounts of JPMIM, or, in some cases, of certain affiliates, advised by portfolio managers employed by JPMIM. As used in paragraphs 6-15, the terms "JPMIM" and "Respondent" refer to JPMIM or the relevant affiliate.

Legal Framework

4. Rule 105 makes it unlawful for a person to purchase equity securities in certain public offerings from an underwriter, broker, or dealer participating in the offering if that person sold short the security that is the subject of the offering during the restricted period defined in the rule, absent an exception. 17 C.F.R. § 242.105; see Short Selling in Connection with a Public Offering, Rel. No. 34-56206, 72 Fed. Reg. 45094 (Aug. 10, 2007) (effective Oct. 9, 2007). The Rule 105 restricted period is the shorter of the period: (1) beginning five business days before the pricing of the offered securities and ending with such pricing; or (2) beginning with the initial filing of a registration statement or notification on Form 1-A or Form 1-E and ending with the pricing. 17 C.F.R. § 242.105(a)(1) and (a)(2).

5. The Commission adopted Rule 105 "to foster secondary and follow-on offering prices that are determined by independent market dynamics and not by potentially manipulative

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

activity." 72 Fed. Reg. 45094. Rule 105 is prophylactic and prohibits the conduct irrespective of the short seller's intent in effecting the short sale. Id.

JPMIM's Violations of Rule 105 of Regulation M

6. On September 6, 2012, JPMIM sold short 450 shares of American International Group, Inc. ("AIG") during the restricted period at a price of $34.2211 per share. On September 10, 2012, AIG priced a follow-on offering of its common stock at $32.50 per share. JPMIM received an allocation that included 54,732 shares in that offering. The difference between JPMIM's proceeds received from the restricted period short sales of AIG shares and the price paid for 450 shares received in the offering was $774.50. Respondent also improperly received a benefit of $26,229.06 by purchasing the remaining 54,282 shares at a discount from AIG's market price. Thus, JPMIM's participation in the 2012 AIG offering resulted in total profits of $27,003.56.

7. On September 15, 2010, JPMIM sold short 4,100 shares of Alexandria Real Estate Equities, Inc. ("ARE") during the restricted period at a price of $72.06 per share. On September 22, 2010, ARE priced a follow-on offering of its common stock at $69.25 per share. JPMIM received an allocation that included 13,803 shares in that offering. The difference between JPMIM's proceeds received from the restricted period short sales of ARE shares and the price paid for 4,100 shares received in the offering was $11,521. Respondent also improperly received a benefit of $8,758.90 by purchasing the remaining 9,703 shares at a discount from ARE's market price. Thus, JPMIM's participation in the 2010 ARE offering resulted in total profits of $20,279.90.

8. On January 9, 2012, JPMIM sold short 7,200 shares of DDR Corp ("DDR") during the restricted period at a price of $12.5925 per share. On January 12, 2012, DDR priced a follow-on offering of its common stock at $12.95 per share. JPMIM received an allocation that included 447,735 shares in that offering. Although the offering price was greater than the price at which JPMIM sold short during the restricted period, JPMIM improperly received a benefit of $194,848.63 by purchasing the remaining 440,535 shares at a discount from DDR's market price. Thus, JPMIM's participation in the 2012 DDR offering resulted in total profits of $194,848.63.

9. On June 21, 2012 and June 22, 2012, JPMIM sold short a total of 860 shares of Digital Realty Trust, Inc. ("DLR") during the restricted period at an average price of $74.0365 per share. On June 26, 2012, DLR priced a follow-on offering of its common stock at $72.25 per share. JPMIM received an allocation that included 140,236 shares in that offering. The difference between JPMIM's proceeds received from the restricted period short sales of DLR shares and the price paid for 860 shares received in the offering was $1,536.39. Respondent also improperly received a benefit of $70,886.63 by purchasing the remaining 139,376 shares at a discount from DLR's market price. Thus, JPMIM's participation in the 2012 DLR offering resulted in total profits of $72,423.02.

10. On October 28, 2010 and November 2, 2010, JPMIM sold short a total of 34,800 shares of HCP, Inc. ("HCP") during the restricted period at an average price of $36.4642. On November 3, 2010, HCP priced a follow-on offering of its common stock at $35.25 per share. JPMIM received an allocation that included 383,000 shares in that offering. The difference between JPMIM's proceeds received from the restricted period short sales of HCP shares and the price paid for 34,800 shares received in the offering was $42,254.16. Respondent also improperly received a benefit of $179,775.66 by purchasing the remaining 348,200 shares at a discount from HCP's market price. Thus, JPMIM's participation in the 2010 HCP offering resulted in total profits of $222,029.82.

11. On April 12, 2010 and April 14, 2010, JPMIM sold short a total of 20,700 shares of The Macerich Company ("MAC") during the restricted period at an average price of $42.3662 per share. On April 15, 2010, MAC priced a follow-on offering of its common stock at $41 per share. JPMIM received an allocation that included 28,330 shares in that offering. The difference between JPMIM's proceeds received from the restricted period short sales of MAC shares and the price paid for 20,700 shares received in the offering was $28,280.34. Thus, JPMIM's participation in the 2010 MAC offering resulted in total profits of $28,280.34.

12. On September 14, 2012 and September 17, 2012, JPMIM sold short a total of 680 shares of Health Care REIT Inc. ("HCN") during the restricted period at an average price of $58.7106 per share. On September 18, 2012, HCN priced a follow-on offering of its common stock at $56 per share. JPMIM received an allocation that included 82,900 shares in that offering. The difference between JPMIM's proceeds received from the restricted period short sales of HCN shares and the price paid for 680 shares received in the offering was $1,843.21. Respondent also improperly received a benefit of $84,826.37 by purchasing the remaining 82,220 shares at a discount from HCN's market price. Thus, JPMIM's participation in the 2012 HCN offering resulted in total profits of $86,669.58.

13. On July 31, 2012, JPMIM sold short 650 shares of Taubman Centers, Inc. ("TCO") during the restricted period at a price of $77.1823 per share. On August 1, 2012, TCO priced a follow-on offering of its common stock at $76 per share. JPMIM received an allocation that included 2,700 shares in that offering. The difference between JPMIM's proceeds received from the restricted period short sales of TCO shares and the price paid for 650 shares received in the offering was $768.49. Respondent also improperly received a benefit of $3,878.81 by purchasing the remaining 2,050 shares at a discount from TCO's market price. Thus, JPMIM's participation in the 2012 TCO offering resulted in total profits of $4,647.30.

14. On October 14, 2011, JPMIM sold short 1,300 shares of Equity Lifestyle Properties, Inc. ("ELS") during the restricted period at a price of $64.22 per share. On October 20, 2011, ELS priced a follow-on offering of its common stock at $60.70 per share. JPMIM received an allocation that included 111,140 shares in that offering. The difference between JPMIM's proceeds received from the restricted period short sales of ELS shares and the price paid for 1,300 shares received in the offering was $4,576. Thus, JPMIM's participation in the 2011 ELS offering resulted in total profits of $4,576.

15. On October 12, 2009, JPMIM sold short 20,900 shares of CBS Corporation ("CBS") during the restricted period at an average price of $12.0885. On October 14, 2009, CBS priced a follow-on offering of its common stock at $12 per share. JPMIM received an allocation that included 21,100 shares in that offering. The difference between JPMIM's proceeds received from the restricted period short sales of CBS shares and the price paid for 20,900 shares received in the offering was $1,849.65. Respondent also improperly received a benefit of $155.26 by purchasing the remaining 200 shares at a discount from CBS' market price. Thus, JPMIM's participation in the 2009 CBS offering resulted in total profits of $2,004.91.

16. In total, JPMIM's violations of Rule 105 resulted in profits of $662,763.

Violations

17. As a result of the conduct described above, JPMIM violated Rule 105 of Regulation M under the Exchange Act.

JPMIM's Remedial Efforts & Cooperation

18. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded to Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent JPMIM's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent JPMIM cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M of the Exchange Act;

B. JPMIM shall within fourteen (14) days of the entry of this Order, pay disgorgement of $662,763, prejudgment interest of $56,758.40, and a civil money penalty in the amount of $364,689 (for a total of $1,084,210.40) to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made on the disgorgement amount, additional interest shall accrue pursuant to SEC Rule of Practice 600. If timely payment is not made on the civil money penalty, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Payments must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;[2]
(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying JPMIM as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Gerald W. Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549.

[2] The minimum threshold for transmission of payment electronically is $1,000,000. For amounts below the threshold, respondents must make payments pursuant to options (2) or (3) above.

C. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Action" means a private damages action brought against Respondent based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76144 / October 14, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16898

In the Matter of **HARVEST CAPITAL STRATEGIES LLC** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER AND CIVIL PENALTY**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Harvest Capital Strategies LLC ("Harvest Capital" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order and Civil Penalty ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

1. These proceedings arise out of a violation of Rule 105 of Regulation M of the Exchange Act by Harvest Capital, a California-based registered investment adviser. Rule 105 prohibits selling short an equity security that is the subject of certain public offerings and purchasing the offered security from an underwriter or broker or dealer participating in the offering, if such short sale was effected during the restricted period as defined therein.

2. In May 2014, Harvest Capital bought offering shares from an underwriter or broker or dealer participating in a follow-on public offering after having sold short the same security during the Rule 105 restricted period. This violation resulted in profits of $18,835.

Respondent

3. Harvest Capital Strategies LLC is a Delaware limited liability company with its principal place of business in San Francisco, California. Harvest Capital Strategies LLC has been registered with the Commission as an investment adviser since February 2006. The firm provides advisory services to nine domestic funds and four foreign funds and currently has total assets under management in excess of $1.6 billion.

Legal Framework

4. Rule 105 makes it unlawful for a person to purchase equity securities in certain public offerings from an underwriter, broker, or dealer participating in the offering if that person sold short the security that is the subject of the offering during the restricted period defined in the rule, absent an exception. 17 C.F.R. § 242.105; see Short Selling in Connection with a Public Offering, Rel. No. 34-56206, 72 Fed. Reg. 45094 (Aug. 10, 2007) (effective Oct. 9, 2007). The Rule 105 restricted period is the shorter of the period: (1) beginning five business days before the pricing of the offered securities and ending with such pricing; or (2) beginning with the initial filing of a registration statement or notification on Form 1-A or Form 1-E and ending with the pricing. 17 C.F.R. § 242.105(a)(1) and (a)(2).

5. The Commission adopted Rule 105 "to foster secondary and follow-on offering prices that are determined by independent market dynamics and not by potentially manipulative activity." 72 Fed. Reg. 45094. Rule 105 is prophylactic and prohibits the conduct irrespective of the short seller's intent in effecting the short sale. Id.

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Harvest Capital's Violation of Rule 105 of Regulation M

6. Over several days in May 2014, Harvest Capital sold short 1,450,000 shares of Glu Mobile Inc. ("GLUU") during the restricted period at an average price of $3.8767 per share. On May 29, 2014, after the market close, GLUU announced the pricing of a follow-on offering of its common stock at $3.5000 per share. Harvest Capital received an allocation of 50,000 shares in that offering. Thus, Harvest Capital's participation in the GLUU offering resulted in total profits of $18,835.

7. In total, Harvest Capital's violation of Rule 105 resulted in profits of $18,835.

Violation

8. As a result of the conduct described above, Harvest Capital violated Rule 105 of Regulation M under the Exchange Act.

Harvest Capital's Remedial Efforts & Cooperation

9. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded to Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Harvest Capital's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Harvest Capital cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M of the Exchange Act;

B. Harvest Capital shall within fourteen (14) days of the entry of this Order, pay disgorgement of $18,835, prejudgment interest of $619.28, and a civil money penalty in the amount of $65,000 (for a total of $84,454.28) to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made on the disgorgement amount, additional interest shall accrue pursuant to SEC Rule of Practice 600. If timely payment is not made on the civil money penalty, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payments must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;[2]

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Harvest Capital as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Gerald W. Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549.

[2] The minimum threshold for transmission of payment electronically is $1,000,000. For amounts below the threshold, respondents must make payments pursuant to options (2) or (3) above.

C. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76142 / October 14, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16896

In the Matter of OMEGA ADVISORS, INC. Respondent.	ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER AND CIVIL PENALTY

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Omega Advisors, Inc. ("Omega" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order and Civil Penalty ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

1. These proceedings arise out of a violation of Rule 105 of Regulation M of the Exchange Act by Omega, a New York-based registered investment adviser. Rule 105 prohibits selling short an equity security that is the subject of certain public offerings and purchasing the offered security from an underwriter or broker or dealer participating in the offering, if such short sale was effected during the restricted period as defined therein.

2. On January 15, 2015, Omega bought offering shares from an underwriter or broker or dealer participating in a follow-on public offering after having sold short the same security during the Rule 105 restricted period. The violation resulted in profits of $68,340.

Respondent

3. Omega Advisors, Inc. is a corporation incorporated in Delaware with its principal place of business in New York, New York. Omega Advisors, Inc. has been registered with the Commission as an investment adviser since March 1993. The firm provides advisory services to three domestic funds and four foreign funds and has total assets under management in excess of $9 billion.

Legal Framework

4. Rule 105 makes it unlawful for a person to purchase equity securities in certain public offerings from an underwriter, broker, or dealer participating in the offering if that person sold short the security that is the subject of the offering during the restricted period defined in the rule, absent an exception. 17 C.F.R. § 242.105; see Short Selling in Connection with a Public Offering, Rel. No. 34-56206, 72 Fed. Reg. 45094 (Aug. 10, 2007) (effective Oct. 9, 2007). The Rule 105 restricted period is the shorter of the period: (1) beginning five business days before the pricing of the offered securities and ending with such pricing; or (2) beginning with the initial filing of a registration statement or notification on Form 1-A or Form 1-E and ending with the pricing. 17 C.F.R. § 242.105(a)(1) and (a)(2).

5. The Commission adopted Rule 105 "to foster secondary and follow-on offering prices that are determined by independent market dynamics and not by potentially manipulative activity." 72 Fed. Reg. 45094. Rule 105 is prophylactic and prohibits the conduct irrespective of the short seller's intent in effecting the short sale. Id.

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Omega's Violation of Rule 105 of Regulation M

6. On January 12, 2015, Omega sold short 150,000 shares of Southwestern Energy Co. ("SWN") during the restricted period at a price of $23.6834 per share. On January 15, 2015, SWN announced the pricing of a follow-on offering of its common stock at $23.00 per share. Omega received an allocation of 100,000 shares in that offering. Thus, Omega's participation in the SWN offering resulted in total profits of $68,340.

7. In total, Omega's violation of Rule 105 resulted in profits of $68,340.

Violation

8. As a result of the conduct described above, Omega violated Rule 105 of Regulation M under the Exchange Act.

Omega's Remedial Efforts & Cooperation

9. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded to Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Omega's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Omega cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M of the Exchange Act;

B. Omega shall within fourteen (14) days of the entry of this Order, pay disgorgement of $68,340, prejudgment interest of $686.58, and a civil money penalty in the amount of $65,000 (for a total of $134,026.58) to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made on the disgorgement amount, additional interest shall accrue pursuant to SEC Rule of Practice 600. If timely payment is not made on the civil money penalty, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payments must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;[2]

[2] The minimum threshold for transmission of payment electronically is $1,000,000. For amounts below the threshold, respondents must make payments pursuant to options (2) or (3) above.

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Omega as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Gerald W. Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549.

C. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76141 / October 14, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16895

In the Matter of

SABBY MANAGEMENT, LLC

Respondent.

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER AND CIVIL PENALTY

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Sabby Management, LLC ("Sabby" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order and Civil Penalty ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

1. These proceedings arise out of violations of Rule 105 of Regulation M of the Exchange Act by Sabby, a New Jersey-based registered investment adviser. Rule 105 prohibits selling short an equity security that is the subject of certain public offerings and purchasing the offered security from an underwriter or broker or dealer participating in the offering, if such short sale was effected during the restricted period as defined therein.

2. On two occasions between December 2014 and February 2015, Sabby bought offering shares from an underwriter or broker or dealer participating in a follow-on public offering after having sold short the same security during the Rule 105 restricted period. The violations resulted in profits of $184,747.10

Respondent

3. Sabby Management, LLC is a limited liability company incorporated in Delaware with its principal place of business in Upper Saddle River, New Jersey. Sabby Management, LLC has been registered with the Commission as an investment adviser since July 2013 and currently has total assets under management in excess of $800 million.

Legal Framework

4. Rule 105 makes it unlawful for a person to purchase equity securities in certain public offerings from an underwriter, broker, or dealer participating in the offering if that person sold short the security that is the subject of the offering during the restricted period defined in the rule, absent an exception. 17 C.F.R. § 242.105; see Short Selling in Connection with a Public Offering, Rel. No. 34-56206, 72 Fed. Reg. 45094 (Aug. 10, 2007) (effective Oct. 9, 2007). The Rule 105 restricted period is the shorter of the period: (1) beginning five business days before the pricing of the offered securities and ending with such pricing; or (2) beginning with the initial filing of a registration statement or notification on Form 1-A or Form 1-E and ending with the pricing. 17 C.F.R. § 242.105(a)(1) and (a)(2).

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

5. The Commission adopted Rule 105 "to foster secondary and follow-on offering prices that are determined by independent market dynamics and not by potentially manipulative activity." 72 Fed. Reg. 45094. Rule 105 is prophylactic and prohibits the conduct irrespective of the short seller's intent in effecting the short sale. Id.

Sabby's Violations of Rule 105 of Regulation M

6. On February 25, 2015, Sabby sold short 50,000 shares of CollabRx ("CLRX") during the restricted period at a price of $1.565 per share. On February 25, 2015, after the market close, CLRX announced the pricing of a follow-on offering of its common stock at $1.27 per share. Sabby received an allocation of 725,000 shares in that offering. The difference between Sabby's proceeds from the restricted period short sales of CLRX shares and the price paid for 50,000 shares received in the offering was $14,750. Respondent also improperly received a benefit of $155,925 by purchasing the remaining 675,000 shares at a discount from CLRX's market price. Thus, Sabby's participation in the CLRX offering resulted in total profits of $170,675.

7. On December 11 and December 12, 2014, Sabby sold short a total of 2,000 shares of Bluebird Bio, Inc. ("BLUE") during the restricted period at a price of $88.216 per share. On December 15, 2014, BLUE announced the pricing of a follow-on offering of its common stock at $85 per share. Sabby received an allocation of 15,000 shares in that offering. The difference between Sabby's proceeds from the restricted period short sales of BLUE shares and the price paid for 2,000 shares received in the offering was $6,432. Respondent also improperly received a benefit of $7,640.10 by purchasing the remaining 13,000 shares at a discount from BLUE's market price. Thus, Sabby's participation in the BLUE offering resulted in total profits of $14,072.10

8. In total, Sabby's violations of Rule 105 resulted in profits of $184,747.10.

Violations

9. As a result of the conduct described above, Sabby violated Rule 105 of Regulation M under the Exchange Act.

Sabby's Remedial Efforts & Cooperation

10. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded to Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Sabby's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Sabby cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M of the Exchange Act;

B. Sabby shall within fourteen (14) days of the entry of this Order, pay disgorgement of $184,747.10, prejudgment interest of $2,331.51, and a civil money penalty in the amount of $91,669.95 (for a total of $278,748.56) to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made on the disgorgement amount, additional interest shall accrue pursuant to SEC Rule of Practice 600. If timely payment is not made on the civil money penalty, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payments must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;[2]

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Sabby as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Gerald W. Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549.

C. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor

[2] The minimum threshold for transmission of payment electronically is $1,000,000. For amounts below the threshold, respondents must make payments pursuant to options (2) or (3) above.

Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76140 / October 14, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4227 / October 14, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16894

In the Matter of **WAR CHEST CAPITAL PARTNERS LLC** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(e) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act"), against War Chest Capital Partners LLC ("War Chest" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, prior to a hearing pursuant to the Commission's Rules of Practice, 17 C.F.R. § 201.100 et seq., and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 21C of the Securities Exchange Act of 1934 and Section 203(e) of the Investment Advisers Act of 1940, Making

Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

1. These proceedings arise out of violations of Rule 105 of Regulation M of the Exchange Act by War Chest, a New York-based private equity firm. Rule 105 prohibits selling short an equity security that is the subject of certain public offerings and purchasing the offered security from an underwriter or broker or dealer participating in the offering, if such short sale was effected during the restricted period as defined therein.

2. On seven occasions, from January 2011 through September 2011, War Chest bought offering shares from an underwriter or broker or dealer participating in a follow-on public offering after having sold short the same security during the restricted period. These violations collectively resulted in profits of $179,516.

Respondent

3. War Chest Capital Partners LLC is a Delaware limited liability company which, at all relevant times, had its principal place of business in New York, New York. During the period of violation, the company provided advisory services to one domestic fund with total assets under management of approximately $8,000,000. At no time was it a registered investment adviser. On September 16, 2013, a prior settled Commission order was instituted, finding that War Chest violated Rule 105 in connection with seven offerings.[2]

Legal Framework

4. Rule 105 makes it unlawful for a person to purchase equity securities in certain public offerings from an underwriter, broker, or dealer participating in the offering if that person sold short the security that is the subject of the offering during the restricted period defined in the rule, absent an exception. 17 C.F.R. § 242.105; see Short Selling in Connection with a Public Offering, Rel. No. 34-56206, 72 Fed. Reg. 45094 (Aug. 10, 2007) (effective Oct. 9, 2007). The Rule 105 restricted period is the shorter of the period: (1) beginning five business days before the pricing of the offered securities and ending with such pricing; or (2) beginning with the initial filing of a registration statement or notification on Form 1-A or Form 1-E and ending with the pricing. 17 C.F.R. § 242.105(a)(1) and (a)(2).

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

[2] War Chest Capital Partners LLC, Exchange Act Release No. 70411 (September 16, 2013).

5. The Commission adopted Rule 105 "to foster secondary and follow-on offering prices that are determined by independent market dynamics and not by potentially manipulative activity." 72 Fed. Reg. 45094. Rule 105 is prophylactic and prohibits the conduct irrespective of the short seller's intent in effecting the short sale. Id.

War Chest's Violations of Rule 105 of Regulation M

6. On January 13, 2011, War Chest sold short 13,100 shares of American Capital Agency Corp. ("AGNC") during the restricted period at an average price of $28.7879 per share. On January 13, 2011, after the market close, AGNC priced a follow-on offering of its common stock at $28 per share. War Chest received an allocation of 53,900 shares in that offering. The difference between War Chest's proceeds received from the restricted period short sales of AGNC shares and the price paid for 13,100 shares received in the offering was $10,321.49. Respondent also improperly received a benefit of $31,611.84 by purchasing the remaining 40,800 shares at a discount from AGNC's market price. Thus, War Chest's participation in the 2011 AGNC offering resulted in total profits of $41,933.33.

7. On March 28, 2011, War Chest sold short 33,000 shares of Energy Transfer Partners, LP ("ETP") during the restricted period at an average price of $50.6689 per share. On March 29, 2011, ETP priced a follow-on offering of its common stock at $50.52 per share. War Chest received an allocation of 63,020 shares in that offering. The difference between War Chest's proceeds received from the restricted period short sales of ETP shares and the price paid for 33,000 shares received in the offering was $4,913.70. Respondent also improperly received a benefit of $4,704.13 by purchasing the remaining 30,020 shares at a discount from ETP's market price. Thus, War Chest's participation in the 2011 ETP offering resulted in total profits of $9,617.83.

8. On May 24, 2011, War Chest sold short 48,500 shares of American International Group, Inc. ("AIG") during the restricted period at an average price of $29.4593 per share. On May 24, 2012, after the market close, AIG priced a follow-on offering of its common stock at $29 per share. War Chest received an allocation of 134,375 shares in that offering. The difference between War Chest's proceeds received from the restricted period short sales of AIG shares and the price paid for 48,500 shares received in the offering was $22,276.05. Thus, War Chest's participation in the 2011 AIG offering resulted in total profits of $22,276.05.

9. On June 2, 2011, War Chest sold short a total of 237,250 shares of Arch Coal Inc. ("ACI") during the restricted period at an average price of $27.4716 per share. On June 3, 2011, ACI priced a follow-on offering of its common stock at $27 per share. War Chest received an allocation of 231,600 shares in that offering. Thus, War Chest's participation in the 2011 ACI offering resulted in total profits of $109,222.56.

10. On June 15, 2011, War Chest sold short a total of 13,500 shares of Five Star Quality Care Inc. ("FVE") during the restricted period at an average price of $5.3508. On June 15, 2011, after the market close, FVE priced a follow-on offering of its common stock at $5 per share. War Chest received an allocation of 55,400 shares in that offering. The difference between War Chest's proceeds received from the restricted period short sales of FVE shares and the price paid

for 13,500 shares received in the offering was $4,735.80. Respondent also improperly received a benefit of $2,710.93 by purchasing the remaining 41,900 shares at a discount from FVE's market price. Thus, War Chest's participation in the 2011 FVE offering resulted in total profits of $7,446.73.

11. On June 23, 2011, War Chest sold short a total of 16,500 shares of the Excel Trust, Inc. ("EXL") during the restricted period at an average price of $10.9391 per share. On June 23, 2011, after the market close, EXL priced a follow-on offering of its common stock at $10.94 per share. War Chest received an allocation of 16,000 shares in that offering.

12. On September 8, 2011, War Chest sold short a total of 4,500 shares of Calumet Specialty Products Partners, LP ("CLMT") during the restricted period at an average price of $18.1073 per share. On September 8, 2011, after the market close, CLMT priced a follow-on offering of its common stock at $18 per share. War Chest received an allocation of 22,550 shares in that offering. The difference between War Chest's proceeds received from the restricted period short sales of CLMT shares and the price paid for 4,500 shares received in the offering was $483.05. Thus, War Chest's participation in the 2011 CLMT offering resulted in total profits of $483.05.

13. War Chest's violations of Rule 105 resulted in illicit profits to War Chest of $179,516.

Violations

14. As a result of the conduct described above, War Chest willfully[3] violated Rule 105 of Regulation M under the Exchange Act.

Undertakings

War Chest has undertaken to:

15. Limit its activities, functions, and operations as an investment adviser for one year, commencing the second Monday following the entry of this Order, by refraining from participating directly or indirectly in any secondary or follow-on offering.

16. Certify, in writing, compliance with the undertaking set forth above. The certification shall identify the undertaking, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be

[3] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" Id. (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

submitted to Anita B. Bandy, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertaking.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent War Chest's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act and Section 203(e) of the Advisers Act, Respondent War Chest shall cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M of the Exchange Act;

B. Respondent is censured;

C. Respondent shall pay disgorgement of $179,516, prejudgment interest of $22,302.02 and a civil penalty of $150,000 (for a total of $351,818.02), to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3).

Payment shall be made in the following installments:

1. $51,818.02 within 30 days of entry of this Order;
2. $30,000 within 60 days of entry of this Order;
3. $30,000 within 90 days of entry of this Order;
4. $30,000 within 120 days of entry of this Order;
5. $30,000 within 150 days of entry of this Order;
6. $30,000 within 180 days of entry of this Order;
7. $30,000 within 210 days of entry of this Order;
8. $30,000 within 240 days of entry of this Order;
9. $30,000 within 270 days of entry of this Order;
10. $30,000 within 300 days of entry of this Order; and
11. $30,000, plus post-judgment interest on the payments described in Section IV.C.1-11 pursuant to SEC Rule of Practice 600, within 330 days of entry of this Order.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. § 3717, shall be due and payable immediately, without further application.

Payments must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;[4]

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying War Chest as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Gerald W. Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

[4] The minimum threshold for transmission of payment electronically is $1,000,000. For amounts below the threshold, respondents must make payments pursuant to options (2) or (3) above.

E. Respondent shall comply with the undertakings enumerated in Paragraphs 15 and 16 above.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76152 / October 14, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-13553

In the Matter of Mary Beth Stevens Respondent.

ORDER AUTHORIZING THE TRANSFER TO THE U.S. TREASURY OF ANY FUNDS RETURNED TO THE FAIR FUND IN THE FUTURE, DISCHARGING THE FUND ADMINISTRATOR, AND TERMINATING THE FAIR FUND

ADMINISTRATIVE PROCEEDING
File No. 3-13554

In the Matter of Paul W. Oliver, Jr. Respondent.

On July 17, 2009, the Securities and Exchange Commission ("Commission" or "SEC") issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order against Paul W. Oliver, Jr. ("Oliver Order")[1] finding that AA Capital Partners, Inc.'s ("AA Capital") former chairman, Paul W. Oliver, Jr. ("Oliver"), aided and abetted and caused AA Capital's violations of Sections 206(2) and 206(4) of the Investment Advisers Act of 1940 ("Advisers Act") and Rule 206(4)-4 thereunder by failing to disclose misappropriations to AA Capital's clients and by failing to take appropriate action to halt the misappropriations after he learned of them. In the Oliver Order, the Commission ordered Oliver to cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-4 thereunder, suspended him from association with any investment adviser for twelve months and

[1] Advisers Act Rel. No. 2903 (July 17, 2009).

ordered him to pay disgorgement of $49,786.44, prejudgment interest of $7,979.71, and a civil money penalty of $75,000. The Oliver Order also created a Fair Fund pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002.

On January 5, 2010, the Commission issued an Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 against Mary Beth Stevens ("Stevens Order")[2] finding that AA Capital's former chief financial officer and chief compliance officer, Mary Beth Stevens ("Stevens"), aided and abetted and caused AA Capital's violations of the antifraud and books and record provisions of the Advisers Act. In the Stevens Order, the Commission ordered Stevens to cease and desist from committing or causing any violations and any future violations of Sections 204, 206(1), 206(2) and 206(4) of the Advisers Act and Rules 204-2(a)(1), 204-2(a)(2), 204-2(a)(6), and 206(4)-4 thereunder. Stevens was also barred from associating with any investment adviser and ordered to pay disgorgement of $79,583.50, prejudgment interest of $22,472.24, and a civil money penalty of $50,000. In addition, the Stevens Order held that the civil money penalty may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002.

On December 22, 2011, the Commission issued a Corrected Notice of Proposed Plan of Distribution and Opportunity for Comment ("Notice") pursuant to Rule 1103 of the Commission's Rules on Fair Fund and Disgorgement Plans ("Rules").[3] On February 24, 2012, the Commission issued a Corrected Order Approving Plan of Distribution and Appointing a Fund Administrator,[4] whereby Anne C. McKinley, a Commission employee, was appointed as the Fund Administrator.

The Final Plan of Distribution ("Plan") provided for the Fair Fund to be distributed to six clients who had funds misappropriated by AA Capital, an investment adviser, and AA Capital's former President, John Orecchio. On January 25, 2013, the Commission issued an order to disburse $273,344.83 to the six clients,[5] and on or about March 14, 2013, $273,344.83 was distributed through the U.S. Department of the Treasury's ("U.S. Treasury") Bureau of the Fiscal Service. Ultimately, all payments were accepted and no funds were returned to the Fair Fund. In addition, the Fair Fund paid a total of $950.00 in taxes and $10,527.06 in Tax Administrator fees and expenses. A balance of $0.00 remains in the Fair Fund.

The Plan provides that the Fair Fund shall be eligible for termination, and the Fund Administrator shall be discharged, after all of the following have occurred: (1) a final accounting, in an SEC standard accounting format, has been submitted by the Fund Administrator for approval of, and has been approved by, the Commission, (2) all taxes, fees and expenses have been paid, and (3) any amount remaining in the Fair Fund has been received by the Commission. A final accounting, which was submitted to the Commission for approval as required by Rule 1105(f) and as set forth in the Plan, is now approved. Staff has verified that all

[2] Advisers Act Rel. No. 2973 (January 5, 2010).
[3] Exchange Act Rel. No. 66039 (December 22, 2011).
[4] Exchange Act Rel. No. 66468 (February 24, 2012).
[5] Exchange Act Rel. No. 68732 (January 25, 2013).

taxes, fees, and expenses have been paid, and there are no funds remaining in the Fair Fund to be received by the Commission.

Accordingly, it is ORDERED that:

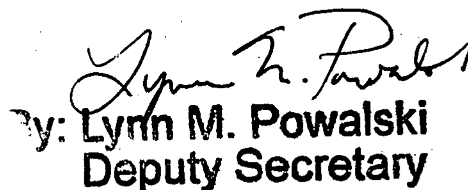
A. Any funds returned to the Fair Fund in the future shall be transferred to the U.S. Treasury;

B. The Fund Administrator, Anne C. McKinley, is discharged; and

C. The Fair Fund is terminated.

By the Commission.

Brent J. Fields
Secretary



UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76166 / October 15, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4229 / October 15, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16904

In the Matter of

Jerry A. Cicolani, Jr.,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Jerry A. Cicolani, Jr. ("Cicolani")
.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Cicolani was associated with PrimeSolutions Securities, Inc. ("PSSI") from August 2010 until May 2014. PSSI, based in Cleveland, Ohio, has been registered with the Commission as a broker-dealer since 1999 and is registered with several states as an investment adviser.

B. RESPONDENT'S CRIMINAL CONVICTIONS

1. On May 29, 2014, the Commission filed a Complaint in the United States District Court for the Northern District of Ohio ("Court"), captioned *SEC v. Abdallah et al.* Cicolani was among the numerous defendants.

2. The Commission's Complaint alleged that from at least October 2012 through May 2014, Cicolani and others solicited investors to invest in KGTA Petroleum, Ltd. ("KGTA"), purportedly a petroleum company that earned profits by buying and reselling crude oil and refined fuel products. In reality, the KGTA oil business was a sham and a Ponzi scheme. Cicolani, in particular, was alleged to have recklessly offered and sold interests in KGTA despite glaring red flags that KGTA was a scam. Cicolani was also alleged to have hidden from investors that he was being paid enormous commissions – over $4 million. Cicolani also did not disclose these investments or his KGTA sales activity to his employer, PSSI. His KGTA commissions were hidden by routing the funds through undisclosed entities controlled by Cicolani and his girlfriend, Kelly Hood ("Hood"). Moreover, since KGTA was a Ponzi scheme, these commissions were taken from investor funds. Cicolani was also alleged to have violated the registration provisions of the Securities Act of 1933. The Complaint named Hood as a relief defendant for her receipt of these commissions.

3. On May 4, 2015, Cicolani pleaded guilty to two criminal counts: sale of unregistered securities [15 U.S.C. §§ 77e(a) and 77e(c)] and structuring [31 U.S.C. §§ 5324(a)(1) and (3)]. The criminal information filed against Cicolani on April 14, 2015 stated that the unregistered securities sold by Cicolani were the private investments in KGTA Petroleum, Ltd. The information filed against Cicolani stated that the funds Cicolani withdrew in violation of the structuring statute constituted commission fees paid to entities owned by Cicolani and Hood from KGTA. Cicolani and Hood withdrew these funds after they each received a subpoena from the Commission requesting information about, among other things, payments received from KGTA.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II above are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act; and

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent as provided for in the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76167 / October 15, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4230 / October 15, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16905

In the Matter of **Kelly C. Hood,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Kelly C. Hood ("Hood").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Hood was associated with PrimeSolutions Securities, Inc. ("PSSI") from March 2012 until May 2014. PSSI, based in Cleveland, Ohio, has been registered with the Commission as a broker-dealer since 1999 and is registered with several states as an investment adviser.

B. RESPONDENT'S CRIMINAL CONVICTION

1. On May 29, 2014, the Commission filed a Complaint in the United States District Court for the Northern District of Ohio ("Court"), captioned *SEC v. Abdallah et al.*

2. The Commission's Complaint alleged that from at least October 2012 through May 2014, Jerry A. Cicolani, Jr. ("Cicolani") and others solicited investors to invest in KGTA Petroleum, Ltd. ("KGTA"), purportedly a petroleum company that earned profits by buying and reselling crude oil and refined fuel products. In reality, the KGTA oil business was a sham and a Ponzi scheme. Cicolani, in particular, was alleged to have recklessly offered and sold interests in KGTA despite glaring red flags that KGTA was a scam. Cicolani was also alleged to have hidden from investors that he was being paid enormous commissions – over $4 million. Cicolani also did not disclose these investments or his KGTA sales activity to his employer, PSSI. His KGTA commissions were hidden by routing the funds through undisclosed entities controlled by Cicolani and his girlfriend, Kelly C. Hood. Moreover, since KGTA was a Ponzi scheme, these commissions were taken from investor funds. Cicolani was also alleged to have violated the registration provisions of the Securities Act of 1933. The Complaint named Hood as a relief defendant for her receipt of these commissions.

3. On May 4, 2015, Cicolani pleaded guilty to two criminal counts: sale of unregistered securities [15 U.S.C. §§ 77e(a) and 77e(c)] and structuring [31 U.S.C. §§ 5324(a)(1) and (3)]. The criminal information filed against Cicolani on April 14, 2015 stated that the unregistered securities sold by Cicolani were the private investments in KGTA Petroleum, Ltd. The information filed against Cicolani stated that the funds Cicolani withdrew in violation of the structuring statute constituted commission fees paid to entities owned by Cicolani and Hood from KGTA. Cicolani and Hood withdrew these funds after they each received a subpoena from the Commission requesting information about, among other things, payments received from KGTA.

4. On May 4, 2015, Hood pleaded guilty to one count of structuring [31 U.S.C. §§ 5324(a)(1) and (3)]. The criminal information filed against Hood on April 14, 2015 stated that the funds Hood withdrew in violation of the structuring statute constituted commission fees paid to entities owned by Cicolani and Hood from KGTA for their solicitation of investments into the offering.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II above are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act; and

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent as provided for in the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76160 / October 15, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4228 / October 15, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16903

In the Matter of JASON A. MUSKEY, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Jason A. Muskey ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2. below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the

Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that

1. Muskey, age 39, is a resident of Moosic, Pennsylvania. From June 2006 through June 2014, he was a registered representative at and person associated with a broker-dealer and investment adviser registered with the Commission. Muskey was the owner and operator of Muskey Financial Services, an unregistered entity. He held Series 6, 7, 24, 26, 63, and 65 licenses.

2. On February 17, 2015, Muskey pled guilty to one count each of mail fraud, money laundering, and aggravated identity theft in violation of Title 18 United States Code, Sections 1341, 1956, and 1028A(a) before the United States District Court for the Middle District of Pennsylvania, in United States v. Jason A. Muskey, Criminal Action No. 3-CR-15-18. Muskey is awaiting sentencing.

3. The counts of the criminal information to which Muskey pled guilty alleged and Muskey admitted in a plea colloquy, among other things, that:

(a) From approximately January 2007 through May 2014, while operating Muskey Financial Services, Muskey conducted a Ponzi-like scheme that defrauded 26 advisory clients and brokerage customers ("Clients") out of approximately $2 million;

(b) Muskey knowingly devised a fraudulent scheme and artifice whereby he obtained funds from Clients by means of materially false and fraudulent pretenses, representations, and promises by telling Clients that he would invest their funds as they instructed, but instead misappropriated and converted the funds for his own use or to repay other Clients who he had defrauded;

(c) In furtherance of the scheme to defraud, Muskey forged Clients' signatures on withdrawal forms or had Clients sign withdrawal forms under false pretenses in order to obtain checks on which he forged Clients' signatures that he deposited into bank accounts under his control; and

(d) Muskey provided Clients with false quarterly account statements, some of which were sent through the United States mail, that misrepresented the value of Clients' investments.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Muskey's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act, and Section 203(f) of the Advisers Act, that Respondent Muskey be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

Pursuant to Section 15(b)(6) of the Exchange Act Respondent Muskey be, and hereby is barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76169 / October 16, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16906

In the Matter of Accentia Biopharmaceuticals, Inc., and Biostem U.S. Corp., Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Accentia Biopharmaceuticals, Inc. and Biostem U.S. Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Accentia Biopharmaceuticals, Inc. (CIK No. 1310094) is a dissolved Florida corporation located in Tampa, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Accentia Biopharmaceuticals, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2012, which reported a net loss of $8,700,000 for the prior three months. As of October 5, 2015, the company's stock (symbol "ABPI") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had ten market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Biostem U.S. Corp. (CIK No. 1455380) is a revoked Nevada corporation located in Clearwater, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Biostem U.S. Corp. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended November 30, 2012, which reported a net loss of $3,584,390 for the prior nine months. As of October 5, 2015, the company's stock (symbol "HAIR") was quoted on OTC Link, seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

3. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

4. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

5. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further

order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76171 / October 16, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16907

In the Matter of Life Care Medical Devices Ltd., and New Leaf Brands, Inc., Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Life Care Medical Devices Ltd. and New Leaf Brands, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Life Care Medical Devices Ltd. (CIK No. 1508363) is a defaulted Nevada corporation located in New Smyrna Beach, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Life Care Medical Devices Ltd. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended January 31, 2013, which reported a net loss of over $94,000 from the company's March 26, 2008 inception to January 31, 2013. As of October 5, 2015, the company's stock (symbol "LCMD") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. New Leaf Brands, Inc. (CIK No. 806175) is a revoked Nevada corporation located in Southbury, Connecticut with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). New Leaf Brands, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2012, which reported a net loss of $1,294,739 for the prior three months. As of October 5, 2015, the company's stock (symbol "NLEF") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

3. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

4. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

5. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further

order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Commissioner Piwowar
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9963 / October 16, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76178 / October 16, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16509

In the Matter of **EDWARD M. DASPIN,** **a/k/a "EDWARD (ED) MICHAEL;"** **LUIGI AGOSTINI; and** **LAWRENCE R. LUX,** **Respondents.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE–AND–DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO LAWRENCE R. LUX**

I.

On April 23, 2015, the Securities and Exchange Commission ("Commission") deeming it appropriate and in the public interest, instituted public administrative and cease-and-desist proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Lawrence R. Lux ("Lux" or "Respondent").

II.

Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934 as to Lawrence R. Lux

("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

A. The Fraud

1. In April 2010, Edward M. Daspin ("Daspin") started a new business capitalizing on the growing popularity of "mixed martial arts." To this end, he founded several companies in his basement: Worldwide Mixed Martial Arts Sports, Inc. ("WMMA"), WMMA Distribution, Inc. ("WMMA Distribution"), and WMMA Holdings, Inc. (collectively the "Companies"). The companies operated out of Daspin's home until they relocated to commercial office space in Little Falls, NJ.

2. As conceived and structured by Daspin, WMMA would contract with local promoters to organize mixed martial arts tournaments around the world and create digital content and branded merchandise. As Daspin envisioned it, WMMA Distribution would sell the content and merchandise, via cable television contracts and online viewing and product sales.

3. WMMA Holdings held the controlling interest in WMMA and WMMA Distribution, and the controlling interest in WMMA Holdings was held by three limited partnerships controlled by Daspin's wife. Daspin was the architect of the corporate structure and made all decisions regarding intra-companies transfers of stock.

4. Daspin enlisted Luigi Agostini ("Agostini"), a friend of his son's, to serve as executive chairman of each of the Companies' boards of directors. Agostini had worked with Daspin at two of Daspin's prior failed ventures; at one of them Agostini was also held out as the company's chairman.

5. Daspin also recruited Lux to serve as a director and CEO of WMMA and WMMA Distribution, and a director of WMMA Holdings. Lux was previously involved in another Daspin venture, a purported private equity company, of which Daspin was the senior partner. According to WMMA's and WMMA Distribution's private placement memorandums ("PPMs"), Lux had an expertise in internet marketing, had been involved with several internet start-ups, and had experience in raising capital for start-ups.

6. Despite officially having no formal role at the Companies, Daspin effectively operated as the Companies' CEO, with authority to make almost every important decision, including decisions about the hiring of employees and executives, capital raising, and negotiating contracts and transactions with third parties.

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

7. Daspin's fraudulent conduct included several oral misrepresentations to investors about the Companies. For example, Daspin falsely presented himself to employee-investors as only a consultant to the Companies, when in reality he effectively operated as the CEO. Daspin also used an alias in order to conceal from investors his prior criminal conviction and failed business ventures; Daspin only revealed his true identity to investors when they were on the verge of investing.

8. WMMA issued two PPMs, dated July 31, 2011 and January 5, 2012, which were provided to prospective investors. At Daspin's direction, the PPMs contained several material misrepresentations. For example, the PPMs misleadingly described Daspin as only a consultant to the Companies and told investors that Lux, Agostini, and a third individual, were the Companies' directors and senior officers. In reality, Daspin exercised ultimate control over virtually every important business decision of the Companies. Agostini, who had previously worked as a disc jockey and in music production, deferred to Daspin on all important business decisions, Lux was often absent from the Companies' offices and distracted by personal issues, and the third individual had not previously been involved in a business other than a chiropractic practice.

9. Additionally, Daspin caused the PPMs to materially misrepresent the nature and value of a contract between WMMA and International Marketing Corporations, Inc. ("IMC"), a marketing database company. The PPMs described the contract as a "long-term strategic alliance" that gave WMMA access to more than 130 million U.S. mobile phone numbers, 4 million websites, 840 million opt-in email addresses, and 100 million press release outfits. The PPMs failed to disclose facts that, at a minimum, raised substantial questions about the truth of these statements and whether the database would be of any real use to the Companies.

10. In addition, at Daspin's insistence, the narrative portion of the January 2012 WMMA PPM included a representation that a consultant (actually Daspin) valued the IMC contract at $82 million – albeit admittedly not in accordance with GAAP – and that WMMA's board had purportedly approved the valuation and requested that the valuation be included in the PPM. This valuation amount was essentially baseless.

11. In raising money for the venture, Daspin targeted unemployed professionals, whom he lured in with offers of executive-level positions at the Companies. Typically, it was only after prospects arrived for a "job interview" that they learned that they would be required to make a substantial investment as a condition of obtaining employment and receiving a salary. From September 2011 through March 2012, Daspin, with the assistance of Lux, fraudulently raised $2,037,000 from six employee-investors.

12. The Companies paid two entities controlled by Daspin approximately $382,000 for bringing in investments. Daspin received a substantial portion of this money. Lux was paid approximately $9,000 for his role in bringing in investments. Between 2011 and 2012, Lux received a total of $36,853 from the Companies.

B. Lux's Role in the Fraud

13. Daspin recruited Lux to serve as a director and CEO of the Companies. Lux served an essential role in Daspin's fraud, enabling Daspin to control the Companies while maintaining the illusion that he was only a consultant. Although Lux, along with Agostini, and another individual, was ostensibly one of Companies' directors and senior officers, he either deferred or acquiesced to Daspin on all important matters. The directors approved the decision to delegate virtually all of the Companies' important business decisions to Daspin. No one at the Companies was responsible for supervising Daspin's actions as a "consultant."

14. Lux was fully aware of the true ownership structure of the Companies and Daspin's control. He was also fully aware of Daspin's criminal conviction and string of failed ventures. In addition, Lux was beholden to Daspin and needed the job that Daspin provided, although ultimately it did not prove remunerative for Lux.

15. Lux and Agostini arranged for the Companies' investment fundraising to be delegated to Daspin, and they knew that Daspin was disseminating the Companies' offering memoranda to prospective investors. Lux and Agostini both turned a blind eye to the content of the offering memoranda. At most, Lux skimmed the PPMs, despite knowing that they contained unreasonable financial figures, and that he did not seek to correct those documents so that they would not be misleading to potential investors.

16. In addition, soliciting investors was a big part of Lux's job at the companies and he participated in the solicitation of prospective investors. Lux thus witnessed Daspin's active concealment of his true identity until late in the solicitation process, and was aware, or reckless for not knowing, that the Companies' PPMs omitted to disclose Daspin's true control of the Companies.

17. The offerings of WMMA and WMMA Distribution securities were not registered with the Commission. Lux, along with Daspin, acted as an unregistered broker by, among other things, actively soliciting investments in those securities, providing prospective investors with advice as to the merits of investments, and receiving compensation based on the sale of those securities.

18. Lux also knew that WMMA's PPM contained baseless valuations for the IMC contract and he told Daspin that his valuation methodology was baseless. Nevertheless, Lux participated in the board meeting of WMMA at which the board approved the $82 million valuation of the IMC contract and the inclusion of the valuation in WMMA's January 2012 PPM.

C. The End of the Companies

19. In March 2012, the Companies produced a charity fundraising mixed martial arts event in El Paso, Texas to generate brand recognition for WMMA. Instead, the El Paso event was the death knell for the Companies, resulting in a loss of approximately $500,000 and consuming

most of their remaining cash. By June 2012, if not sooner, the Companies had run out of cash, and ceased doing business.

RESPONDENT VIOLATED SECTIONS 5(a), 5(c), AND 17(a) OF THE SECURITES ACT AND SECTION 15(a) OF THE EXCHANGE ACT

20. As a result of the conduct described above, Respondent willfully violated Sections 17(a)(2) and 17(a)(3) of the Securities Act by negligently participating in the solicitation of investors even though he knew or should have known there was no reasonable basis for the descriptions of the IMC database in the PPMs and the $82 million valuation of the IMC contract in the January 2012 WMMA PPM and because he knew or should have known that Daspin actively concealed his true identity to investors until late in the solicitation process.

21. As a result of the conduct described above, Respondent willfully violated Sections 5(a) and 5(c) of the Securities Act by participating in the unregistered offerings of securities for which no exemption from registration was available.

22. As a result of the conduct described above, Respondent willfully violated Section 15(a) of the Exchange Act by engaging in unregistered brokerage activity.

COMMISSION FINDINGS

Based on the foregoing, the Commission finds that:

23. Respondent willfully violated Sections 17(a)(2) and 17(a)(3) of the Securities Act;

24. Respondent willfully violated Sections 5(a) and 5(c) of the Securities Act; and

25. Respondent willfully violated Section 15(a) of the Exchange Act.

UNDERTAKINGS

26. In connection with these proceedings and any related judicial or administrative proceeding or investigation commenced by the Commission or to which the Commission is a party, Respondent (i) agrees to appear and be interviewed by Commission staff at such times and places as the staff requests upon reasonable notice; (ii) will accept service by mail, electronic mail, or facsimile transmission of notices or subpoenas issued by the Commission for documents or testimony at depositions, hearings, or trials, or in connection with any related investigation by Commission staff; (iii) with respect to such notices and subpoenas, waives the territorial limits on service contained in Rule 45 of the Federal Rules of Civil Procedure and any applicable local rules, provided that the party requesting the testimony reimburses Respondent's travel, lodging, and subsistence expenses at the then-prevailing U.S. Government per diem rates; and (iv) consents to personal jurisdiction over Respondent in any United States District Court for purposes of enforcing any such subpoena.

27. In determining whether to accept Respondent Lux's Offer, the Commission has

considered the cooperation Lux afforded the Commission staff, and the above undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, and for the protection of investors to impose the sanctions agreed to in Respondent Lux's Offer.

Accordingly, pursuant to Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Lux cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, Sections 5(a) and 5(c) of the Securities Act and Section 15(a) of the Exchange Act.

B. Respondent Lux be, and hereby is, barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent shall pay disgorgement of $36,853.21 which represents profits gained as a result of the conduct described herein, and prejudgment interest of $4,061.05, but that payment of such amount is waived based upon Respondent's sworn representations in his Statement of Financial Condition dated August 17, 2015 and other documents submitted to the Commission. Also based upon Respondent's sworn representations in his Statement of Financial Condition dated August 17, 2015 and other documents submitted to the Commission, the Commission is not imposing a penalty against Respondent.

E. The Division of Enforcement ("Division") may, at any time following the entry of this Order, petition the Commission to: (1) reopen this matter to consider whether Respondent knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding; provided inaccurate or incomplete financial information at the time such representations were made; or otherwise failed to comply with the undertakings enumerated in Section III, Paragraph 26 of the Order; and (2) seek an order directing payment of a civil penalty and/or disgorgement and pre-judgment interest. No other issue shall be considered in connection

with this petition other than whether Respondent knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding; whether the financial information provided by Respondent was fraudulent, misleading, inaccurate, or incomplete in any material respect; and whether Respondent otherwise failed to comply with the undertakings enumerated in Section III, Paragraph 26 of the Order. Respondent may not, by way of defense to any such petition: (1) contest the findings in this Order; (2) assert that payment of disgorgement and interest, or payment of a penalty, should not be ordered; (3) contest the amount of disgorgement and interest to be ordered or the imposition of the maximum penalty allowable under the law; or (4) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9964 / October 19, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4233 / October 19, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31869 / October 19, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16909

In the Matter of **UBS Willow Management L.L.C. and UBS Fund Advisor L.L.C.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against UBS Willow Management L.L.C. ("UBS Willow Management") and pursuant to Section 203(e) of the Advisers Act against UBS Fund Advisor L.L.C. ("UBS Fund Advisor," and collectively with UBS Willow Management, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings

herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds that:

Summary

1. These proceedings arise from UBS Willow Management's misrepresentations and omissions concerning a material change in the investment strategy[1] of UBS Willow Fund L.L.C. (the "Fund"), a continuously offered, closed-end, registered investment company and UBS Willow Management's only client. From the Fund's inception in 2000, UBS Willow Management marketed the Fund as a product that primarily invested in distressed debt *(i.e.,* a thesis that debt would *increase* in value). UBS Willow Management pursued this investment strategy until 2008, when it changed course and shorted credit *(i.e.,* a thesis that debt would *decrease* in value) by purchasing large amounts of credit default swaps ("CDS") for the Fund. Indeed, by fall 2008, the Fund had transitioned from its historical long-credit position and became net short credit. Thereafter, the Fund remained net short credit through its CDS exposure. Ultimately, the CDS exposure resulted in significant losses at the Fund and, in part, as a result of those losses, the Fund's board of directors ("Board") liquidated the Fund in 2012.

2. Once the Fund had become net short credit, UBS Willow Management misrepresented the Fund's investment strategy (and its risks) in various communications to investors, prospective investors and the Board, and caused the Fund to misrepresent the strategy in filings with the Commission. In particular, the Fund's Offering Memorandum ("OM") misrepresented the Fund's investment strategy from fall 2008 to 2012 because UBS Willow Management failed to update it to reflect the change from long credit to short credit. Similarly, from fall 2008 to May 2009, UBS Willow Management provided potential investors with a marketing brochure representing that the Fund had a long-credit investment strategy and used CDS "occasionally," when the Fund actually had moved to a short-credit investment strategy largely driven by CDS. From fall 2008 to August 2011, UBS Willow Management also disseminated investor letters with false or misleading information about the Fund's CDS exposure. Finally, from fall 2008 through the Fund's liquidation in 2012, UBS Willow Management caused the Fund to misrepresent its investment strategy in shareholder reports filed with the Commission.

3. UBS Fund Advisor had contractual control and supervisory authority over UBS Willow Management. Accordingly, UBS Fund Advisor was obligated to ensure that UBS Willow Management adhered to the Fund's stated investment strategy and that UBS Willow Management adequately disclosed the Fund's investment strategy to the Board and investors. UBS Fund Advisor was aware of the investment strategy change, but did not cause UBS Willow Management

[1] As used in this Order, the term "investment strategy" refers to the principal portfolio emphasis of the Fund, including the types of securities in which it invests or will invest principally.

to revert to an investment strategy consistent with the Fund's disclosures. Moreover, after the change in principal investment strategy, UBS Fund Advisor failed to ensure adequate disclosure of the change to the Fund's Board or investors. By allowing UBS Willow Management to deviate from the principal investment strategy without adequate disclosure to the Fund's Board or investors, UBS Fund Advisor failed reasonably to supervise UBS Willow Management.

Respondents

4. **UBS Willow Management L.L.C. ("UBS Willow Management"),** which ceased operations in 2014, was a Delaware limited liability company with its principal place of business in New York, New York. UBS Willow Management was registered with the Commission as an investment adviser from March 2000 until it voluntarily terminated its registration in February 2014. UBS Willow Management was organized as a joint venture between UBS Fund Advisor and Bond Street Capital L.L.C. ("Bond Street"), a third-party portfolio manager. UBS Willow Management's sole purpose was to provide investment advice to the Fund. UBS Willow Management was formerly known as PW Willow Management L.L.C.

5. **UBS Fund Advisor L.L.C. ("UBS Fund Advisor")** is a Delaware limited liability company with its principal place of business in New York, New York. UBS Fund Advisor has been registered with the Commission as an investment adviser since 1998. As of April 2014, UBS Fund Advisor had approximately $5.6 billion in regulatory assets under management. UBS Fund Advisor is an indirect, wholly-owned subsidiary of UBS AG and is part of UBS's Wealth Management Americas division. UBS Fund Advisor was formerly known as PW Fund Advisor L.L.C. UBS Fund Advisor was the controlling member of UBS Willow Management from incorporation until September 2010.[2]

Other Relevant Entities

6. **UBS Willow Fund L.L.C. ("Fund"),** no longer in business, was a Delaware limited liability company with its principal place of business in New York, New York. The Fund was a continuously offered, closed-end, non-diversified investment company registered under the Investment Company Act. The Fund was formerly known as PW Willow Fund L.L.C. and UBS PW Willow Fund L.L.C. UBS Willow Management served as investment adviser to the Fund, which commenced operations in May 2000, and ceased to be registered under the Investment Company Act pursuant to an order issued under Section 8(f) of that Act in January 2014. At its peak in 2007, the Fund had $512 million in net assets.

7. **Bond Street Capital L.L.C. ("Bond Street"),** no longer in business, was UBS Fund Advisor's joint venture partner in UBS Willow Management. Bond Street was a limited liability company formed and based in Englewood Cliffs, New Jersey. Bond Street was registered with the Commission as an investment adviser from March 2000 to March 2014.

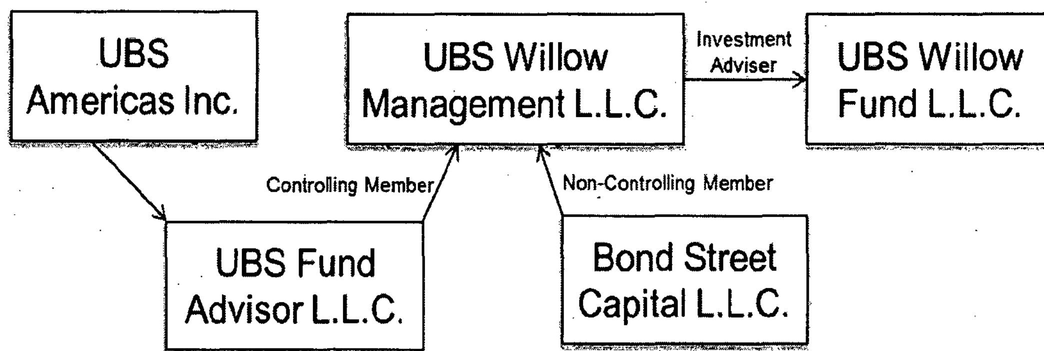
[2] Unless otherwise noted, references to UBS Fund Advisor pertain to the period through September 2010, when it was the controlling member of UBS Willow Management.

Background

8. UBS Willow Management was formed in 2000 as a joint venture between UBS Fund Advisor and Bond Street for the sole purpose of providing investment advice to the Fund (see organizational chart below). Subject to UBS Fund Advisor's supervision, Bond Street, a small adviser with few employees, was responsible for developing and implementing the Fund's investment strategy. UBS Fund Advisor, through UBS Willow Management and other UBS affiliates, performed all other operations related to the Fund, including marketing, sales, the review and dissemination of investor letters, and the preparation of regulatory filings. Pursuant to the investment advisory agreement between UBS Willow Management and the Fund, the Fund paid UBS Willow Management an advisory fee at the annual rate of 1.25% (plus a conditional incentive allocation of 20%) for providing investment advice to the Fund. From the third quarter of 2008 through the end of 2011, UBS Willow Management received $8,223,112 in revenue for providing such advice.

9. UBS Fund Advisor had ultimate responsibility for the Fund's investments. UBS Willow Management's Limited Liability Company Agreement ("L.L.C. Agreement") designated UBS Fund Advisor as "Managing Member" and Bond Street as "Non-Managing Member." As Managing Member, UBS Fund Advisor had the unlimited authority to "manage and direct ... the investment activities of [the Fund]." While Bond Street was responsible for day-to-day portfolio management, its investment decisions were "subject to the supervision of the Managing Member *[i.e.,* UBS Fund Advisor]." Under the L.L.C. Agreement, UBS Fund Advisor could terminate Bond Street (without Board approval) if it determined that doing so was in the Fund's "best interests."

Organizational Structure for
UBS Willow Management L.L.C.



Offering Memorandum

10. UBS Willow Management began offering the Fund in May 2000 and continued to offer the Fund through at least July 2012. During that period, the Fund's OM stated that the investment objective was to "maximize total return" and that the Fund sought to achieve its objective by "investing primarily in debt securities ... of U.S. companies that are experiencing significant financial or business difficulties." Investing in distressed debt is a long-credit strategy,

meaning that the value of the Fund's investments could be expected to increase if the perceived credit quality of debt issuers improved.

11. While the OM identified investing in distressed debt as the Fund's principal portfolio emphasis, it also authorized the Fund to buy and sell a range of other securities, including derivative instruments, for both hedging and speculative purposes. The OM noted that derivatives "can be volatile" and "involve various degrees of risk" and that derivatives "may entail investment exposures that are greater than their cost would suggest, meaning that a small investment in [d]erivatives could have a large potential impact on the Fund's performance." The OM did not contain any specific disclosures for CDS, which were not widely traded at the time that the Fund was initially offered to the public, but which are, in fact, derivatives.

UBS Willow Management Changed the Fund's Investment Strategy

12. From the Fund's inception until 2008, UBS Willow Management invested Fund assets primarily in distressed debt, and these long-credit investments drove the Fund's performance. While the Fund occasionally bought and sold derivatives, including CDS, the CDS exposure was modest.[3] Prior to 2008, the notional amount of CDS never exceeded the Fund's net assets, and the market value of the CDS portfolio was never more than 2.6% of the Fund's net assets. During this period, the Fund consistently maintained a net long-credit position.

13. Beginning around 2008, Bond Street began to believe that credit market conditions would deteriorate. In response, Bond Street, with UBS Fund Advisor's knowledge, changed the Fund's investment strategy. In 2008 and early 2009, Bond Street significantly increased the Fund's short exposure by making large CDS purchases. At the beginning of 2008, the notional size of the Fund's CDS portfolio was $315 million. By the end of the first quarter of 2009, this increased to a notional size of nearly $2.4 billion.[4] In market value terms, the CDS portfolio grew from 2.6% of net assets at the beginning of 2008 to 25% by the end of the first quarter of 2009.

14. The large CDS portfolio dramatically changed the Fund's risk profile. CDS has synthetic leverage, meaning that its value is highly sensitive to changes in the value of the underlying debt. In other words, CDS values move significantly more than traditional bond prices in response to credit market fluctuations. Accordingly, even though the market value of the CDS portfolio comprised less than a quarter of the Fund's net assets in 2008, the CDS portfolio was the primary driver of the Fund's performance from fall 2008 until the Fund was liquidated. Indeed, the disproportionate impact of the CDS exposure caused the Fund to become net short credit. By fall 2008, instead of primarily investing *in* distressed debt, as disclosed in the OM, the Fund was primarily *shorting* distressed debt. Moreover, because of its inherent synthetic leverage, the CDS portfolio amplified the Fund's profit and losses, making the Fund more volatile.

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[3] CDS is a financial instrument that provides protection against default by a debt issuer. As a buyer of CDS, the Fund paid premiums in exchange for a potential payoff if the debt issuer defaulted. Buying CDS is a short-credit strategy because CDS gains value if the debt issuer's credit deteriorates. Conversely, CDS decreases in value if the debt issuer's credit improves.

[4] The Fund was never exposed to losses in the amount of the CDS portfolio's notional value. The Fund's risk of loss was based on the premiums outstanding and the market value loss of the CDS position.

15. The change in investment strategy contributed to significant losses for the Fund. Starting around April 2009, credit conditions began to improve and distressed debt increased in value, leading to large mark-to-market losses for the Fund's CDS portfolio. In addition, the high cost of maintaining the CDS positions (exceeding 25% of the Fund's assets by 2010) contributed to the Fund's losses. In 2012, the Fund performed very poorly in large part because of its short-credit CDS portfolio, and the Board voted to liquidate the Fund.

UBS Willow Management Did Not Adequately Disclose the Fund's Change in Investment Strategy to the Board or Investors

16. UBS Willow Management did not adequately disclose the investment strategy change and the risks related to the change to the Fund's Board. Further, UBS Willow Management misrepresented the Fund's investment strategy in various investor communications and did not amend the OM to reflect the change in strategy.[5]

17. UBS Fund Advisor, acting on behalf of UBS Willow Management, met regularly with the Board, but from fall 2008 to May 2009 it failed to ensure adequate disclosure to the Board of the Fund's change in investment strategy. Further, from May 2009 to August 2011, UBS Willow Management did not adequately disclose significant, known risks posed by the Fund's large CDS exposure. For example, on the morning of the May 2009 Board meeting, UBS Fund Advisor received the results of a recent stress test showing large potential CDS losses. UBS Fund Advisor did not inform the Board of the stress test results. Similarly, UBS Willow Management did not alert the Board to the substantial cost of maintaining the CDS positions, which, by 2010, annually exceeded 25% of the Fund's net assets.

18. From fall 2008 until the Fund was liquidated in 2012, UBS Willow Management provided prospective investors with a materially false OM. In that period, UBS Willow Management continued to use the Fund's original OM that described a long-credit principal investment strategy of investing in distressed debt. Beginning in fall 2008, the OM's description of the Fund's principal investment strategy was false because the Fund was actually short credit and betting *against* distressed debt.

19. From fall 2008 to May 2009, UBS Willow Management similarly provided prospective investors with a marketing brochure containing false statements about the Fund's investment strategy. For example, the brochure identified "general widening of credit spreads" - a risk of a long-credit distressed debt strategy - as a potential risk of the Fund. At the time, however, the Fund's short-credit exposure meant that the actual risk was from *tightening* credit spreads. Similarly, the brochure referred to the Fund's "occasional" use of CDS, when, in fact, CDS was the primary driver of the Fund's performance at that time. In May 2009, UBS Willow Management, at the direction of UBS employees, stopped providing prospective investors with the brochure.

20. From fall 2008 to August 2011, UBS Willow Management disseminated investor letters containing false or misleading statements about the Fund's investment strategy. For

[5] The Fund's financial statements filed with the Commission contained certain information about the CDS holdings, but this information did not sufficiently convey the risks associated with the Fund's increased reliance on CDS.

example, the quarterly letters during this period referenced benchmark indices inapplicable to the Fund's short-credit strategy. There also was a misleading statement about the Fund's leverage. The fourth quarter 2008 letter represented that the Fund did not use leverage. Although the Fund did not utilize leverage in the traditional sense of investing with borrowed money, the Fund relied heavily on CDS, which has inherent synthetic leverage. Similarly, the first quarter 2009 letter contained misleading information about the cost of maintaining the CDS portfolio. Only in the August 2011 investor letter did UBS Willow Management provide current Fund investors with a complete explanation of the effect of the CDS positions on Fund performance and the risks posed by the large CDS exposure.

21. UBS Willow Management was aware of the change in the Fund's investment strategy and knew or should have known that the representations in the OM, marketing brochure, and investor letters were false or materially misleading. UBS Willow Management also knew or should have known that it omitted certain material information about the change in investment strategy in discussions with the Board.

UBS Willow Management Did Not Adequately Disclose the Change in Investment Strategy in the Registration Statement or Annual Shareholder Report

22. Form N-2, the registration statement for closed-end investment companies, requires the investment company to describe the investment objectives and policies constituting the Fund's principal portfolio emphasis. The principal portfolio emphasis includes the types of investments, investment policies, practices, and techniques that the investment company employs or intends to employ, the extent to which it may engage in investment policies, and the risks inherent in such policies. Form N-2 also requires a closed-end registered investment company to discuss the principal risk factors associated with investment in the investment company.

23. Investment Company Act Rule 8b-16(a) requires that a registered management investment company amend its registration statement annually. Rule 8b-16(b) provides that a closed-end fund need not amend its registration statement provided that it includes certain information in its annual shareholder reports, including any material changes in the fund's investment objectives or policies that have not been approved by shareholders and any material changes in the principal risk factors associated with investment in the fund.

24. From fall 2008 until the Fund was liquidated, UBS Willow Management caused the Fund to make filings with the Commission that misrepresented the Fund's investment strategy and principal risk factors. Pursuant to Section 30(e) of the Investment Company Act, the Fund was required to file certified shareholder reports on Form N-CSR with the Commission. In each of the Fund's semi-annual and annual Forms N-CSR from December 31, 2008 through liquidation, the Fund stated that it sought to achieve its investment objective of maximizing total return "with low volatility by making investments in distressed assets." In fact, the increased emphasis on CDS was *high* volatility, with performance driven by *shorting* distressed assets. UBS Willow Management never amended the Fund's registration statement on Form N-2 to reflect the new emphasis on CDS. UBS Willow Management provided prospective investors with these Forms N-CSR during the relevant period.

25. UBS Willow Management was aware of the change in the Fund's investment strategy and knew or should have known that the representations in the Fund's Forms N-CSR were false or materially misleading and that the Fund had not updated its registration statement or disclosed the change in investment strategy in its annual shareholder report.

UBS Fund Advisor was Aware of UBS Willow Management's Deviation from the Fund's Disclosures and Did Not Ensure Adequate Disclosure of the Fund's Change in Investment Strategy

26. UBS Fund Advisor, the Managing Member of UBS Willow Management, was aware of the change in investment strategy. UBS Fund Advisor had real-time access to all of the Fund's holdings, and UBS Fund Advisor had multiple discussions with Bond Street's principal concerning the Fund's CDS exposure.

27. Despite this knowledge, UBS Fund Advisor did not direct UBS Willow Management to reduce the Fund's CDS exposure or ensure that UBS Willow Management adequately disclosed the change in investment strategy to the Board or investors. Under the L.L.C. Agreement, UBS Fund Advisor, as the Managing Member of UBS Willow Management, had the ultimate authority for the Fund's investments, but UBS employees acting on behalf of UBS Fund Advisor were not aware of these contractual powers and failed to exercise this authority. By failing to direct UBS Willow Management to invest Fund assets in a manner consistent with the disclosed investment strategy, to direct UBS Willow Management to disclose the changed investment strategy, and to prevent UBS Willow Management from making material misrepresentations about the Fund's investment strategy, UBS Fund Advisor failed reasonably to supervise UBS Willow Management.

Violations

28. As a result of its misrepresentations to prospective investors in the OM, marketing brochure, and Forms N-CSR, UBS Willow Management willfully[6] violated Sections 17(a)(2) and 17(a)(3) of the Securities Act, which, respectively, prohibit making untrue statements of material fact or material omissions in the offer or sale of securities and engaging in a course of business which operates as a fraud or deceit in the offer or sale of securities. A violation of Section 17(a)(2) or 17(a)(3) may rest on a finding of simple negligence; scienter is not required. *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 453-54 (3d Cir. 1997).

29. As a result of its failure to inform the Fund's Board of the investment strategy change, and of certain material risks posed by the change, UBS Willow Management willfully violated Section 206(2) of the Advisers Act, which prohibits an investment adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client. A violation of Section 206(2) may rest on a finding of simple negligence; scienter is not required. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)).

[6] A willful violation of the securities laws merely means '"that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor '"also be aware that he is violating one of the Rules or Acts.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

30. As a result of its misrepresentations to investors in the OM, marketing brochure, Forms N-CSR, and investor letters, UBS Willow Management willfully violated Section 206(4) of the Advisers Act and Rules 206(4)-8(a)(l) and 206(4)-8(a)(2) thereunder, which, respectively, make it unlawful for any adviser to a pooled investment vehicle to make any false or misleading statement of material fact to any investor or prospective investor in the pooled investment vehicle and make it unlawful to engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle. A violation of Section 206(4) or Rule 206(4)-8(a)(l) or 206(4)-8(a)(2) may rest on a finding of simple negligence; scienter is not required. *SEC v. Steadman*, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)).

31. As a result of its misrepresentations in the Forms N-CSR, UBS Willow Management caused the Fund to violate Section 34(b) of the Investment Company Act, which, among other things, makes it unlawful for any person to make any untrue or misleading statement of material fact in any registration statement, application, report, account, record, or other document filed with the Commission under the Investment Company Act. A violation of Section 34(b) may rest on a finding of simple negligence; scienter is not required. *In the Matter of Chariot Advisors, LLC, et al.*, Investment Company Act Release No. 31149, at 9 (July 3, 2014).

32. As a result of its failure to cause the Fund to file an amended registration statement or to disclose the change in investment strategy in the annual shareholder report, UBS Willow Management caused the Fund to violate Rule 8b-16 of the Investment Company Act, which requires that a material change in the Fund's investment objectives and policies constituting its principal portfolio emphasis be disclosed either in an amended registration statement on Form N-2, or in the annual shareholder report. A violation of Rule 8b-16 does not require scienter.

33. As a result of the conduct described above, UBS Fund Advisor failed reasonably to supervise UBS Willow Management, with a view to preventing violations of the federal securities laws, while UBS Willow Management was subject to UBS Fund Advisor's supervision, within the meaning of Section 203(e)(6) of the Advisers Act. A failure reasonably to supervise within the meaning of Section 203(e)(6) does not require scienter.

Undertakings

34. Respondents UBS Willow Management L.L.C. and UBS Fund Advisor L.L.C, jointly and severally, have undertaken, as set forth below, to compensate Fund investors for investor losses suffered while the Fund was invested in a manner inconsistent with the Fund's stated investment strategy.

35. Respondents have undertaken to compensate Fund investors for losses attributable to the Fund's change in investment strategy. Respondents have assessed how the change in investment strategy affected Fund investors. Using a methodology not unacceptable to the Commission staff, Respondents compared the Fund's actual performance to that of a hypothetical portfolio in which the market value of the CDS positions was limited to no more than ten percent of the Fund's net assets (an approximation of the point at which the Fund deviated from its stated

investment strategy), and determined that the performance of the hypothetical portfolio exceeded that of the actual portfolio by $4,903,620 (the "Investor Losses").

36. Respondents have undertaken to make, within the time frames discussed below, a payment to the affected Fund investors in the amount of $13,126,730 (the "Distribution"), comprising the disgorgement ordered below and Investor Losses.

37. Respondents shall be responsible for administering the payment of the Distribution to the affected Fund investors. Respondents shall:

i. Deposit the amount of the Distribution into a segregated account such as a separate bank account (the "Distribution Account") within 60 days of the date of entry of the Order and provide the Commission staff with evidence of such deposit in a form acceptable to the Commission staff;

ii. Submit to the Commission staff for its approval, within 90 days of the date of entry of the Order, a disbursement calculation (the "Calculation") that identifies (1) each Fund investor that will receive a portion of the Distribution,[7] (2) the exact amount of that payment as to each Fund investor,[8] and (3) the methodology used to determine the exact amount of that payment as to each Fund investor; and

iii. Complete payment to all affected Fund investors within 60 days of the staffs approval of the Calculation.[9]

38. Respondents agree to be responsible for all of Respondents' tax compliance responsibilities associated with the Distribution and shall retain any professional services necessary. The costs and expenses of any such professional services shall be borne by Respondents, and the payment of taxes applicable to the Distribution Account, if any, shall not be paid out of Distribution funds.

39. Within 90 days after Respondents have completed payment of the Distribution, Respondents shall submit to the Commission staff a final accounting, in a form acceptable to the Commission, and certification of the disposition of the Distribution. The final accounting and certification shall include but not be limited to: (1) the amount paid to each payee; (2) the date of each payment; (3) the check number or other identifier of money transferred or proof of payment made; (4) the date and amount of any returned payment; and (5) a description of any effort to locate a prospective payee whose payment was returned, or to whom payment was not made due to factors beyond Respondents' control. Any and all supporting documentation for the accounting and certification shall be provided to the Commission staff upon request. Respondents shall

[7] For the purposes of this Order and the Calculation, affected Fund investors shall not include principals or other investment personnel employed by Bond Street.

[8] Fund investors who already have received compensation from UBS in connection with the conduct described herein will have their payments reduced accordingly.

[9] If there are any funds remaining in the Distribution Account after Respondents have attempted to complete payment to all affected Fund investors, the remaining funds shall be transferred to the Commission for transmittal to the United States Treasury.

cooperate with reasonable requests for information in connection with the accounting and certification.

40. After Respondents have submitted the final accounting to the Commission staff, the staff shall submit the final accounting to the Commission for approval.

41. Commission staff may extend any of the Distribution procedural dates set forth above for good cause shown. Deadlines for dates relating to the Distribution shall be counted in calendar days, except if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

42. In determining whether to accept the Offer, the Commission has considered these undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Sections 203(e) and 203(k) of the Advisers Act, and Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent UBS Willow Management L.L.C. cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-8(a)(l) and 206(4)-8(a)(2) thereunder, and Section 34(b) of the Investment Company Act and Rule 8b-16 thereunder.

B. Respondents UBS Willow Management L.L.C. and UBS Fund Advisor L.L.C. are censured.

C. Respondents, jointly and severally, shall pay disgorgement of $8,223,110, reflecting the revenues Respondent UBS Willow Management L.L.C. received from advising the Fund from the third quarter of 2008 through the end of 2011, to affected Fund investors in accordance with their undertakings enumerated in paragraphs 34-42 of Section III above.

D. Respondents, jointly and severally, shall, within 30 days of the entry of this Order, pay prejudgment interest of $1,373,436.74 and a civil money penalty of $3,000,000, for a total sum of $4,373,436.74, to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

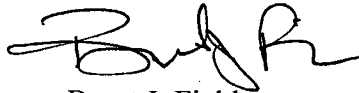
(2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying UBS Willow Management L.L.C. and/or UBS Fund Advisor L.L.C. as Respondents in these proceedings, and the file number of these proceedings. A copy of the cover letter and check or money order must be simultaneously sent to Julie M. Riewe, Co-Chief, Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549-5010.

By the Commission.



Brent J. Fields
Secretary

Commissioner Aguilar Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76195 / October 19, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16910

In the Matter of NICHOLAS TOMS, Esq., Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Nicholas Toms ("Respondent" or "Toms") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any attorney . . . who has been by name (A) [p]ermanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder; or (B) . . .found by the Commission in any administrative proceeding to which he or she is a party to have violated (unless the violation was found not to have been willful) or aided and abetted the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

proceedings, and the findings contained in Section III below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Toms, age 66, is a Florida resident living in Boca Raton, Florida. Toms is a member of the New York State Bar. Toms has never held any securities licenses and is not registered with the Commission in any capacity.

2. On February 11, 2015, the Commission issued an Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 In the Matter of Nicholas Toms. On October 19, 2015, the Commission issued an Order Making Findings and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934, finding that Respondent willfully violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder ("Order Making Findings").

3. The Order Making Findings found, among other things, that Toms, while the chairman, chief executive officer ("CEO"), and president of a public company, owned and sold millions of shares of his employer's stock through a nominee and concealed it from investors. He received proceeds of over $897,000 from his secret sales. From November 2009 through at least mid-2014, Toms beneficially owned and sold more than 2.3 million shares of his employer's stock. To do so, he used his long-time secretary as a nominee on an account held by an entity he controlled. He concealed his true stock ownership and sales from his employer, who consequently made materially false filings with the Commission. Toms falsely certified the accuracy of these filing.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice, effective immediately, that:

A. Toms is suspended from appearing or practicing before the Commission as an attorney for five years from the date of the Order.

B. After five years from the date of the Order, Respondent may request that the Commission consider his application to resume appearing and practicing before the Commission as an attorney. The application should be sent to the attention of the Office of the General Counsel.

C. In support of such an application, Respondent must provide a certificate of good standing from each state bar where Respondent is a member.

D. In support of such an application, Respondent must also submit an affidavit truthfully stating, under penalty of perjury:

1. that Respondent has complied with the Order and Order Making Findings;

2. that Respondent:

   a. is not currently suspended or disbarred as an attorney by a court of the United States (or any agency of the United States) or the bar or court of any state, territory, district, commonwealth, or possession; and

   b. since the entry of the Order and the Order Making Findings, has not been suspended as an attorney for an offense involving moral turpitude by a court of the United States (or any agency of the United States) or the bar or court of any state, territory, district, commonwealth, or possession, except for any suspension concerning the conduct that was the basis for the Order;

3. that Respondent, since the entry of the Order, has not been convicted of a felony or misdemeanor involving moral turpitude as set forth in Rule 102(e)(2) of the Commission's Rules of Practice; and

4. that Respondent, since the entry of the Order:

   a. has not been found by the Commission or a court of the United States to have committed a violation of the federal securities laws, except for any finding concerning the conduct that was the basis for the Order;

   b. has not been charged by the Commission or the United States with a violation of the federal securities laws, except for any charge concerning the conduct that was the basis for the Order;

   c. has not been found by a court of the United States (or any agency of the United States) or any state, territory, district, commonwealth, or possession, or any bar thereof, to have committed an offense involving moral turpitude, except for any finding concerning the conduct that was the basis for the Order; and

d. has not been charged by the United States (or any agency of the United States) or any state, territory, district, commonwealth, or possession, or any bar thereof, with having committed an offense involving moral turpitude, except for any charge concerning the conduct that was the basis for the Order.

E. If Respondent provides the documentation required in Paragraphs C and D, and the Commission determines that he truthfully attested to each of the items required in his affidavit, he shall by Commission order be permitted to resume appearing and practicing before the Commission as an attorney.

F. If Respondent is not able to truthfully attest to the statements required in Subparagraphs D(2)(b) or D(4), Respondent shall provide an explanation as to the facts and circumstances pertaining to the matter and the Commission may hold a hearing to determine whether there is good cause to permit him to resume appearing and practicing before the Commission as an attorney.

By the Commission.

Brent J. Fields
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76253 / October 23, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16921

In the Matter of The Jenex Corp., Orgral Technologies Corp., Professional Services Network, Inc., and UBX Technologies, Inc., Respondents.	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents The Jenex Corp., Orgral Technologies Corp., Professional Services Network, Inc., and UBX Technologies, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. The Jenex Corp. (CIK No. 1309552) is an Alberta corporation located in Burlington, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). The Jenex Corp. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F/A for the period ended March 18, 2005, which reported a net loss of over $1.8 million (Canadian) for the year ended December 31, 2004.

2. Orgral Technologies Corp. (CIK No. 1294612) is a void Delaware corporation located in Toronto, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Orgral Technologies Corp. is

delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended August 31, 2007, which reported a net loss of over $2,500 from the company's June 7, 2004 inception to August 31, 2007.

3. Professional Services Network, Inc. (CIK No. 1205758) is a revoked Nevada corporation located in North York, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Professional Services Network, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on November 19, 2002, which reported a net loss of $5,860 from the company's August 26, 2002 inception to October 31, 2002.

4. UBX Technologies, Inc. (CIK No. 1136945) is a permanently revoked Nevada corporation located in Thornhill, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). UBX Technologies, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on March 20, 2001, which reported a net loss of $400 from the company's October 16, 2000 inception to October 31, 2000.

B. DELINQUENT PERIODIC FILINGS

5. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

6. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

7. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76252 / October 23, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16920

In the Matter of

Oriental Nonferrous Metals Technology Co., Ltd.,
Pantheon China Acquisition Corp.,
Queen 1, Inc.,
Queen 2, Inc., and
Stand International Holdings, Ltd.,

Respondents.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Oriental Nonferrous Metals Technology Co., Ltd., Pantheon China Acquisition Corp., Queen 1, Inc., Queen 2, Inc., and Stand International Holdings, Ltd.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Oriental Nonferrous Metals Technology Co., Ltd. (CIK No. 1529067) is a Cayman Islands corporation located in Heilongjiang Province, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Oriental Nonferrous Metals Technology Co., Ltd. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-FR registration statement on September 30, 2011.

2. Pantheon China Acquisition Corp. (CIK No. 1367209) is a merged Delaware corporation located in Beijing, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Pantheon China Acquisition Corp. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2009, which reported a net loss of over $1.048 million from the company's April 10, 2006 inception to March 31, 2009.

3. Queen 1, Inc. (CIK No. 1373763) is a Nevada corporation located in Toronto, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Queen 1, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended December 31, 2007, which reported a net loss of $9,035 for the prior six months, and having never filed a Form 10-K annual report.

4. Queen 2, Inc. (CIK No. 1373764) is a permanently revoked Nevada corporation located in Toronto, Ontario, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Queen 2, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended December 31, 2007, which reported a net loss of $9,035 for the prior six months, and having never filed a Form 10-K annual report.

5. Stand International Holdings, Ltd. (CIK No. 1350592) is a void Delaware corporation located in Hong Kong with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Stand International Holdings, Ltd. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on July 19, 2006, which reported a net loss of $4,000 from the company's December 8, 2005 inception to June 30, 2006.

B. DELINQUENT PERIODIC FILINGS

6. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

7. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

8. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to

notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

By Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76250 / October 23, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3715 / October 23, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16919

In the Matter of ARTHUR F. KNAPP, Jr., CPA Respondent.	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Arthur F. Knapp, Jr. ("Respondent" or "Knapp") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice. [1]

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Knapp, age 66, was licensed to practice as a Certified Public Accountant in Pennsylvania starting in 1973, until he allowed that license to lapse in approximately 1980. He joined OCZ Technology Group, Inc. ("OCZ") in November 2005 and served as the Chief Financial Officer ("CFO") until March 2009 and from October 2010 through March 2013. From March 2009 until October 2010 he was OCZ's Vice President of Finance.

2. OCZ was, at all relevant times, a Delaware corporation with its principal place of business in San Jose, California. OCZ sold computer memory storage and power supply devices primarily to distributors, e-tailers, and original equipment manufacturers. The common stock of OCZ had been registered under Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") since November 29, 2009. As of April 2010, OCZ's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and listed on the NASDAQ Capital Market. OCZ's stock was delisted from NASDAQ as of March 6, 2014, causing OCZ's Section 12(b) registration to be terminated and its Section 12(g) registration to be revived. On April 16, 2015, the Commission issued an Order Instituting Proceedings, Making Findings and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934.

3. On October 13, 2015, a final judgment was entered by consent against Knapp, permanently enjoining him from future violations of Sections 17(a)(2) and (3) of the Securities Act of 1933 ("Securities Act"), Section 13(b)(5) of the Exchange Act and Rules 13b2-1 and 13a-14 thereunder, and permanently enjoining him from aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-11 and 13a-13 thereunder, in the civil action entitled Securities and Exchange Commission v. Knapp, Civil Action Number 5:15-cv-04598, in the United States District Court for the Northern District of California. Knapp was also ordered to pay $92,107 in disgorgement of profits gained resulting from his conduct plus $7,893 in prejudgment interest, and a $30,000 civil money penalty.

4. The Commission's complaint alleges, among other things, that Knapp, as CFO, had responsibility for OCZ's internal accounting controls and that he instituted or maintained several

policies and practices that caused OCZ to record transactions in a manner that was not in accordance with U.S. Generally Accepted Accounting Principles ("GAAP") and caused OCZ to report materially inflated revenues and/or gross profits. These policies included (1) reclassifying costs of goods sold as research and development expenses, without sufficient basis to do so; (2) failing to capitalize labor and overhead costs in OCZ's inventory costs; (3) recognizing revenues upon product shipment, rather than upon delivery of the product to OCZ's customers; and (4) understating OCZ's accruals for product returns. Knapp also failed to implement sufficient internal accounting controls to prevent OCZ from misclassifying sales discounts as marketing expenses, among other things. Knapp signed and certified OCZ's annual reports on Form 10-K and quarterly reports on Form 10-Q relating to the periods from the second quarter of fiscal 2011 ending August 31, 2010 through the first quarter of fiscal 2013 ending May 31, 2012, which contained materially misstated financial results. Knapp also signed current reports on Form 8-K and registration statements that included or incorporated materially misstated financial results.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in Respondent Knapp's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that, Knapp is suspended from appearing or practicing before the Commission as an accountant.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76266 / October 26, 2015

Admin. Proc. File No. 3-16518

In the Matter of the Application of KABANI & COMPANY, INC., HAMID KABANI, CPA, MICHAEL DEUTCHMAN, CPA, and KARIM KHAN MUHAMMAD, CPA For Review of Disciplinary Action Taken by the PCAOB	ORDER DENYING MOTION FOR A PROTECTIVE ORDER

On April 28, 2015, Kabani & Company, Inc., Hamid Kabani, CPA, Michael Deutchman, CPA, and Karim Khan Muhammad, CPA (together, "Applicants"), filed an application for review of disciplinary action taken by the Public Company Accounting Oversight Board ("PCAOB"). After filing their brief in support of that application on July 6, 2015, and a reply brief on August 19, 2015, Applicants filed the instant motion on August 26, 2015, requesting "a protective order sealing all the briefs and everything about and related to these proceedings related to [Applicants'] application for review . . . until such time as the SEC issues its final order." The PCAOB opposes that motion. For the reasons below, we deny Applicants' request for a protective order.

Section 105(b)(5) of the Sarbanes-Oxley Act of 2002 generally provides for confidential and privileged treatment of documents and information in connection with a PCAOB inspection or investigation.[1] Applicants interpret this provision to mean that "PCAOB proceedings must remain confidential until after an adverse ruling by the full U.S. Securities [&] Exchange [Commission]'s review of the sanctions." But the Sarbanes-Oxley Act expressly limits confidential and privileged treatment of PCAOB proceedings "unless and until" such documents and information are "presented in connection with a public proceeding."[2] We previously have held that Commission review proceedings of PCAOB disciplinary actions are public

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1 15 U.S.C. § 7215(b)(5)(A).

2 *Id.*

proceedings.[3] That determination is consistent with the Sarbanes-Oxley Act, which specifies that Commission review proceedings of PCAOB disciplinary actions are governed by Sections 19(d)(2) and 19(e)(1) of the Securities Exchange Act of 1934, "as fully as if the [PCAOB] were a self-regulatory organization."[4] And it is well established that review proceedings of self-regulatory organizations are public (with limited exceptions not at issue here).[5]

Although "[d]ocuments and testimony introduced in a public hearing are presumed to be public," Rule of Practice 322 allows a party to seek to "limit from disclosure to other parties or to the public documents or testimony that contain confidential information."[6] A motion for a protective order "shall be granted only upon a finding that the harm resulting from disclosure would outweigh the benefits of disclosure."[7] Applicants' request for a blanket, retroactive protective order does not meet this standard. They claim that disclosure of the PCAOB's disciplinary action and their appeal of that action will cause them reputational harm. That generalized concern does not outweigh the important public interest in conducting an open administrative proceeding.[8] Further weighing against Applicants' confidentiality concern is that

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3 *See Gately & Assocs., LLC*, Admin. Proc. File No. 3-13535, 2009 WL 6805010, at *1 (Oct. 23, 2009) (holding that review proceedings of a PCAOB disciplinary action were public).

4 15 U.S.C. § 7217(c); *see also* Commission Rule of Practice 440, 17 C.F.R. § 201.440.

5 Rule of Practice 301, 17 C.F.R. § 201.301; *see Dominick A. Alvarez*, Securities Exchange Act Release No. 53231, 2006 WL 328034, at *1 (Feb. 6, 2006) ("The Commission has long underscored the importance of conducting open administrative proceedings that, 'with attendant public scrutiny, have the effect of protecting against the abuse of power by governmental entities.'" (quoting *Disciplinary Proceedings Involving Professionals Appearing or Practicing Before the Commission*, 53 Fed. Reg. 26427, 26428–29 (July 13, 1988))); *accord FCC v. Schreiber*, 381 U.S. 279, 293 (1965) (finding that the FCC's "procedural rule, establishing a presumption in favor of public proceedings, accords with the general policy favoring disclosure of administrative agency proceedings").

6 17 C.F.R. § 201.322(a), (b).

7 *Id.* § 201.322(b).

8 *Cf. Schreiber*, 381 U.S. at 293 (agreeing that making the FCC's administrative proceedings public "stimulat[es] the flow of information, . . . serve[s] to inform those segments of the public primarily affected by the agency's regulatory policies and . . . induce[s] . . . public acceptance of the results of the investigation"); *Gately & Assocs.*, 2009 WL 6805010, at *1 (finding no circumstances that justified making PCAOB review proceedings non-public); *Joseph John VanCook*, Securities Exchange Act Release No. 58756, 2008 WL 4500339, at *1 (Oct. 8, 2008) (stating that "Commission administrative proceedings, and the documents filed by parties pursuant to those proceedings, generally are accessible to the public unless the circumstances warrant a departure from the norm in accordance with our Rules of Practice"); *Disciplinary Proceedings Involving Professionals Appearing or Practicing Before the Commission*, Exchange Act Release No. 25893, 1988 WL 1000021, at *2–*4, *12 (July 7, 1988) (discussing the

(continued...)

they did not seek a protective order until more than four months after they initiated these review proceedings, and until after they filed their brief in support of their petition for review and their reply brief.[9]

Nevertheless, if Applicants wish to shield specific information in these proceedings from disclosure, they may submit a motion requesting a protective order. That motion should clearly identify which information Applicants seek to protect and should offer an explanation as to why the harm resulting from disclosure would outweigh the benefits of disclosure.[10]

Accordingly, it is ORDERED that Applicants' motion for a protective order is DENIED.

By the Commission.

Brent J. Fields
Secretary

By: Lynn M. Powalski
Deputy Secretary

(...continued)

"presumption in favor of public proceedings" and the importance of "the public's right of access to the [government's] decisionmaking processes").

[9] *Cf. Gambale v. Deutsche Bank AG*, 377 F.3d 133, 144 (2d Cir. 2004) (finding party was not entitled to have previously disclosed information sealed because, "however confidential it may have been beforehand, subsequent to publication it was confidential no longer . . . . We simply do not have the power, even were we of the mind to use it if we had, to make what has thus become public private again"); *RegScan, Inc. v. Bureau of Nat. Affairs, Inc.*, No. 1:11CV1129 (JCC/JFA), 2012 WL 2994075, at *8 (E.D. Va. July 19, 2012) (finding the fact that information had "been in the public domain for some time—some of them for months" weighed against granting party's motion to place that information under seal).

[10] *See* Rule of Practice 322, 17 C.F.R. § 201.322.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76279 / October 27, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16928

In the Matter of **Pan Asia Mining Corp.,** **Petro Horizon Energy Corp., and** **Powerhouse Energy Corp.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Pan Asia Mining Corp., Petro Horizon Energy Corp., and Powerhouse Energy Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Pan Asia Mining Corp. (CIK No. 1168479) is a Yukon corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Pan Asia Mining Corp. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F/R registration statement on April 1, 2002, which reported a net loss of $890 for the nine months ended September 30, 2001.

2. Petro Horizon Energy Corp. (CIK No. 1380342) is a British Columbia corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Petro Horizon Energy Corp. is delinquent in its periodic filings with the Commission, having not filed

any periodic reports since it filed a Form 20-F for the period ended February 28, 2009, which reported a net loss of over $1.06 million (Canadian) for the prior twelve months.

3. Powerhouse Energy Corp. (CIK No. 1106923) is a British Columbia corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Powerhouse Energy Corp. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended February 14, 2000. As of October 19, 2014, the company's stock (symbol "PEGYF") was traded on the over-the-counter markets.

B. DELINQUENT PERIODIC FILINGS

4. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

5. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

6. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76315 / October 30, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16935

In the Matter of **American Power Corp., and Locan, Inc.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents American Power Corp. and Locan, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. American Power Corp. (CIK No. 1436174) is a revoked Nevada corporation located in Denver, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). American Power Corp. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2012, which reported a net loss of $4,700,163 from the company's August 7, 2007 inception to December 31, 2012. As of October 26, 2015, the company's stock (symbol "AMPW") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had eleven market makers, and was eligible for the "piggyback" exception of the Exchange Act Rule 15c2-11(f)(3).

2. Locan, Inc. (CIK No. 1431837) is a delinquent Delaware corporation located in Bartlesville, Oklahoma with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Locan, Inc. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2012, which reported a net loss of $49,904 for the prior nine months. As of October 26, 2015, the company's stock (symbol "LOCN") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

3. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

4. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

5. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further

order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for **October 2015**, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

MARY JO WHITE, CHAIR

LUIS A. AGUILAR, COMMISSIONER

KARA M. STEIN, COMMISSIONER

MICHAEL S. PIWOWAR, COMMISSIONER

(21 DOCUMENTS)

Chair White
Not participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 76118 / October 8, 2015

Admin. Proc. File No. 3-13678r

In the Matter of the Application of

JOHN M.E. SAAD

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDINGS

Misappropriation

Associated person of member firm barred, in remanded proceedings, based on earlier findings that he misappropriated member firm's funds by filing a false expense report. *Held*, association's disciplinary action is *sustained*.

APPEARANCES:

Steven N. Berk, of Berk Law PLLC, for John M.E. Saad

Alan Lawhead, Jennifer Brooks, and *Michael Garawski*, for FINRA

Appeal filed: April 13, 2015
Last brief received: August 3, 2015

John M.E. Saad, formerly a registered representative associated with Homer, Townsend & Ken ("HTK"), a FINRA member firm, appeals from FINRA disciplinary action.[1] FINRA found that Saad misappropriated funds of HTK's parent company, Penn Mutual Life Insurance Co., in violation of NASD Rule 2110, by accepting reimbursement based on Saad's submission of false expense reimbursement requests and receipts.[2] FINRA barred Saad in all capacities and assessed costs, which we sustained after Saad appealed. Saad then filed a limited appeal of our decision with the Court of Appeals for the District of Columbia Circuit, "not contest[ing] his culpability, but instead argu[ing] only that the SEC abused its discretion in upholding the lifetime bar."[3] The court remanded the proceeding, finding that we "fail[ed] to address several potentially mitigating factors."[4] We, in turn, remanded the proceeding to FINRA to address the concerns raised by the court. On remand, FINRA again determined to bar Saad, which led to this appeal. We base our findings on an independent review of the record.

I. Background

We summarize below the pertinent facts and procedural history of this matter, which are undisputed. Although the findings of violation against Saad are not now at issue, the facts supporting those findings provide context for our review of FINRA's sanctioning determination.

A. Saad submitted a false expense claim for a canceled business trip.

In July 2006, when a scheduled business trip to Memphis, Tennessee was canceled, Saad, who lived and worked in Atlanta, Georgia, did not go into work but instead checked into an Atlanta hotel for two nights. Shortly thereafter, he submitted a false expense report to HTK in which he sought reimbursement for two nights at a Memphis hotel and roundtrip airfare to that city. The expense report Saad submitted included an airline travel receipt and a Memphis hotel receipt, both of which he had forged. In doing so, he sought to make his fake receipts look authentic by researching the cost of a last minute flight from Atlanta to Memphis and Memphis hotel rates, and by downloading and copying from the internet corporate logos and related graphics for Delta Airlines and Marriot International, Inc. In describing his efforts and the resulting forged documents, Saad testified that he "had to be consistent with the fact that, you know, it was a last minute purchase-type of ticket." He also testified that he used "an estimated room rate of what it would be to stay there" and "what [he] thought . . . was the rate . . . at the

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1 FINRA is the successor to the National Association of Securities Dealers, Inc. (the "NASD"), which was the regulatory authority that initially investigated these matters. While Saad's conduct occurred before the creation of FINRA, FINRA's Department of Enforcement, together with FINRA's Office of Hearing Officers, initiated proceedings against Saad, applying NASD rules. Generally, references to the NASD and FINRA are interchangeable throughout the opinion.

2 Rule 2110 requires that members and their associated persons "observe high standards of commercial honor and just and equitable principles of trade."

3 *Saad v. SEC*, 718 F.3d 904, 906 (D.C. Cir. 2013).

4 *Id.* at 912.

time." In addition, he submitted reimbursement requests to his office administrator for meals and other expenses, purportedly incurred in Memphis, but actually incurred in Atlanta. These, he testified, were designed "to show [he] was in Memphis in some form."

Saad explained that his actions were a consequence of personal and professional stress he was then experiencing. During the preceding year, his production had declined and he had virtually halted business travel, which was considered a significant aspect of his professional responsibilities.[5] In June 2006, he was issued a production warning and directed to increase his sales. According to Saad, he learned that the Memphis meeting had been canceled on the way to the airport and "panicked because [his] travel was down dramatically."

Saad explained his decision to check into an Atlanta hotel by stating that if he "had gone to the office, that it would have been evident that [he] hadn't done any travel." Also at this time, he had two young children, one of whom had recently been hospitalized with "significant" health problems.[6] He stated that, by checking into the hotel, he hoped to have a "couple of days that I could focus on my work." When Penn Mutual approved the expense report, Saad accepted the unwarranted reimbursement.

Saad's forgery was discovered by the office administrator, who noticed that Saad had attached to his expense report an unaltered, apparently authentic, receipt for four drinks purchased in an Atlanta hotel lounge on the same day when, according to his expense report, he was supposed to be in Memphis. When the administrator asked him about the receipt, Saad took it back and threw it away. The administrator retrieved the receipt from the trash, and provided it to Penn Mutual's home office, which eventually discovered what Saad had done and terminated him. Saad never offered to repay the misappropriated funds until "after [Penn Mutual] came back to [him] and asked [him] about the expenses."

B. Saad submitted a false reimbursement request for a cell phone.

Also in July 2006, but apparently unrelated to the claimed Memphis trip, Saad sought $392.19 in reimbursement for the purchase of a cell phone, claiming on the report that it was to replace an "old Treo [that] broke." The section on the attached receipt indicating the cell phone recipient had been blacked out. Saad could not recall whether he had blacked out the receipt, but "assum[ed]" that he "probably did." Saad also admitted to writing the justification for the reimbursement request and that, in fact, he had not purchased the phone to replace his own phone, as the justification suggested. Instead, as he later admitted, he obtained the phone for an insurance agent with another firm whom he hoped to recruit.

Saad testified that he believed that the purchase was legitimate because it furthered the Firm's recruiting objectives and was consistent with prior recruiting practices and reimbursement

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[5] As a Penn Mutual regional director, Saad's chief duties entailed recruiting new sales agents and helping existing agents grow their business. Saad initially was a top producer and traveled extensively on recruiting trips but, by June 2006, he had effectively stopped traveling.

[6] *Saad v. SEC*, 718 F.3d at 908.

policy. But, when asked about the altered receipt he submitted, he testified: "I was under the pressure of the situation that I just said, you know, I'm just going to put it down as my own, but I should have put it down as exactly the way it should have been put down and expensed it that way." He further admitted that, despite his claims about the Firm's reimbursement policy, the cell phone purchase "probably wouldn't have been" an approved expense if the Firm had known the identity of the recipient. The hearing panel, which observed his demeanor during testimony, did not credit his claim that the purchase was consistent with prior practice.

C. After Saad's termination, FINRA investigated and instituted disciplinary proceedings.

Approximately two months after his termination in the fall of 2006, Saad was questioned by FINRA investigators about the circumstances surrounding it. When confronted, Saad sought to mislead FINRA by providing false answers to their questions. For example, he told investigators that the expenses claimed on the report were "for a business trip that had yet to occur" when, in fact, they were for a trip that had been canceled and not rescheduled. He also falsely indicated that the cell phone purchase was to replace his own broken phone. He further initially claimed that he did not know whether he had purchased a plane ticket for the July trip to Memphis. Only when FINRA investigators asked Saad to document the airfare purchase, through a credit card statement, did he admit that he did not "believe [he] purchased that ticket."

FINRA instituted disciplinary proceedings in September 2007, alleging "conversion of funds" in violation of NASD Rule 2110. A FINRA hearing panel found that Saad deliberately deceived his employer both with regard to the travel report and the cell phone purchase; that this constituted conversion of the Firm's funds; and that such conversion was inconsistent with Rule 2110's requirement that members and their associated persons adhere to just and equitable principles of trade. The panel imposed a permanent bar, noting that, according to FINRA Sanction Guidelines, a bar is standard for conversion regardless of the amount involved.[7] Saad appealed first to FINRA's National Adjudicatory Council (the "NAC") and then to the Commission, both of which affirmed the findings of violation and imposition of the bar.[8]

In remanding the case to us following Saad's appeal, the D.C. Circuit held that our decision "ignore[d] several potentially mitigating factors asserted by Saad and supported by evidence in the record."[9] The court further noted that it had previously "cautioned that the SEC 'must be particularly careful to address potentially mitigating factors' before affirming a permanent bar."[10] In particular, the court criticized our failure to consider that HTK had

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7 The D.C. Circuit also applied FINRA's Guidelines.

8 The NAC characterized Saad's actions as "misappropriation" rather than "conversion" but found that the same sanction was warranted. We agreed with the NAC. *See* n. 19 and accompanying text..

9 *Saad*, 718 F. 3d at 913.

10 *Id.* (quoting *Paz Sec., Inc. v. SEC*, 494 F.3d 1059, 1065 (D.C. Cir. 2007)).

disciplined Saad by terminating him and Saad's argument that he "was under severe stress with a hospitalized infant and a stressful job environment." Although the court took "no position on the proper outcome of the case," it remanded so that we could "fully address *all* potentially mitigating factors that might militate against a lifetime bar."[11]

D. FINRA determined that Saad should be barred.

Following our remand order, the NAC reaffirmed its decision to bar Saad. In doing so, it considered Saad's various claims in support of reduced sanctions, but found that they did "not rise to the level of mitigation that would be sufficient to reduce the sanctions we originally imposed." It further held that, "[i]n light of the absence of qualifying mitigating factors, the presence of aggravating factors, the troubling nature of Saad's misconduct, and his concealment of that misconduct from regulators, it remains appropriate to bar Saad for misappropriation of his firm's funds." Among the factors the NAC identified as aggravating were that Saad's actions were "intentional and ongoing" and "did not result from any misunderstanding." The NAC further found that Saad's conduct resulted in $1,144 in monetary gain to Saad and an equal loss to the Firm.

With respect to the two potentially mitigating factors specifically identified by the court, the NAC held that termination prior to regulatory detection is not mitigating, citing FINRA and other precedent as support for this position. The NAC further supported its position by noting that such termination "does not disqualify an individual from working elsewhere . . . ." As for Saad's claimed stress, the NAC held that "personal problems" could be mitigating if they "interfered with an ability to comply with FINRA rules or that violations resulted from, or were exacerbated by, such problems." It further held that establishing stress or similar personal circumstances as a mitigating factor is "a difficult burden to meet" and will, in any event, be "weighed together with all other relevant considerations."

While the NAC found that Saad was under "significant" professional and personal stress, it did not consider such circumstances mitigating because there was no evidence that the stress "interfered with his *ability* to comply with FINRA rules or his understanding of what those rules required . . . ."[12] According to FINRA, "this was not a situation where a stressful situation caused a person to be momentarily distracted from his compliance obligation . . . ." Instead, Saad, in response to a stressful situation, "voluntarily chose and then methodically continued an unethical course of conduct . . . ." In rejecting stress as a mitigating factor here, the NAC expressed concern that Saad could again engage in misconduct if he faced another stressful situation related to his job or family, "which could recur at any time."

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[11] *Id.* at 14 (emphasis in original).

[12] (Emphasis in original).

The NAC addressed various other claims by Saad but also found them not mitigating. These included Saad's lack of a disciplinary history and the asserted "modest" amount of money involved. According to the NAC, "regardless of whether $1,144 is a 'large' sum or not, the amount involved is less important . . . than Saad's willingness to engage in a series of deceptive actions that he knew would result in financial loss to his firm and benefit to him." Nor did it credit Saad's claim that he accepted responsibility for his actions, noting that he did so only after having been caught. Similarly, it rejected Saad's claim of remorse, finding it unsupported and "at odds with his numerous efforts to minimize his transgressions . . . [and] blame others."

Having considered all the circumstances, the NAC concluded that "Saad's remaining in the industry, which relies so heavily on personal integrity . . . poses serious risks to the investing public." Therefore, it found that barring Saad was necessary to "protect the public from future harm and deter others . . . ."

II. Analysis

Under Securities Exchange Act Section 19(e)(2), we will sustain a FINRA sanction unless we find that it is "excessive or oppressive" or imposes an unnecessary or inappropriate burden on competition.[13] We also consider whether the sanctions imposed by FINRA are remedial in nature and not punitive.[14] Based on our independent review, we affirm FINRA's determination to bar Saad.

FINRA's Sanction Guidelines state that "a bar is standard" for conversion "regardless of [the] amount converted."[15] This approach reflects the judgment that, absent mitigating factors,[16] conversion "poses so substantial a risk to investors and/or the markets as to render the violator unfit for employment in the securities industry."[17] Indeed, conversion is antithetical to the basic requirement that customers and firms must be able to trust securities professionals with their

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[13] 15 U.S.C. § 78s(e)(2). Saad does not claim, and the record does not show, that FINRA's action imposed an unnecessary or inappropriate burden on competition.

[14] *Paz Sec., Inc. v. SEC*, 494 F.3d 1059, 1065; *see also* Guidelines, at 2 ("Disciplinary sanctions are remedial in nature and should be designed to deter future misconduct and to improve overall business standards in the securities industry.").

[15] Although we are not bound by FINRA's Sanction Guidelines, we use them as a benchmark in conducting our review under Exchange Act Section 19(e)(2). *John Joseph Plunkett,* Exchange Act Release No. 69766, 2013 WL 2898033, at *11 (June 14, 2013).

[16] The Guidelines include a list of non-exhaustive aggravating and mitigating factors (*i.e.*, "Principal Considerations"), and state that, "as appropriate, Adjudicators should consider case-specific factors in addition to those listed." Guidelines, at 6-7.

[17] *Charles C. Fawcett, IV*, Exchange Act Release No. 56770, 2007 WL 3306105, at *5 n.27 (Nov. 8, 2007).

money.[18] Although we, like the NAC, found in our decision in Saad's first appeal that Saad's action constituted misappropriation rather than conversion, the same public interest concerns motivate us in assessing the sanction FINRA imposed. [19]

It is aggravating that Saad attempted to conceal his misconduct from Penn Mutual and regulators, and that he profited from his actions and Penn Mutual suffered loss. The Guideline's Principal Consideration 10 considers "[w]hether the respondent attempted to conceal his . . . misconduct or . . . mislead . . . regulatory authorities or" his firm. Saad admittedly concealed his actions from his employer for months and concealed his actions from regulators through repeated omissions and affirmative misrepresentations, including statements to regulators that the Memphis expenses were for a future trip and that the phone charges were to replace Saad's own broken phone. The Guideline's Principal Considerations 11 and 17 include whether the misconduct resulted in "injury" to the respondent's firm and/or "monetary or other gain" to the respondent. Given that Saad was reimbursed for the false expense reports, both of these considerations apply and support the bar.

Nevertheless, Saad argues that the bar is "an impermissible penalty," dismissing his actions as "a series of blunders in desperate times" accompanied by a "foolish[] (aided by poor legal advice) attempt[] to cover up that mistake." Saad further challenges FINRA's "refusal to accept 'termination of employment' as a mitigating factor." In support, he cites the Guideline's statement that adjudicators are to consider "[w]hether the member firm with which an individual respondent is/was associated disciplined respondent for the same misconduct at issue prior to regulatory detection."

We repeatedly have held that the "collateral consequences" of misconduct, including loss of employment, reputation, and income, are not mitigating.[20] That said, the Guidelines direct that employment termination, which we have held is a form of disciplinary action, should be considered mitigating if it was related to the misconduct at issue and it occurred before

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[18] *See John Edward Mullins*, Exchange Act Release No. 66373, 2012 WL 423413, at *18 (Feb. 10, 2012) (stating that conversion "is extremely serious and patently antithetical to the high standards of commercial honor and just and equitable principles of trade that underpin the self-regulation of the securities markets" (internal quotation omitted)); *Joseph H. O'Brien II*, Exchange Act Release No. 34105, 1994 WL 234279, at *3 (May 25, 1994) ("In converting [customer] funds, O'Brien abused the trust that is the cornerstone of the relationship between a securities professional and his customer.").

[19] The court affirmed this position in its remand order, stating that "[t]he SEC reasonably concluded that 'misappropriation is doubtless analogous to conversion'. . . . Because the Guidelines do not list a particular sanction for misappropriation, it was not arbitrary and capricious for the Commission to analogize to the guideline's conversion prong in this way." *Saad v. SEC*, 718 F.3d at 911.

[20] *See, e.g., Kent M. Houston*, Exchange Act Rel. No. 71589A, 2014 WL 936398, at 8 (Feb. 20, 2014) (finding that collateral consequences from misconduct were not mitigating).

regulatory detection.[21] But, as we have held in a similar situation, "the mitigating effect from [respondent's] termination is no guarantee of changed behavior . . ." and may not be enough to overcome our concern that he or she "poses a continuing danger to investors and other securities industry participants (including would-be employers) . . . ."[22]

It is undisputed that Saad repeatedly used dishonest means to overcome personal and professional disappointments and obstacles, and to mislead his employer and regulators. Not only did he submit false expense requests; he also took considerable effort in forging documents to support those requests, and diligently persevered in his dishonest scheme despite partial exposure by his administrator. Then, when confronted by authorities with reason to doubt his claims, he again chose dishonesty in a failed attempt to avoid the consequences of his actions. Indeed, Saad's continued deception during the investigation of this matter, which occurred months after his termination, shows that his termination was insufficient to dissuade him from further misconduct. As a result, we cannot conclude that termination, while mitigating under certain circumstances, overcomes the threat he would pose to investors and other securities industry participants were he to return to the industry.

Nor are we persuaded by Saad's argument that "[h]is conduct spr[a]ng from pressure and stress not innate dishonesty" and that "[h]e did not intend to harm anyone."[23] Although we credit Saad's assertion that he was under both professional and personal stress at the time of his relevant conduct, we find that his stress is not a mitigating factor under these circumstances. His course of conduct was not the type that one might associate with stress, such as an unthinking reaction during a stressful moment that is later redressed; instead, his deceptive conduct demonstrated a high degree of intentionality over a long period of time.

When his trip to Memphis was cancelled, Saad did not disclose this professional setback to his Firm. Even if this failure standing alone might have been viewed as an unthinking reaction to stress, his next steps were intended to deceive his Firm and required planning and research. He led his Firm to believe that the Memphis trip had occurred as planned by disappearing for two days at an Atlanta hotel, methodically forging hotel and airfare receipts that bore logos that he had copied from the internet, incurring expenses in Atlanta during those two days to make it

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[21] *Denise M. Olson*, Exchange Act Rel. No. 75837, 2015 WL 5172954, at *5 (Sept. 3, 2015) (holding that termination of employment for the misconduct at issue can be mitigating factor). FINRA seeks to distinguish termination from other disciplinary actions, noting that the Guidelines "contain no references to 'loss of employment' but ask whether a firm 'disciplined' a respondent." It further asserts that, "[w]hen a firm terminates an associated person, it relinquishes control, making firm-imposed discipline unattainable." We do not find this distinction persuasive given the pertinent language, and find that termination in this context constitutes disciplinary action and, as such, may be mitigating under the Guidelines.

[22] *Id.*

[23] Saad also argues that "[s]ubmitting accurate expense reports is a private matter between employer and employee" and not subject to "regulatory scrutiny." But, as noted, Saad did not contest our earlier findings of violation, so his liability is no longer subject to challenge.

appear as if he had incurred them on a business trip to Memphis, and then submitting a falsified expense report that attached the receipts. Although Saad could have admitted the truth when questioned about his conduct—including when his office administrator challenged one of his receipts—he repeatedly chose deception. Separate and apart from the Memphis trip, Saad, used dishonest means and a false justification to circumvent Firm reimbursement policy to purchase a cell phone for a recruiting prospect. Saad compounded his deception by misleading FINRA investigators.

The extent of Saad's planning, and his detailed execution of that plan, belies Saad's assertion that his conduct was simply "a series of blunders." And Saad's repeated deception of his employer and attempt to mislead FINRA investigators are contrary to his assertions that his conduct was a result of "stress not innate dishonesty." We find that Saad's stress is not a mitigating factor under these circumstances.

Saad makes certain other claims in support of his appeal, none of which we find justifies modification of the sanction. He suggests that he does not pose a risk to investors because there was "no evidence" that he "misappropriated one dollar of customer money" and because "[h]e was mostly in the recruitment side of the business where his job was to recruit other brokers." But we previously have upheld bars where the underlying dishonesty did not relate directly to customers. [24]

Finally, Saad argues that FINRA erred in not considering that, other than this matter, he has a clean disciplinary record. Moreover, according to Saad, "even if FINRA had facts to support a finding of investor 'risk' in 2006, that finding would, at a minimum, be diluted over the past 9 years, particularly as Mr. Saad has been complaint free in that time period." But we have repeatedly held that a clean disciplinary record is not mitigating. [25] And, as FINRA noted, Saad's lack of additional problems in the period subsequent to the misconduct at issue here can be at least partially credited to his employment termination and FINRA bar. [26]

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[24] *See Richard Dale Grafman*, Exchange Act Release No. 21648, 1985 WL 548687, at *2 n.2 (Jan. 14, 1985) ("[W]e do not agree with [respondent] that his misconduct was somehow less serious because it did not involve public customers. The fact that he defrauded a brokerage firm instead is hardly a factor in his favor."); *Henry E. Vail*, Exchange Act Release No. 35872, 52 S.E.C. 339, 1995 WL 380145, at *2 (June 20, 1995) (imposing bar and other sanctions based on respondent's commingling of funds of political organization with personal funds), *aff'd*, 101 F.3d 37 (6th Cir. 1996).

[25] *See World Trade Fin. Corp.*, Exchange Act Rel. No. 66114, 2012 WL 32121, at *16 (Jan. 6, 2012) ("'[L]ack of disciplinary history is not a mitigating factor' because 'firms and their associated persons should not be rewarded for acting in accordance with their duties.'") (citation omitted). We note that the Guidelines expressly state that, "while the existence of a disciplinary history is an aggravating factor when determining the appropriate sanction, its absence is not mitigating." Guidelines at 6 (citing *Rooms v. SEC*, 444 F.3d 1208, 1214-15 (10th Cir. 2006)).

[26] Saad's offer to pay back his firm is not mitigating because it did not occur "prior to detection and intervention." *See* Guidelines at 6 (Principal Considerations in Determining

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It is undisputed that Saad made two false expense claims, seeking more than $1000 to which he was not entitled. Moreover, Saad's deception was carried out with noteworthy attention to detail and imagination, suggesting considerable planning and deliberation. Additionally, at various times, he was questioned about his conduct and could have admitted his deceptions, but he chose, instead, to engage in more dishonest conduct by seeking to mislead HTK personnel and regulators. As discussed, disappointments and challenges in Saad's personal and professional life may have influenced his decision to engage in misconduct, but on the facts of this case, those factors neither excuse that misconduct nor mitigate his responsibility or the need for a strong remedy.

We, like FINRA, believe that one who, regardless of motivation, intentionally misappropriates money from others on more than one occasion, may do so again. In short, Saad's actions betray a dishonest character that is wholly inconsistent with the high standards demanded of securities professionals. They demonstrate that he cannot be entrusted with firm or customer money, and that therefore he would pose a continuing and unacceptable threat to investors and other industry participants if not barred. We also agree with FINRA that a bar in this situation serves important deterrent objectives and reaffirms long-standing FINRA policy that such dishonesty by members or their associated persons will not be tolerated. Because we conclude that a bar is necessary to protect FINRA members, their customers, and other securities industry participants, we find that it is remedial, not punitive.

An appropriate order will issue.[27]

By the Commission (Commissioners AGUILAR, STEIN and PIWOWAR); Chair WHITE not participating.

Brent J. Fields
Secretary

By: Lynn M. Powalski
Deputy Secretary

Sanctions, No. 4). Nor is his unsupported claim that he provided substantial assistance to FINRA. Indeed, as discussed, he sought to thwart FINRA's investigation.

[27] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76118/October 8, 2015

Admin. Proc. File No. 3-13678r

In the Matter of the Application of

JOHN M.E. SAAD

For Review of Disciplinary Action Taken by

FINRA

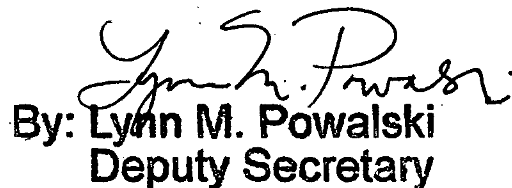
ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY FINRA

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken by FINRA against John M. E. Saad and its assessment of costs are SUSTAINED.

By the Commission.

Brent J. Fields
Secretary



By: Lynn M. Powalski
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-76183; File No. S7-04-09)

October 16, 2015

ORDER EXTENDING TEMPORARY CONDITIONAL EXEMPTION FOR NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS FROM REQUIREMENTS OF RULE 17g-5(a)(3) UNDER THE SECURITIES EXCHANGE ACT OF 1934 AND REQUEST FOR COMMENT

I. Introduction

On May 19, 2010, the Securities and Exchange Commission ("Commission") conditionally exempted, with respect to certain credit ratings and until December 2, 2010, nationally recognized statistical rating organizations ("NRSROs") from certain requirements in Rule 17g-5(a)(3)[1] under the Securities Exchange Act of 1934 ("Exchange Act"), which had a compliance date of June 2, 2010.[2] Pursuant to the Order, an NRSRO is not required to comply with Rule 17g-5(a)(3) until December 2, 2010 with respect to credit ratings where: (1) the issuer of the structured finance product is a non-U.S. person; and (2) the NRSRO has a reasonable basis to conclude that the structured finance product will be offered and sold upon issuance, and that any arranger linked to the structured finance product will effect transactions of the structured finance product after issuance, only in transactions that occur outside the U.S. ("covered transactions").[3] On November 23, 2010, the Commission extended the conditional temporary exemption until December 2, 2011.[4] On November 16, 2011, the Commission extended the

1 See 17 CFR 240.17g-5(a)(3).

2 See Exchange Act Release No. 62120 (May 19, 2010), 75 FR 28825 (May 24, 2010) ("Order").

3 See id. at 28827-28 (setting forth conditions of relief).

4 See Exchange Act Release No. 63363 (Nov. 23, 2010), 75 FR 73137 (Nov. 29, 2010) ("First Extension Order").

conditional temporary exemption until December 2, 2012.[5] On November 26, 2012, the Commission extended the conditional temporary exemption until December 2, 2013.[6] On November 22, 2013, the Commission extended the conditional temporary exemption until December 2, 2014.[7] On November 19, 2014, the Commission extended the conditional temporary exemption until December 2, 2015.[8] The Commission is extending the temporary conditional exemption exempting NRSROs from complying with Rule 17g-5(a)(3) with respect to rating covered transactions until December 2, 2017.

II. Background

Rule 17g-5 identifies, in paragraphs (b) and (c) of the rule, a series of conflicts of interest arising from the business of determining credit ratings.[9] Paragraph (a) of Rule 17g-5[10] prohibits an NRSRO from issuing or maintaining a credit rating if it is subject to the conflicts of interest identified in paragraph (b) of Rule 17g-5 unless the NRSRO has taken the steps prescribed in paragraph (a)(1) (i.e., disclosed the type of conflict of interest in Exhibit 6 to Form NRSRO in accordance with Section 15E(a)(1)(B)(vi) of the Exchange Act[11] and Rule 17g-1)[12] and paragraph (a)(2) (i.e., established and is maintaining and enforcing written policies and procedures to address and manage conflicts of interest in accordance with Section 15E(h) of the

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5 See Exchange Act Release No. 65765 (Nov. 16, 2011), 76 FR 72227 (Nov. 22, 2011) ("Second Extension Order").

6 See Exchange Act Release No. 34-68286 (Nov. 26, 2012), 77 FR 71201 (Nov. 29, 2012) ("Third Extension Order").

7 See Exchange Act Release No. 34-70919 (Nov. 22, 2013), 78 FR 70984 (Nov. 27, 2013) ("Fourth Extension Order").

8 See Exchange Act Release No. 34-73649 (Nov. 19, 2014), 79 FR 70261 (Nov. 25, 2014) ("Fifth Extension Order").

9 17 CFR 240.17g-5(b) and (c).

10 17 CFR 240.17g-5(a).

11 15 U.S.C. 78o-7(a)(1)(B)(vi).

12 17 CFR 240.17g-1.

Exchange Act).[13] Paragraph (c) of Rule 17g-5 specifically prohibits eight types of conflicts of interest. Consequently, an NRSRO is prohibited from issuing or maintaining a credit rating when it is subject to these conflicts regardless of whether it had disclosed them and established procedures reasonably designed to address them.

In November 2009, the Commission adopted paragraph (a)(3) of Rule 17g-5. This provision requires an NRSRO that is hired by an arranger to determine an initial credit rating for a structured finance product to take certain steps designed to allow an NRSRO that is not hired by the arranger to nonetheless determine an initial credit rating – and subsequently monitor that credit rating – for the structured finance product.[14] In particular, under Rule 17g-5(a)(3), an NRSRO is prohibited from issuing or maintaining a credit rating when it is subject to the conflict of interest identified in paragraph (b)(9) of Rule 17g-5 (i.e., being hired by an arranger to determine a credit rating for a structured finance product)[15] unless it has taken the steps prescribed in paragraphs (a)(1) and (2) of Rule 17g-5 (discussed above) and the steps prescribed in paragraph (a)(3) of Rule 17g-5.[16] Rule 17g-5(a)(3), among other things, requires that the NRSRO must:

- Maintain on a password-protected Internet Web site a list of each structured finance product for which it currently is in the process of determining an initial credit rating in chronological order and identifying the type of structured finance product, the name of the issuer, the date the rating process was initiated, and the Internet Web site

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13 15 U.S.C. 78o-7(h).

14 See 17 CFR 240.17g-5(a)(3); see also Exchange Act Release No. 61050 (Nov. 23, 2009), 74 FR 63832 (Dec. 4, 2009) ("Adopting Release") at 63844-45.

15 Paragraph (b)(9) of Rule 17g-5 identifies the following conflict of interest: issuing or maintaining a credit rating for a security or money market instrument issued by an asset pool or as part of any asset-backed securities transaction that was paid for by the issuer, sponsor, or underwriter of the security or money market instrument. 17 CFR 240.17g-5(b)(9).

16 17 CFR 240.17g-5(a)(3).

address where the arranger represents the information provided to the hired NRSRO can be accessed by other NRSROs;

- Provide free and unlimited access to such password-protected Internet Web site during the applicable calendar year to any NRSRO that provides it with a copy of the certification described in paragraph (e) of Rule 17g-5 that covers that calendar year;[17] and
- Obtain from the arranger a written representation that can reasonably be relied upon that the arranger will, among other things, disclose on a password-protected Internet Web site the information it provides to the hired NRSRO to determine the initial credit rating (and monitor that credit rating) and provide access to the Web site to an NRSRO that provides it with a copy of the certification described in paragraph (e) of Rule 17g-5.[18]

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17 Paragraph (e) of Rule 17g-5 requires that an NRSRO seeking to access the hired NRSRO's Internet Web site during the applicable calendar year must furnish the Commission with the following certification:

The undersigned hereby certifies that it will access the Internet Web sites described in 17 CFR §240.17g-5(a)(3) solely for the purpose of determining or monitoring credit ratings. Further, the undersigned certifies that it will keep the information it accesses pursuant to 17 CFR §240.17g-5(a)(3) confidential and treat it as material nonpublic information subject to its written policies and procedures established, maintained, and enforced pursuant to section 15E(g)(1) of the Act (15 U.S.C. 78o-7(g)(1)) and 17 CFR §240.17g-4. Further, the undersigned certifies that it will determine and maintain credit ratings for at least 10% of the issued securities and money market instruments for which it accesses information pursuant to 17 CFR §240.17g-5(a)(3)(iii), if it accesses such information for 10 or more issued securities or money market instruments in the calendar year covered by the certification. Further, the undersigned certifies one of the following as applicable: (1) In the most recent calendar year during which it accessed information pursuant to §17 CFR 240.17g-5(a)(3), the undersigned accessed information for [Insert Number] issued securities and money market instruments through Internet Web sites described in 17 CFR §240.17g-5(a)(3) and determined and maintained credit ratings for [Insert Number] of such securities and money market instruments; or (2) The undersigned previously has not accessed information pursuant to 17 CFR §240.17g-5(a)(3) 10 or more times during the most recently ended calendar year.

18 In particular, under paragraph (a)(3)(iii) of Rule 17g-5, the arranger must represent to the hired NRSRO that it will:

(1) maintain the information described in paragraphs (a)(3)(iii)(C), (a)(3)(iii)(D), and (a)(3)(iii)(E) of Rule 17g-5 available at an identified password-protected Internet Web site that presents the information in a manner indicating which information currently should be relied on to determine or monitor the credit rating; (2) provide access to such password-protected Internet Web site during the applicable calendar year to any NRSRO that provides it with a copy of the certification described in paragraph (e) of Rule 17g-5 that

The Commission stated in the Adopting Release that Rule 17g-5(a)(3) is designed to address conflicts of interest and improve the quality of credit ratings for structured finance products by making it possible for more NRSROs to rate structured finance products.[19] For example, the Commission noted that when an NRSRO is hired to rate a structured finance product, some of the information it relies on to determine the rating is generally not made public.[20] As a result, structured finance products frequently are issued with ratings from only the one or two NRSROs that have been hired by the arranger, with the attendant conflict of interest that creates.[21] The Commission stated that Rule 17g-5(a)(3) was designed to increase the number of credit ratings extant for a given structured finance product and, in particular, to promote the issuance of credit ratings by NRSROs that are not hired by arrangers.[22] The Commission's goal in adopting the rule was to provide users of credit ratings with more views on

covers that calendar year, provided that such certification indicates that the nationally recognized statistical rating organization providing the certification either: (i) determined and maintained credit ratings for at least 10% of the issued securities and money market instruments for which it accessed information pursuant to paragraph (a)(3)(iii) of Rule 17g-5 in the calendar year prior to the year covered by the certification, if it accessed such information for 10 or more issued securities or money market instruments; or (ii) has not accessed information pursuant to paragraph (a)(3) of Rule 17g-5 10 or more times during the most recently ended calendar year; (3) post on such password-protected Internet Web site all information the arranger provides to the NRSRO, or contracts with a third party to provide to the NRSRO, for the purpose of determining the initial credit rating for the security or money market instrument, including information about the characteristics of the assets underlying or referenced by the security or money market instrument, and the legal structure of the security or money market instrument, at the same time such information is provided to the NRSRO; (4) post on such password-protected Internet Web site all information the arranger provides to the NRSRO, or contracts with a third party to provide to the NRSRO, for the purpose of undertaking credit rating surveillance on the security or money market instrument, including information about the characteristics and performance of the assets underlying or referenced by the security or money market instrument at the same time such information is provided to the NRSRO; and (5) post on such password-protected Internet Web site, promptly after receipt, any executed Form ABS Due Diligence-15E containing information about the security or money market instrument delivered by a person employed to provide third-party due diligence services with respect to the security or money market instrument.

19 Adopting Release at 63844.

20 Id.

21 Id.

22 Id.

the creditworthiness of structured finance products.[23] In addition, the Commission stated that Rule 17g-5(a)(3) was designed to reduce the ability of arrangers to obtain better than warranted ratings by exerting influence over NRSROs hired to determine credit ratings for structured finance products.[24] Specifically, by opening up the rating process to more NRSROs, the Commission intended to make it easier for the hired NRSRO to resist such pressure by increasing the likelihood that any steps taken to inappropriately favor the arranger could be exposed to the market through the credit ratings issued by other NRSROs.[25]

Rule 17g-5(a)(3) became effective on February 2, 2010, and the compliance date for Rule 17g-5(a)(3) was June 2, 2010.

III. Extension of Conditional Temporary Extension

In the Order, the Commission requested comment generally, but also on a number of specific issues.[26] The Commission received six comment letters in response to this solicitation of comment.[27] The commenters expressed concern that the extraterritorial application of Rule 17g-5(a)(3) could, in the commenter's view, among other things, disrupt local securitization markets,[28] inhibit the ability of local firms to raise capital,[29] and conflict with local laws.[30]

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23 Id.

24 Id.

25 Id.

26 See Order at 28828.

27 Letter from Masamichi Kono, Vice Commissioner for International Affairs, Financial Services Agency, Japan, dated Nov. 12, 2010 ("Japan FSA Letter"); Letter from Masaru Ono, Executive Director, Securitization Forum of Japan, dated Nov. 12, 2010 ("SFJ Letter"); Letter from Rick Watson, Managing Director, Association for Financial Markets in Europe / European Securitisation Forum, dated Nov. 11, 2010 ("AFME Letter"); Letter from Jack Rando, Director, Capital Markets, Investment Industry Association of Canada, dated Sep. 22, 2010 ("IIAC Letter"); Letter from Christopher Dalton, Chief Executive Officer, Australian Securitisation Forum, dated Jun. 27, 2010 ("AuSF Letter"); Letter from Takefumi Emori, Managing Director, Japan Credit Rating Agency, Ltd. ("JCR"), dated Jun. 25, 2010 ("JCR Letter").

28 See Japan FSA Letter; SFJ Letter; AFME Letter; JCR Letter; AuSF Letter.

29 See AFME Letter; JCR Letter; AuSF Letter.

Several commenters also requested that the conditional temporary exemption be extended or made permanent.[31] The First Extension Order again solicited public comment on issues raised in connection with the extra-territorial application of Rule 17g-5(a)(3).[32] One commenter requested that the Order be made permanent, citing many of the same reasons set forth in prior comment letters.[33] The Second Extension Order again solicited public comment on issues raised in connection with the extra-territorial application of Rule 17g-5(a)(3).[34] Commenters supported the exemption regarding the extra-territorial application of the rule,[35] with one of those commenters again requesting that the Order be made permanent.[36] The Third Extension Order again solicited public comment on issues raised in connection with the extra-territorial application of Rule 17g-5(a)(3). No comments were received. The Fourth Extension Order again solicited public comment on issues raised in connection with the extra-territorial application of Rule 17g-5(a)(3). Two comments were received and the commenters supported the exemption regarding the extra-territorial application of the rule.[37] The Fifth Extension Order again solicited public comment on issues raised in connection with the extra-territorial application of Rule 17g-5(a)(3). No comments were received.

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30 See Japan FSA Letter; AFME Letter; JCR Letter; AuSF Letter; IIAC Letter.

31 See Japan FSA Letter; SFJ Letter; AFME Letter; JCR Letter.

32 See Letter from Tom Deutsch, Executive Director, American Securitization Forum, and Chris Dalton, Chief Executive Officer, Australian Securitisation Forum, dated Aug. 9, 2011 ("ASF/AuSF Letter 1"); Letter from Jack Rando, Director, Capital Markets, Investment Industry Association of Canada, dated Nov. 2, 2011 ("IIAC Letter 2").

33 See ASF/AuSF Letter 1.

34 Letter from Chris Barnard to the Commission, dated Nov. 23, 2011 ("Barnard Letter"); Letter from Tom Deutsch, Executive Director, American Securitization Forum, and Chris Dalton, Chief Executive Officer, Australian Securitisation Forum, dated Aug. 28, 2012 ("ASF/AuSF Letter 2").

35 See Barnard Letter; ASF/AuSF Letter 2.

36 See ASF/AuSF Letter 2.

37 See Letter from Chris Barnard to the Commission, dated Nov. 26, 2013; Letter from Richard Hopkin, Managing Director, Association for Financial Markets in Europe, dated Nov. 10, 2014.

Given the continued concerns about potential disruptions of local securitization markets, and because the Commission's consideration of the issues raised will benefit from additional time to engage in further dialogue with interested parties and to monitor market and regulatory developments, the Commission believes extending the conditional temporary exemption until December 2, 2017 is necessary or appropriate in the public interest, and is consistent with the protection of investors.

IV. Request for Comment

The Commission believes that it would be useful to continue to provide interested parties opportunity to comment. Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (http://www.sec.gov/rules/exorders.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-04-09 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549–1090.

All submissions should refer to File Number S7-04-09. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/exorders.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F St. NE,

Washington, DC 20549 on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

V. Conclusion

For the foregoing reasons, the Commission believes it would be necessary or appropriate in the public interest and consistent with the protection of investors to extend the conditional temporary exemption exempting NRSROs from complying with Rule 17g-5(a)(3) with respect to rating covered transactions until December 2, 2017.

ACCORDINGLY,

IT IS HEREBY ORDERED, pursuant to Section 36 of the Exchange Act, that a nationally recognized statistical rating organization is exempt until December 2, 2017 from the requirements in Rule 17g-5(a)(3) (17 CFR 240.17g-5(a)(3)) for credit ratings where:

(1) The issuer of the security or money market instrument is not a U.S. person (as defined under Securities Act Rule 902(k)); and

(2) The nationally recognized statistical rating organization has a reasonable basis to conclude that the structured finance product will be offered and sold upon issuance, and that any arranger linked to the structured finance product will effect transactions of the structured finance product after issuance, only in transactions that occur outside the U.S.

By the Commission.

Brent Fields
Secretary

Chair White
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76175 / October 16, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4231 / October 16, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31868 / October 16, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16657

In the Matter of

WELHOUSE & ASSOCIATES, INC., AND MARK P. WELHOUSE,

Respondents.

ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS, A CENSURE AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), 203(f), AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940

I.

On June 29, 2015, the Unites States Securities and Exchange Commission (the "Commission") instituted administrative and cease-and-desist proceedings pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Welhouse & Associates, Inc. ("Welhouse") and Mark P. Welhouse ("Mr. Welhouse") (collectively, "Respondents).

II.

Respondents have each submitted an Offer of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of settling these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, and except as provided herein in Section IV.H., Respondents consent to the entry of the Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934, Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940 ("Order") as set forth below.

3 of 21

III.

On the basis of this Order and Respondents' Offers, the Commission finds[1] that:

SUMMARY

1. From approximately February 2010 to January 2013 (the "relevant time period"), Mr. Welhouse, the sole owner of Welhouse, an investment adviser registered with the State of Wisconsin, engaged in fraudulent trade allocation – "cherry-picking." Mr. Welhouse – and, through him, Welhouse – executed this cherry-picking scheme by unfairly allocating options trades in an S&P 500 ETF called SPY. Mr. Welhouse disproportionately allocated those trades that had appreciated in value during the course of the day to his personal and business accounts, while allocating trades that had depreciated in value during the day to the accounts of his advisory clients. He did this by purchasing the options in an omnibus account and delaying allocation of the purchases until later in the day, after he saw whether the securities appreciated in value.

2. By virtue of their conduct, the Respondents willfully violated Section 10(b) of the Exchange Act [15 U.S.C. §§78j(b)] and Rule 10b-5 [17 C.F.R. §§240.10b-5] promulgated thereunder, and Sections 206(1) [15 U.S.C. §80b-6(1)] and 206(2) [15 U.S.C. §80b-6(2)] of the Advisers Act.

RESPONDENTS

3. Welhouse & Associates, Inc., is a Wisconsin corporation with its principal place of business in Appleton, Wisconsin and has been registered with the State of Wisconsin as an investment adviser since 1999. According to the most recent Form ADV filed in January 2013, Welhouse had approximately 72 accounts and a total of $4.8 million under management. Welhouse is wholly owned and controlled by Mr. Welhouse. Welhouse's clients are individuals and families.

4. Mark. P. Welhouse, age 58, resides in Appleton, Wisconsin. Mr. Welhouse is the owner, principal, and CCO of Welhouse, which he formed in 1999.

RESPONDENTS' CONDUCT

Mr. Welhouse Claimed That His SPY Trades Were Allocated Pro Rata

5. During the relevant time period, Mr. Welhouse and Welhouse's clients had their accounts in custody at a brokerage firm ("the broker"). To execute options trades, Mr. Welhouse made trades in a master account at the broker and later allocated the trades to either his or his clients' accounts.

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

6. Mr. Welhouse was interviewed by the Commission staff on January 28, 2014. Mr. Welhouse agreed that the interview could be recorded, and the staff recorded the interview. During that recorded interview, Mr. Welhouse claimed that to allocate a trade, he needed to manually create a spreadsheet with the trade allocation and then submit the spreadsheet on the broker's trading platform. Mr. Welhouse said his practice was to submit the trade allocation for each account to the broker before 5:00 p.m. on the date the trade was made. Mr. Welhouse stated that he used one master account for trades in his four personal accounts and a different master account for his clients' trades. Despite this statement, Mr. Welhouse also stated that there were times when he allocated SPY options trades from the client master account to his personal accounts. Mr. Welhouse called these allocations "mistakes" and stated that the broker called many times and expressed concern about his allocating SPY options from the clients' master account to his personal accounts.

7. Mr. Welhouse said that during the relevant time period, in investing his clients' funds, he followed four investment models: conservative, moderate, aggressive, and options. Mr. Welhouse said that the options model traded only SPY options, but that he also traded SPY options in the other models.

8. Mr. Welhouse stated that he allocated all trades pro rata across all accounts for a particular model (including pro rata across Mr. Welhouse's own accounts and his clients' accounts that were on the same model). Mr. Welhouse also stated that Welhouse's January 2012 Form ADV Part 2A's reference to fair and equitable trade allocation is a reference to Mr. Welhouse's pro rata allocation across a model. Additionally, Welhouse's firm brochures on Form ADV, which the Respondents were required to provide to clients, stated that Welhouse did not trade for its own account and that it restricted the trading of employees' accounts. Welhouse's firm brochures did not disclose that Mr. Welhouse invested in, or bought and sold, the same securities that he recommended to clients, failed to discuss the conflicts of interest such trading presents, and did not disclose how Welhouse addresses the conflicts posed by personal trading, as required by Form ADV. Accordingly, parts of Welhouse's Form ADV, Part 2A were false or misleading. In addition, the Respondents did not otherwise disclose the facts underlying the material conflict of interest posed by Mr. Welhouse's purchase and sale of SPY options for both himself and his advisory clients.

9. Welhouse's written policies and procedures for trade allocation state: (1) "[a]ll clients are assigned to a model portfolio. . ."; and (2) "[w]hen a trade is put on the trade is purchased by the model portfolio and automatically allocated to the clients account" on a pro rata basis. The Welhouse trade allocation policies and procedures also state: "We do not have written order tickets or spreadsheet documents reflecting allocations of orders. Our model portfolios have been in use for over 10 years. Our trade allocations are built into our model portfolios."

Welhouse's SPY Options Trades Were Not Allocated Pro Rata

10. Contrary to Welhouse's policies and procedures and its Form ADV statements, Mr. Welhouse, on behalf of Welhouse, did not allocate SPY options trades pro rata. During the relevant time period, Mr. Welhouse allocated a disproportionate number of profitable SPY options trades to favored accounts (accounts belonging to Mr. Welhouse or another person with the last name Welhouse), while allocating unprofitable SPY options trades to client accounts. Mr. Welhouse did so by trading securities in a master account, typically using a day-trading

strategy, and then delaying the allocations until later in the day when he could determine whether trades had appreciated or declined in value. During the relevant time period, approximately 58% of SPY options trades occurred before 11:00 a.m. while about 58% of SPY options trades were allocated to accounts after 2:00 p.m. Moreover, approximately 47% of SPY options trades were allocated to accounts after 3:00 p.m., during the last hour of regular market hours for options trading. This delay allowed Mr. Welhouse to selectively allocate profitable trades to his personal accounts.

11. For trades that increased in value on the day of the purchase, Mr. Welhouse often day-traded by selling the option on the same day he purchased it, allocating a disproportionate share of those profitable day trades to his personal accounts. For trades that decreased in value on the day of the purchase, Mr. Welhouse often did not sell the option on the day of purchase; he allocated a disproportionate share of these trades to his clients' accounts.

12. According to the broker's internal compliance notes, an employee of the broker told Mr. Welhouse in April 2010 that the broker was monitoring his trade allocations. During this conversation, Mr. Welhouse agreed to separate his personal and client trading in different accounts. Following the April 2010 conversation, the broker's trade allocation surveillance system flagged Mr. Welhouse's joint account nine times between May 2011 and September 2012. In February 2012, another employee of the broker called Mr. Welhouse again because he seemed to be making preferential trade allocations from his clients' master account to his personal account. Mr. Welhouse returned the employee's call, and, during the recorded telephone call, the employee reminded Mr. Welhouse to keep his personal trading separate from his clients' master account and Mr. Welhouse agreed he would do so. Then, in June 2012, another employee of the broker called Mr. Welhouse and told him that he was continuing to allocate trades to his personal account from his clients' master account, which had the appearance of preferential trade allocation. The employee reminded Mr. Welhouse of the two prior conversations on the same issue, and the employee told Mr. Welhouse that the broker would consider blocking allocations from a master account to his personal accounts if the practice continued. In September 2012, the broker flagged Mr. Welhouse's trade allocation a ninth and final time. In December 2012, the broker terminated its relationship with Mr. Welhouse.

13. Mr. Welhouse stated that he had allocated from the clients' master account to his personal account several times and that the broker had spoken to him about this practice numerous times before it ceased. Mr. Welhouse stated that any allocations from the clients' master account to his personal account were "mistakes." To support his claims that he had allocated trades pro rata, Mr. Welhouse described how, based on his memory, the performance of his clients' SPY options trades during the period 2009 to 2013 was similar to that of his own SPY options trades.

Mr. Welhouse Reaped Substantial Profits From His Cherry-Picking Scheme

14. Commission staff in the Division of Economic and Risk Analysis ("DERA") analyzed first-day profits and one-day returns for both Mr. Welhouse's personal accounts and his clients' accounts. To do this, DERA first classified all SPY options trades as either day trades or multi-day trades. Day trades are those where both the purchase and sale occur on the same day. All other trades are multi-day trades. DERA analyzed only the first-day return of both day

trades and multi-day trades because it is only on the day of purchase, when Mr. Welhouse allocated the trade, that he had the opportunity to cherry-pick the profits.

15. During the relevant time period, Mr. Welhouse allocated 496 SPY options trades to his personal accounts and 1,127 to his clients. The total cost of these trades was $7.25 million for Mr. Welhouse's personal accounts and $8.46 million for his clients' accounts. Mr. Welhouse's total first-day profits on these 496 trades was $455,277. In contrast, Mr. Welhouse's clients suffered a total first-day loss of $427,190. The average first-day return for the trades Mr. Welhouse allocated to himself was 6.28%, while his clients' average first-day return was -5.05%. Combined, the first-day return for all SPY options trades was $28,087, for an average first-day return of 0.18%. In other words, if Mr. Welhouse had allocated all SPY options' first-day returns on a pro rata basis, every SPY options client (including Mr. Welhouse and all his clients who owned SPY options) would have had made a first-day return of 0.18%. By comparing Mr. Welhouse's actual first-day returns of 6.28% to the overall average of 0.18%, DERA concluded that Mr. Welhouse reaped $442,319 in ill-gotten gains.

16. The following chart summarizes the profitability of the SPY option trading:

SPY-Options	Investment	1-Day Profits	1-Day Return	N	Average Profit Per Trade
Panel A: All Trades					
Welhouse Accounts	$7,248,754	$455,277	6.28%	496	$918
Non-Welhouse Accounts	$8,463,500	-$427,190	-5.05%	1,127	-$379
All Accounts	$15,712,254	$28,087	0.18%	1,623	$17
Panel B: Day Trades					
Welhouse Accounts	$5,622,098	$560,883	9.98%	334	$1,679
Non-Welhouse Accounts	$3,913,718	$139,194	3.56%	487	$286
All Accounts	$9,535,815	$700,077	7.34%	821	$853
Panel C: Multi-Day Trades					
Welhouse Accounts	$1,626,657	-$105,606	-6.49%	162	-$652
Non-Welhouse Accounts	$4,549,782	-$566,384	-12.45%	640	-$885
All Accounts	$6,176,439	-$671,990	-10.88%	802	-$838

17. The difference between Mr. Welhouse's first-day profit and that of his clients is highly statistically significant. To test whether the first day profitability of trades allocated to

Mr. Welhouse's personal accounts was significantly different from that of those allocated to his clients' accounts, a simulation was run one million times. The simulation tests the possibility that although Mr. Welhouse's accounts were very profitable, he simply selected a lucky combination of trades by chance. Mr. Welhouse's $455,277 profit was substantially higher than every one of the one million random simulations. These results show that there is only an infinitesimal likelihood of achieving by chance a profit like Mr. Welhouse's. Finally, when comparing the proportion of profitable trades allocated to Mr. Welhouse's accounts to the proportion of profitable trades allocated to Mr. Welhouse's clients' accounts, the likelihood of Mr. Welhouse's personal accounts receiving such a high proportion of profitable trades by pure random chance is less than one in one trillion.

Welhouse's clients were not aware of the cherry-picking scheme

18. Mr. Welhouse's clients were not aware that he was trading options in their accounts, or that he was using those accounts to further his own interests by cherry-picking profitable day trades. The Commission staff interviewed three Welhouse clients who experienced significant investment losses on SPY options trades, including unprofitable first day returns. In each instance, the client considered himself or herself to be an inexperienced investor seeking a conservative approach in managing his or her accounts. None of the clients was aware that he or she had invested in options on the S&P 500 Index, and two of the clients did not know what options were. Each of the clients' practice was to review the total account value in a periodic account statement, and these clients did not review the performance of underlying account holdings. Although these reviews could have revealed Mr. Welhouse was trading options, they could never have revealed the cherry-picking scheme. One of the clients recalled significant account losses. When the client asked Mr. Welhouse about the losses, Mr. Welhouse told the client that he had experienced the same losses in his personal accounts. Mr. Welhouse did not reveal that he was selectively allocating trades to client accounts.

VIOLATIONS

19. As a result of the conduct above, Welhouse and Mr. Welhouse willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Mr. Welhouse also willfully aided and abetted and caused Welhouse's violations of those provisions. Section 10(b) of the Exchange Act makes it unlawful for any person to use or employ, in connection with the purchase or sale of any security any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe. Rule 10b-5 under the Exchange Act makes it unlawful for any person, directly or indirectly, (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, and (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

20. As a result of the conduct above, Welhouse and Mr. Welhouse also willfully violated Sections 206(1) and 206(2) of the Advisers Act. Mr. Welhouse also willfully aided and abetted and caused Welhouse's violations of those provisions. Section 206(1) of the Advisers Act prohibits any investment adviser from employing any device, scheme, or artifice to defraud any client or prospective client, and Section 206(2) of the Advisers Act prohibits any investment

adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Section 21C of the Exchange Act, Sections 203(e), 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act of 1940, it is hereby ORDERED that:

A. Respondents Welhouse and Mr. Welhouse shall cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Advisers Act.

B. Respondent Welhouse is censured.

C. Respondent Mr. Welhouse be, and hereby is:

Barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

D. Any reapplication for association by Respondent Mr. Welhouse will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against Respondent Mr. Welhouse, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

E. Respondents shall, within 10 days of the entry of this Order, pay, jointly and severally, disgorgement of $418,141 (consisting of $442,319 in ill-gotten gains, less $24,178 that Respondents have demonstrated to Commission staff they have previously paid to a harmed investor), and prejudgment interest of $50,918.60 to the Securities and Exchange Commission. The Commission will hold funds paid pursuant to this paragraph in an account at the United States Treasury pending a decision whether the Commission, in its discretion, will seek to distribute funds or, transfer them to the general fund of the United States Treasury, subject to

Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.

F. Respondents shall, within 10 days of the entry of this Order, pay, jointly and severally, a civil money penalty in the amount of $300,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

Payment of disgorgement, prejudgment interest and civil penalty must be made in one of the following ways:

(1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Welhouse & Associates, Inc. and Mark P. Welhouse as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Robert B. Baker, Assistant Regional Director, Asset Management Unit, Division of Enforcement, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110.

G. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondents agree that in any Related Investor Action, they shall not argue that they are entitled to, nor shall they benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondents' payments of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondents agree that they shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor

Action" means a private damages action brought against Respondents by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

H. It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent Mr. Welhouse, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent Mr. Welhouse of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chair White
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76179 / October 16, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4232 / October 16, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16908

In the Matter of

FREDERICK V. MCMENIMEN, III,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Frederick V. McMenimen, III ("McMenimen" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, and consents to the entry of this Order Instituting Administrative Proceedings

Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. McMenimen was employed as a registered representative at Pruco Securities, LLC ("Pruco"), which is dually-registered with the Commission as a broker-dealer and an investment adviser. McMenimen worked at a Pruco office located in Portsmouth, New Hampshire until he voluntarily resigned in 2011. FINRA permanently barred McMenimen from the securities industry in 2013.

2. McMenimen is 52 years old. McMenimen was a resident of Exeter, New Hampshire and is presently incarcerated at Fort Dix Federal Correctional Institution in Fort Dix, New Jersey.

3. On October 31, 2014, McMenimen agreed to plead guilty to: (i) one count of Mail Fraud (18 U.S.C. §1341); (ii) one count of Money Laundering (18 U.S.C. §1957); and (iii) three counts of Tax Evasion (26 U.S.C. §7201) before the United States District Court for the District of New Hampshire in United States of America v. Frederick V. McMenimen, III, No. 12-CR-130-01-SM. On February 11, 2015, a judgment of criminal conviction was entered against McMenimen. He was sentenced to a prison term of 42 months on each count (to be served concurrently), followed by three years of supervised release and ordered to pay restitution in the amount of $1,443,749.

4. In connection with that plea, McMenimen admitted that from approximately September 2008 to about October 2011:

   a. he fraudulently solicited $1,443,749 in purported investments from three elderly customers by advising each customer to liquidate existing annuities or other investments and to entrust them to him for investment in another, fictitious investment vehicle;

   b. he misappropriated all of the funds for personal benefits; and

   c. he did not claim the above funds as income on his tax returns filed for tax years 2008, 2009 and 2010.

IV.

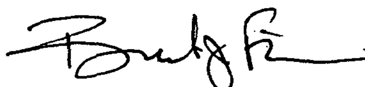
In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent McMenimen's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, that Respondent McMenimen be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

Pursuant to Section 15(b)(6) of the Exchange Act Respondent McMenimen be, and hereby is barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.



Brent J. Fields
Secretary

Chair White
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76194 / October 19, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16384

In the Matter of Nicholas Toms, Respondent.	ORDER MAKING FINDINGS AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate to enter this Order Making Findings and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Nicholas Toms ("Toms" or "Respondent").[1]

II.

Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondent consents to the entry of this Order Making Findings and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Exchange Act ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[2] that:

[1] On February 11, 2015, the Commission instituted a cease-and-desist proceeding against Respondent pursuant to Section 21C of the Exchange Act.

[2] The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

A. SUMMARY

1. Toms, while the chairman, chief executive officer ("CEO"), and president of a public company, owned and sold millions of shares of his employer's stock through a nominee and concealed it from investors. He received proceeds of over $897,000 from his secret sales.

2. From November 2009 through at least mid-2014, Toms beneficially owned and sold more than 2.3 million shares of his employer's stock. To do so, he used his long-time secretary as a nominee on an account held by an entity he controlled. He concealed his true stock ownership and sales from his employer, who consequently made materially false filings with the Commission. Toms falsely certified the accuracy of these filings.

3. Toms defrauded investors through these false filings. The filings materially understated Toms' ownership of his employer's stock and led investors to believe that he was increasing his stock position when in fact he, the company's top officer, was selling substantial amounts of the company's stock.

B. RESPONDENT

4. **Toms**, 66, is a resident of Boca Raton, Florida. From 2003 through mid-2014, Toms was chairman, CEO, and president of DecisionPoint Systems, Inc. ("DecisionPoint"). From 1981 through 1989, Toms was an associate at a prominent New York law firm, where he was then a self-described expert on the federal securities laws. He still remains licensed to practice law in New York. At all times, Toms owned at least 10% of Edwardstone & Co., Inc. ("Edwardstone"), and, until at least June 2009, he was Edwardstone's CEO. In June 2014, Toms resigned as the chairman of DecisionPoint. On August 15, 2014, he resigned as its CEO and president and as a member of its Board of Directors.

C. OTHER RELEVANT ENTITIES AND INDIVIDUALS

5. **Edwardstone** is a Delaware corporation. Since 2009, it has been located at Toms' former Manhattan residence. Toms controls Edwardstone and at all times has owned at least 10% of it. From at least 2009 through the present, Edwardstone has had no operations.

6. **DecisionPoint** is a Delaware corporation with its headquarters in Foothill Ranch, California. DecisionPoint's common stock is currently traded under the symbol DPSI on the OTC market.

7. **Barbara Martorano ("Martorano")**, age 57, is a resident of Polk City, Florida. From at least 1999 through 2014, she was Toms' secretary at several different employers.

D. BACKGROUND

8. Since 1989, Toms has been associated with Edwardstone. At all relevant times, Toms has controlled Edwardstone and used it as a vehicle for his personal finances.

9. In 1999, Martorano began working for Toms as his secretary. Toms then worked at Cape Systems, Inc.

10. In April 2009, Toms purchased a majority of the stock of Canusa Systems, Inc. ("Canusa"), a shell company not registered under Section 12.

11. In June 2009, DecisionPoint merged into Canusa. The resulting entity changed its name to DecisionPoint. DecisionPoint voluntarily filed annual reports with the Commission on Form 10-K.

12. In June 2009, Toms became DecisionPoint's chairman, CEO, and president. Martorano continued to work as Toms' secretary.

13. In approximately 2009, Toms changed Edwardstone's address to his townhouse in Manhattan.

E. TOMS USED MARTORANO AS A NOMINEE

14. In October 2009, Toms directed Martorano to open an account in Edwardstone's name at Broker A, then a registered broker-dealer firm.

15. Toms directed Martorano to identify herself to Broker A as Edwardstone's vice president.

16. Martorano faxed account opening documents to Broker A that identified her as Edwardstone's vice president and the "primary account holder." Her fax contained instructions for wiring the proceeds of stock sales out of the account. The instructions identified a single recipient of such proceeds: a bank account in Edwardstone's name (the "Edwardstone Bank Account"). Toms and his wife were the only signatories for that account.

17. Martorano in fact had no decision-making authority for Edwardstone. At all times, Martorano merely followed Toms' trading instructions in the Edwardstone account and communicated with Broker A on Toms' behalf. Martorano never took direction from anyone other than Toms as to Edwardstone's Broker A account.

18. Toms used Edwardstone's Broker A account only to sell DecisionPoint stock. Broker A sent all proceeds from these sales to the Edwardstone Bank Account.

F. EDWARDSTONE OBTAINED AND SOLD DECISIONPOINT STOCK AT TOMS' DIRECTION AND FOR HIS BENEFIT

19. On June 30, 2009, in connection with DecisionPoint's merger with Canusa, Red Lodge Ltd., a privately-held company Toms controlled, received 1,386,000 shares of DecisionPoint stock from Canusa's minority shareholders. At Toms' direction, Martorano identified herself as Red Lodge's corporate secretary and directed DecisionPoint's transfer agent to transfer 786,000 shares from Red Lodge to Edwardstone. Again at Toms' direction, Martorano subsequently deposited these shares into Edwardstone's Broker A account.

20. On September 29, 2009, Toms sent DecisionPoint's transfer agent a letter requesting that an additional 760,000 DecisionPoint shares then held by Canusa minority shareholders be transferred to Edwardstone and sent to Martorano. On October 7, 2009, at Toms' direction, Martorano sent a letter to DecisionPoint's transfer agent identifying herself as Edwardstone's corporate secretary. Her letter directed the transfer agent to transfer 660,000 of these shares to Edwardstone's Broker A account. The shares were later deposited into the account.

21. In January and April 2010, approximately 554,500 additional DecisionPoint shares were deposited into Edwardstone's Broker A account.

22. On September 17, 2010, DecisionPoint issued 881,512 shares to Toms when he exercised certain DecisionPoint stock options. On September 28, 2010, Toms directed DecisionPoint's transfer agent to transfer these shares to an individual lender as collateral for a $70,000 loan to Toms. Toms later defaulted on the loan but nevertheless received some DecisionPoint shares back from the lender. On March 11, 2011, Toms had 365,000 of these returned shares deposited into Edwardstone's Broker A account.

23. In total, from June 2009 through March 2011, 2,365,500 shares of DecisionPoint stock passed through Edwardstone's Broker A account.

24. Between November 2009 and March 2011, Toms directed Martorano to sell all of the shares in thirty-four separate transactions. Edwardstone's proceeds from those sales totaled $898,705.74.

25. After each sale, Toms instructed Martorano to have Broker A wire the proceeds to the Edwardstone Bank Account. In total, Broker A wired virtually all of the proceeds, $897,593.76, to the Edwardstone Bank Account.

26. Toms controlled the Edwardstone Bank Account and treated it as his personal account.

27. Toms commingled the DecisionPoint stock sale proceeds with other deposits in the Edwardstone Bank Account.

28. Toms spent a substantial portion of the DecisionPoint stock sale proceeds on his own personal expenses. These expenses included transfers to Toms' personal checking account, home utility bills, home repair expenses, medical expenses, pet supplies, contributions for his daughter's trip to Italy, association fees for a club in the Bahamas, designer clothing, shoes, and health club dues.

G. DECISIONPOINT FILED MATERIALLY FALSE ANNUAL REPORTS AND TOMS FALSELY CERTIFIED THEIR ACCURACY

29. On March 31, 2010, DecisionPoint voluntarily filed an annual report on Form 10-K with the Commission for the year that had ended on December 31, 2009 (the "2009 10-K"). The 2009 10-K reported that Toms owned 3,521,170 DecisionPoint shares. It failed to report the additional 1,296,000 DecisionPoint shares Toms beneficially owned through Edwardstone's Broker A account on December 31, 2009. The 2009 10-K therefore underreported Toms' ownership of DecisionPoint shares by over 36%.

30. Toms certified the accuracy of the 2009 10-K, while knowing it falsely underreported his beneficial ownership of DecisionPoint shares.

31. On March 16, 2011, DecisionPoint voluntarily filed a Form 10-K with the Commission for the year that ended on March 15, 2011 (the "2010 10-K"). The 2010 10-K reported that Toms owned 3,684,899 DecisionPoint shares. It failed to report the additional 524,512 shares that Toms beneficially owned through Edwardstone's Broker A account on March 15, 2011. The 2010 10-K therefore underreported Toms' ownership of DecisionPoint shares by over 14%.

32. Toms certified the accuracy of the 2010 10-K, while knowing it falsely underreported his beneficial ownership of DecisionPoint shares.

33. On December 22, 2011, DecisionPoint filed a Form 10-K-A amendment with the Commission for the year that ended on March 15, 2011 (the "2010 10-K-A"). Like the 2010 10-K, the 2010 10-K-A reported that Toms owned 3,684,899 DecisionPoint shares, when in fact he beneficially owned an additional 524,512 shares through Edwardstone's Broker A account on March 15, 2011. The 2010 10-K-A therefore underreported Toms' ownership of DecisionPoint shares by over 14%.

34. Toms certified the accuracy of the 2010 10-K-A, while knowing it falsely underreported his beneficial ownership of DecisionPoint shares.

35. The disclosures in the 2009 and 2010 10-Ks and the 2010 10-K-A not only materially understated Toms' beneficial ownership of DecisionPoint shares but also materially misrepresented that Toms had increased his holdings of DecisionPoint shares. In fact, he had significantly reduced them.

H. TOMS CONTINUED TO TRADE THROUGH A NOMINEE IN A SECOND EDWARDSTONE BROKERAGE ACCOUNT

36. In June 2011, Broker A sold its brokerage business to Broker B, another registered broker-dealer firm. Broker A transferred the Edwardstone brokerage account to Broker B. At the time, the account held 17,400 shares of DecisionPoint stock.

37. On June 16, 2011, the DecisionPoint shares in the new Broker B account were canceled pursuant to a reverse stock split and replaced with 2,175 new DecisionPoint shares.

38. Martorano continued serving as Edwardstone's nominal officer and taking direction from Toms on the Broker B account. At Toms' direction, Martorano placed Edwardstone's orders and directed Broker B to wire Edwardstone's DecisionPoint stock sale proceeds to the Edwardstone Bank Account.

39. On August 18 and October 21, 2011, Edwardstone sold 2000 and 160 shares, respectively, of DecisionPoint stock at Toms' direction.

40. On May 10, 2013, Edwardstone sold 10,000 shares of DecisionPoint stock, again at Toms' direction.

41. As of June 30, 2014, Edwardstone's Broker B account held 7,745 shares of DecisionPoint stock, worth approximately $3,500.

I. VIOLATIONS

42. As a result of the conduct described above, Toms violated, and Toms caused DecisionPoint's violation of, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which make it unlawful for any person, directly or indirectly, to employ any device, scheme, or artifice to defraud, to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Toms' Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Toms cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Pursuant to Section 21C(f) of the Exchange Act, Respondent Toms be, and herby is prohibited, for five years following the date of this Order, from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act, or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

C. Respondent shall, within ten days of the entry of this Order, pay disgorgement of $85,918, which represents profits gained as a result of the conduct described herein, and prejudgment interest of $16,953.40 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Nicholas Toms as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Andrew Calamari, Regional Director, Securities and Exchange Commission, Brookfield Place, 200 Vesey St., New York, NY 10281.

D. Respondent shall, within ten days of the entry of this Order, pay a civil money penalty in the amount of $175,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

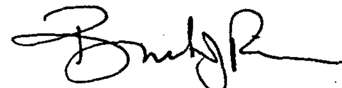
Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Nicholas Toms as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Andrew Calamari, Regional Director, Securities and Exchange Commission, Brookfield Place, 200 Vesey St., New York, NY 10281.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.



Brent J. Fields
Secretary

Chair White
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4235 / October 21, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16914

In the Matter of

EVELYN LITWOK,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"), against Evelyn Litwok ("Respondent" or "Litwok").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Litwok was an unregistered investment adviser, from approximately June 1994 through approximately October 1997, residing and operating investment funds in East Hampton, New York. Litwok was the principal of several corporations, also unregistered investment advisers, through which she conducted her investment advisory business, including Kohn Investment Management, Inc., Kohn Capital Management, Inc. 33 and Kohn Investment Management II, Inc. From 1984 to March 1994, Litwok was associated with various broker-

dealers as a registered representative, and held Series 7, Series 63 and Series 15 licenses. Litwok, 64 years old, is currently a resident of the Bronx, New York.

B. RESPONDENT'S CRIMINAL CONVICTION

2. On January 18, 2013, a federal jury convicted Litwok of one count of tax evasion in violation of Title 26 United States Code, Section 7201, in the United States District Court for the Eastern District of New York (United States v. Evelyn Litwok, 2:02 CR-0427-001(LDW)(E.D.N.Y.)). On August 8, 2013, the District Court sentenced Litwok to a prison term of 24 months followed by three years of supervised release and ordered her to pay restitution in the amount of $1,097,534. The Second Circuit affirmed the conviction on April 28, 2015.

3. The count of the criminal information of which Litwok was convicted alleged, among other things, that Litwok knowingly and willfully attempted to evade income tax due and owing by her to the United States of America for the 1995 calendar year. The misconduct occurred during the period in which Litwok was associated with an investment adviser.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against her upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

Chair White
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76218 / October 21, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4237 / October 21, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16915

In the Matter of

RETIREMENT INVESTMENT ADVISORS, INC., RESEARCH HOLDINGS, LLC, AND JOSEPH WAYNE BOWIE,

Respondents.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Retirement Investment Advisors, Inc. ("RIA"); Research Holdings, LLC ("Research Holdings"); and Joseph Wayne Bowie ("Bowie") (collectively referred to as "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 and Sections 203(e),

203(f) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds[1] that:

Summary

1. From 2006 through the first quarter of 2009, respondents Research Holdings, an unregistered investment adviser, and Bowie offered and sold interests in five private funds (the "Funds") co-managed by Bowie, to Bowie's advisory clients at respondent RIA, a Commission-registered investment adviser located in Oklahoma City, Oklahoma. The private placement memoranda ("PPMs") for the Funds provided that the financial statements of the Funds would be prepared in accordance with generally accepted accounting principles ("GAAP") and, in two instances, that they would be audited annually by an accounting firm selected by Research Holdings. Despite these provisions, Bowie and Research Holdings did not obtain financial statements prepared in accordance with GAAP or, for the applicable funds, audited financial statements.

2. Bowie and RIA valued RIA's clients' investments in the Funds based on the acquisition costs of the assets held in the Funds even though Bowie knew or should have known that some of the assets came to have no value or no significant value. This was inconsistent with the valuation methodology set out in RIA's policies and procedures. As a result of this conduct, RIA overcharged fees to clients who invested in the Funds. In addition, RIA failed to maintain a copy of all business communications relating to recommendations, advice and disbursement of funds or securities and Bowie was the cause of this conduct.

Respondents

3. Retirement Investment Advisers, Inc., is an investment adviser headquartered in Oklahoma City, Oklahoma, that has been registered with the Commission since 1993. It provides investment advice to separately-managed client accounts and has approximately $445 million in assets under management.

4. Research Holdings, LLC, is an Oklahoma limited liability company headquartered in Oklahoma City, Oklahoma. Research Holdings is the manager of five pooled investment funds: Advisor's Realty Growth, LLC (the "Growth Fund"); Advisor's Realty Income, LLC (the "Income Fund"); Advisor's Realty Growth Two, LLC; Advisor's Realty Income Two, LLC and Advisors Healthcare Fund, LLC (collectively defined previously as the "Funds").

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[1] The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

5. Joseph Wayne Bowie, age 55, has been the President or Co-President of RIA since January 1990 and was a Co-Manager of Research Holdings from 2006 to 2013, when he voluntarily resigned the position. He resides in Edmond, Oklahoma. From 2003 through early 2010, Bowie was associated with the registered broker-dealer affiliated with the majority owner of RIA.

Facts

6. From 2006 through the first quarter of 2009, Bowie and Research Holdings offered and sold interests in the Funds to Bowie's investment advisory clients at RIA. Beginning in the first half of 2006 through June of 2007, Bowie and Research Holdings offered and sold interests in the Growth Fund and the Income Fund. In the later part of 2007 through the first quarter of 2009, Bowie and Research Holdings offered and sold interests in the remaining three funds, the Income Two Fund, the Growth Two Fund and the Healthcare Fund. The Funds, advised by Bowie and Research Holdings, primarily invested in securities issued by limited partnerships and LLCs that in turn had issued loans to or purchased equity interests in real estate, such as senior housing, hospitals, multifamily properties, condominiums and retail, land and residential development.

7. The PPMs for two of the Funds, the Growth Fund and the Income Fund, provided that the annual financial statements of these two funds would be audited. Bowie and Research Holdings hired accountants to audit the two funds' financial statements, but decided not to complete the audit because of the cost to the investors in the funds, and advised them of that decision. Research Holdings, the manager of the two funds, and Bowie, a co-manager of Research Holdings, were responsible for obtaining audited financial statements for the Growth Fund and the Income Fund but failed to do so.

8. The PPMs for each of the five Funds state that "[t]he financial statements of the Fund for each fiscal year will be prepared in accordance with generally accepted accounting principles" and that financial statements and portfolio valuations would be provided to investors following the close of the fiscal year. Research Holdings, as manager of the Funds, and Bowie, as a co-manager of Research Holdings, were responsible for obtaining financial statements prepared in accordance with GAAP as represented. Research Holdings and Bowie did not obtain financial statements prepared in accordance with GAAP for any of the Funds. Instead, from 2006 to July 2010 Research Holdings and Bowie valued the Funds' assets at acquisition cost rather than fair value under ASC 820, the provision of GAAP that defines "fair value," despite having information at various points from 2009 through 2010 showing that some of the real estate-related securities in which the Funds invested were of no value or no significant value because of negative project and real estate market developments.

9. RIA's policy on valuation of securities provided that: "[f]or securities where ready valuation information is not available from independent sources, e.g. hedge funds, private placements, illiquid securities, derivatives or other such situations, these securities are to be reviewed and priced by Joe Bowie in good faith to reflect the security's fair and current market value, and supporting documentation maintained." RIA and Bowie did not perform any such review.

10. RIA charged clients who invested in the Funds an asset-based advisory fee on, among other things, the value of their investments in the Funds. From 2006 to July 2010, RIA billed advisory fees to

clients who invested in the Funds. The value of the clients' interests in the Funds was premised on the acquisition cost of the assets held in the Funds even though Bowie knew or should have known that some of the assets came to have no value or no significant value. This valuation of the Funds' interests was inconsistent with RIA's valuation policy. RIA ultimately charged clients an estimated $144,243.09 more in fees than would have been permitted if it had followed its valuation policy.

11. In July 2010, Bowie emailed the third-party custodian for the Funds' investments (the "Custodian"), noting that certain investments held by the Funds were a "problem," and indicating that he would send "a list of investments to mark down to $1 as they are in default." Later that month, Bowie instructed the Custodian to mark down certain assets that were in default, expressing concern that they were charging fees based on asset values "that are either gone or will be gone." Based on Bowie's instructions, the Custodian marked down the value of 31 of the Funds' investments to $1, if Bowie thought the investments ultimately would be profitable, or $0, if he thought that they would be unprofitable. Bowie made no effort to assess the market value of the investments and did not create appropriate documentation to support his valuations. Since July 2010, in an effort to support the Funds, Bowie paid significant sums to cover their expenses or capital calls from the Funds' investors and also personally guaranteed loans obtained by some of the Funds.

12. After the July 2010 write-down of assets, RIA, Research Holdings and Bowie misstated to RIA clients who invested in the Funds that the July 2010 reduction in asset values was meant to save clients fees and was not a reflection of the value of the Funds' assets.

13. Bowie sometimes used his personal email account for communications with RIA clients, and on occasion he deleted some of these emails if he regarded them as "primarily personal." Some of these emails involved the disbursement of fees and advice about client accounts. As a result, some of Bowie's email communications with his RIA clients with respect to their investments were not preserved as required under the Advisers Act.

Violations

14. As a result of the conduct described above, RIA and Bowie willfully[2] violated Section 206(2) of the Advisers Act, which prohibits investment advisers from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

15. As a result of the conduct described above, RIA willfully violated Section 204 of the Advisers Act and Rule 204-2(a)(7)(i) promulgated thereunder, which requires that registered investment advisers "make and keep true, accurate and current...[o]riginals of all written communications received and copies of all written communications sent by such investment adviser relating to...any

[2]A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing."' *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (*quoting Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts."' *Id.* (*quoting Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

recommendation made or proposed to be made and any advice given or proposed to be given...." Bowie caused RIA's violations of Section 204 and Rule 204-2 thereunder.

16. As a result of the conduct described above, Research Holdings and Bowie willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder, which prohibit making an untrue statement of a material fact or omitting any material fact to an investor or prospective investor in a pooled investment vehicle and engaging in any act, practice, or course of business that is fraudulent or deceptive with respect to any investor or prospective investor in a pooled investment vehicle.

Remedial Efforts

17. In determining to accept the Offers, the Commission considered remedial acts promptly undertaken by Research Holdings and RIA and cooperation afforded the Commission staff. Specifically, before the SEC examination, Research Holdings ceased charging fees to the final three funds offered as early as January 2010, and RIA ceased charging fees on its clients' investments in the Funds in late 2011. Moreover, these entities previously reimbursed approximately $29,000 to the Funds and to clients of RIA. Additionally, RIA engaged a compliance consultant.

Undertakings

18. Within thirty (30) days of the entry of this Order, RIA shall provide a copy of the Order to each of RIA's existing advisory clients who are invested in any of the Funds as of the entry of this Order via mail, email, or such other method as may be acceptable to the Commission staff, together with a cover letter in a form not unacceptable to the Commission staff. Furthermore, for a period of six (6) months from the entry of this Order, RIA shall provide a copy of the Order, via mail, email, or such other method as may be acceptable to the Commission staff, together with a cover letter in a form not unacceptable to the Commission staff, to all RIA existing or prospective advisory clients who are solicited to invest in any of the Funds during the six (6) month period. The provision of this Order to said existing or prospective advisory clients shall occur at the time said existing or prospective advisory clients are solicited to invest in any of the Funds.

19. Independent Compliance Consultant. With respect to the retention of an independent compliance consultant, RIA has agreed to the following undertakings:

a. RIA shall retain, within thirty (30) days of the entry of this Order, the services of an independent compliance consultant (the "Independent Consultant") that is not unacceptable to the Commission staff. The Independent Consultant's compensation and expenses shall be borne exclusively by RIA. RIA shall require that the Independent Consultant conduct comprehensive reviews of RIA's policies and procedures relating to valuation (including, but not limited to, the valuation of client assets invested in private funds managed by RIA, Bowie and/or any of their affiliates), the maintenance of books and records, as well as communications with clients, investors and prospective clients and investors (the "Reviews") within thirty (30) days of the entry of this Order.

b. RIA shall provide to the Commission staff, within ten (10) days of retaining the

Independent Consultant, a copy of the engagement letter detailing the Independent Consultant's responsibilities, which shall include comprehensive compliance reviews as described in Paragraph 19.a. of this Order.

c. RIA shall require that, within ninety-five (95) days from the entry of this Order, the Independent Consultant shall submit a written and detailed report of its findings to RIA and to the Commission staff (the "Report"). RIA shall require that the Report include a description of the Review performed, the names of the individuals who performed the Review, the conclusions reached, the Independent Consultant's recommendations for changes or improvements to RIA's policies and procedures and/or disclosures to clients and prospective clients, and a procedure for implementing the recommended changes or improvements to RIA's policies and procedures and/or disclosures.

d. RIA shall adopt all recommendations contained in the Report within sixty (60) days of the Report; provided, however, that within forty-five (45) days after the date of the Report, RIA shall in writing advise the Independent Consultant and the Commission staff of any recommendations that RIA considers to be unduly burdensome, impractical, or inappropriate. With respect to any recommendation that RIA considers unduly burdensome, impractical or inappropriate, RIA need not adopt that recommendation at that time but shall propose in writing an alternative policy, procedure or system designed to achieve the same objective or purpose.

e. As to any recommendation regarding RIA's policies and procedures on which RIA and the Independent Consultant do not agree, RIA and the Independent Consultant shall attempt in good faith to reach an agreement within sixty (60) days after the date of the applicable Report. Within fifteen (15) days after the conclusion of the discussion and evaluation by the RIA and the Independent Consultant, RIA shall require that the Independent Consultant inform RIA and the Commission staff in writing of the Independent Consultant's final determination concerning any recommendation that RIA considers to be unduly burdensome, impractical or inappropriate. RIA shall abide by the determinations of the Independent Consultant and, within sixty (60) days after final agreement between RIA and the Independent Consultant or final determination by the Independent Consultant, whichever occurs first, RIA shall adopt and implement all of the recommendations that the Independent Consultant deems appropriate.

f. Within ninety (90) days of RIA's adoption of all of the recommendations in a Report that the Independent Consultant deems appropriate as determined pursuant to the procedures set forth herein, RIA shall certify in writing to the Independent Consultant and the Commission staff that RIA has adopted and implemented all of the Independent Consultant's recommendations in the applicable Report. Unless otherwise directed by the Commission staff, all Reports, certifications, and other documents required to be provided to the Commission staff shall be sent to Marshall S. Sprung, Co-Chief, Asset Management Unit, Los Angeles Regional Office, Securities and Exchange Commission, 444 South Flower St., Los Angeles, CA 90071, or such other address as the Commission staff may provide.

g. RIA shall cooperate fully with the Independent Consultant and shall provide the Independent Consultant with access to such of its files, books, records, and personnel as are reasonably requested by the Independent Consultant for review.

h. To ensure the independence of the Independent Consultant, RIA:

i. Shall not have the authority to terminate the Independent Consultant or substitute another independent compliance consultant for the initial Independent Consultant, without the prior written approval of the Commission staff;

ii. Shall compensate the Independent Consultant and persons engaged to assist the Independent Consultant for services rendered pursuant to this Order at their reasonable and customary rates; and

iii. Shall require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two (2) years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with RIA, or any of their present or former affiliates, partners, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in the performance of his/her duties under this Order shall not, without prior written consent of the Commission staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with RIA, or any of their present or former affiliates, partners, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two (2) years after the engagement.

20. Certification of Compliance by RIA: RIA shall certify, in writing, compliance with the undertakings in Paragraphs 18-19 according to the timelines set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and RIA agrees to provide such evidence. The certification and supporting material shall be submitted to Marshall S. Sprung, Co-Chief, Asset Management Unit, Los Angeles Regional Office, Securities and Exchange Commission, 444 South Flower St., Los Angeles, CA 90071, or such other address as the Commission staff may provide, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Section 15(b)(6) of the Exchange Act, and Sections 203(e), 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent RIA cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 204 of the Advisers Act and Rule 204-2 thereunder.

B. Respondent Research Holdings cease and desist from committing or causing any

violations and any future violations of Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

C. Respondent Bowie cease and desist from committing or causing any violations and any future violations of Sections 204, 206(2), and 206(4) of the Advisers Act and Rules 204-2 and 206(4)-8 thereunder.

D. Respondents RIA, Research Holdings and Bowie are censured.

E. Respondent RIA shall pay disgorgement and prejudgment interest as follows:

1. RIA shall pay disgorgement of $144,243.09, consistent with the provisions of this Subsection E. Within ten (10) days of the entry of this Order, RIA shall deposit the full amount of the disgorgement (the "Disgorgement Fund") into an escrow account acceptable to the Commission staff and RIA shall provide the Commission staff with evidence of such deposit in a form acceptable to the Commission staff. In addition, within ten (10) days of the entry of this Order, RIA shall pay prejudgment interest of $14,724.02, in the manner provided in Subsection H below. If timely deposit of the Disgorgement Fund or timely payment of the prejudgment interest is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.

2. RIA shall be responsible for administering the Disgorgement Fund. RIA shall submit to the Commission staff, within sixty (60) days of the date of entry of this Order, the Disbursement Schedule which identifies (i) each current and former advisory client that will receive a portion of the Disgorgement Fund; (ii) the exact amount of that payment as to each affected client; and (iii) the methodology used to determine the exact amount of that payment as to each affected client. No portion of the Disgorgement Fund shall be paid to any client account in which any of the Respondents have a financial interest. Any portion of the Disgorgement Fund that is allocable to any client account in which any of the Respondents have a financial interest shall be transferred to the Commission for transfer to the United States Treasury in accordance with Subsection H below. If any person or entity is due an amount totaling less than ten dollars ($10.00), where such amount cannot be credited to a current client account or fund, RIA shall instead pay such amount to the Commission for transfer to the United States Treasury in the manner provided in Subsection H below.

3. RIA shall complete the transmission of all amounts otherwise payable to affected advisory clients pursuant to the approved Disbursement Schedule within ninety (90) days of the entry of this Order, unless such time period is extended as provided for in Subsection E.9 below.

4. If RIA does not distribute or return any portion of the Disgorgement Fund for any reason, including an inability to locate an affected advisory client or any factors beyond RIA's control, or if RIA has not transferred any portion of the Disgorgement Fund to a client because that client is due less than $10.00, RIA shall transfer any such undistributed funds to the Commission for transmittal to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3) after the final accounting provided for in this Subsection E is approved by the Commission. Any such payment shall be made in accordance with Subsection H below.

5. RIA shall be responsible for any and all tax compliance responsibilities associated with the Disgorgement Fund and may retain any professional services necessary. The costs and expenses of any such professional services shall be borne by RIA and shall not be paid out of the Disgorgement Fund.

6. Within two hundred and ten (210) days after the date of entry of this Order, RIA shall submit for Commission approval a final accounting of the disposition of the Disgorgement Fund. The final accounting shall be on a standardized accounting form to be provided by the Commission staff and shall include, but not be limited to: (i) the amount paid to each payee; (ii) the date of each payment; (iii) the check number or other identifier of money transferred; (iv) the date and amount of any returned payment; and (v) any amounts to be forwarded to the Commission for transfer to the United States Treasury. In addition, RIA shall provide to Commission staff a cover letter representing that all of the requirements of this Subsection E have been completed and that the information requested has been accurately reported to the Commission ("the certification"). Also included in the certification should be a description of any efforts to locate a prospective payee whose payment was returned or to whom payment was not made for any reason. RIA shall submit proof and supporting documentation of such payment (whether in the form of fee credits, cancelled checks, or otherwise) in a form acceptable to the Commission staff and under a cover letter that identifies RIA as Respondent in these proceedings and the file number of these proceedings to Marshall S. Sprung, Co-Chief, Asset Management Unit, Los Angeles Regional Office, Securities and Exchange Commission, 444 South Flower St., Los Angeles, CA 90071, or such other address as the Commission staff may provide.

7. RIA shall provide any and all supporting documentation for the accounting and certification to the Commission staff upon its request and shall cooperate with any additional requests by the Commission staff in connection with the accounting and certification.

8. After RIA has submitted the final accounting to the Commission staff, the staff shall submit the final accounting to the Commission for approval and shall request Commission approval to send any remaining amount to the United States Treasury.

9. The Commission staff may extend any of the procedural dates set forth in Section III., paragraphs18-20 and Section IV., Subsection E for good cause shown. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday the next business day shall be considered to be the last day.

F. Respondent Bowie shall, within 30 days of the entry of this Order, pay a civil money penalty of $25,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3).

G. Respondent RIA shall, within 30 days of the entry of this Order, pay a civil money penalty of $37,500 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3).

H. Respondent Research Holdings shall, within 30 days of the entry of this Order, pay a civil money penalty of $37,500 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3).

If timely payment of the amounts in Paragraphs IV.F, IV.G, or IV.H is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. If timely payment of the amounts in Paragraphs IV.E is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

1. Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

2. Respondents may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

3. Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

   Enterprise Services Center
   Accounts Receivable Branch
   HQ Bldg., Room 181, AMZ-341
   6500 South MacArthur Boulevard
   Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying RIA, Research Holdings, and Bowie as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Marshall Sprung, Co-Chief, Asset Management Unit, Los Angeles Regional Office, Securities and Exchange Commission, 444 South Flower St., Los Angeles, CA 90071.

I. Respondent RIA shall comply with the undertakings enumerated in Section III., paras. 18-20 above.

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Chapter II

[Release Nos. 33-9965, 34-76240, 39-2507, IC-31879, IA-4238; File No. S7-21-15]

List of Rules to be Reviewed Pursuant to the Regulatory Flexibility Act

AGENCY: Securities and Exchange Commission.

ACTION: Publication of list of rules scheduled for review.

SUMMARY: The Securities and Exchange Commission is publishing a list of rules to be reviewed pursuant to Section 610 of the Regulatory Flexibility Act. The list is published to provide the public with notice that these rules are scheduled for review by the agency and to invite public comment on whether the rules should be continued without change, or should be amended or rescinded to minimize any significant economic impact of the rules upon a substantial number of such small entities.

DATES: Comments should be submitted by [insert date 30 days after publication in the Federal Register].

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number [S7-21-15] on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

- Send paper comments to Brent Fields, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to File No. S7-21-15. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/other.shtml). Comments also are available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Anne Sullivan, Office of the General Counsel, 202-551-5019.

SUPPLEMENTARY INFORMATION: The Regulatory Flexibility Act ("RFA"), codified at 5 U.S.C. 600-611, requires an agency to review its rules that have a significant economic impact upon a substantial number of small entities within ten years of the publication of such rules as final rules. 5 U.S.C. 610(a). The purpose of the review is "to determine whether such rules should be continued without change, or should be amended or rescinded . . . to minimize any significant economic impact of the rules upon a substantial number of such small entities." 5 U.S.C. 610(a). The RFA sets forth specific considerations that must be addressed in the review of each rule:

- the continued need for the rule;
- the nature of complaints or comments received concerning the rule from the public;
- the complexity of the rule;

- the extent to which the rule overlaps, duplicates or conflicts with other federal rules, and, to the extent feasible, with state and local governmental rules; and
- the length of time since the rule has been evaluated or the degree to which technology, economic conditions, or other factors have changed in the area affected by the rule. 5 U.S.C. 610(c).

The Securities and Exchange Commission, as a matter of policy, reviews all final rules that it published for notice and comment to assess not only their continued compliance with the RFA, but also to assess generally their continued utility. When the Commission implemented the Act in 1980, it stated that it "intend[ed] to conduct a broader review [than that required by the RFA], with a view to identifying those rules in need of modification or even rescission." Securities Act Release No. 6302 (Mar. 20, 1981), 46 FR 19251 (Mar. 30, 1981). The list below is therefore broader than that required by the RFA, and may include rules that do not have a significant economic impact on a substantial number of small entities. Where the Commission has previously made a determination of a rule's impact on small businesses, the determination is noted on the list.

The Commission particularly solicits public comment on whether the rules listed below affect small businesses in new or different ways than when they were first adopted. The rules and forms listed below are scheduled for review by staff of the Commission during the next 12 months. The list includes 21 rules adopted by the Commission in 2004.

Title: **Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies**

Citation: 17 CFR 270.30b1-5; 17 CFR 270.30a-2; 17 CFR 270.30a-3; 17 CFR 270.30d-1; 17 CFR 249.331; 17 CFR 249.332; 17 CFR 239.14; 17 CFR 239.15A; 17 CFR 239.17; 17 CFR 274.11A; 17 CFR 274.11a-1; 17 CFR 274.11b; 17 CFR 274.130; 17 CFR 274.128; 17 CFR 210.6; and 17 CFR 210.12

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77s(a), and 77z-3; 78j(b), 78l, 78m, 78o(d), 78w(a), and 78mm; 80a-6(c), 80a-8, 80a-24, 80a-24(a), 80a-29, 80a-30, and 80a-37

Description: The amendments require open-end management investment companies to disclose fund expenses borne by shareholders during the reporting period in reports to shareholders; permit a management investment company registered under the Investment Company Act to include a summary portfolio schedule in its reports to shareholders; exempt money market funds from including a portfolio schedule in reports to shareholders provided that the complete portfolio schedule is filed with the Commission on Form N-CSR and is provided to shareholders free of charge; require reports to shareholders by funds to include a tabular or graphic presentation of a fund's portfolio holdings by identifiable categories; require a fund to file its complete portfolio schedule as of the end of its first and third fiscal quarters with the Commission on new Form N-Q and certified by the fund's principal executive and financial officers; and require a mutual fund to include Management's Discussion of Fund Performance in its annual report to shareholders.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the Commission's adoption of Release No. 33-8393 (Feb. 27, 2004). The Commission considered comments received on the proposing release and the Initial Regulatory Flexibility Analysis prepared in Release No. IC-25870 (Dec. 18, 2002) at that time.

* * * * *

Title: **Adoption of Amendments to the Rules of Practice and Delegations of Authority of the Commission**

Citation: 17 CFR 200.30-7; 17 CFR 200.30-14; 17 CFR 201.100; 17 CFR 201.102; 17 CFR 111; 17 CFR 201.141; 17 CFR 201.150 -154; 17 CFR 201.201-202; 17 CFR 201.210; 17 CFR 201.230-233; 17 CFR 201.350-351; 17 CFR 201.360; 17 CFR 201.400; 17 CFR 201.411; 17 CFR 201.420; 17 CFR 201.430; 17 CFR 201.440-441; 17 CFR 201.450-451; 17

CFR 201.460; 17 CFR 201.460; 17 CFR 201.470; 17 CFR 201.601; 17 CFR 201.1100-1106; 17 CFR 240.19d-4

Authority: 15 U.S.C. 7202; 15 U.S.C. 77s, 78s , 77sss, 78w, 79t, . 80a-37 and 80a-39 and 80b-11

Description: The Commission adopted rules and rule amendments to implement provisions under the Sarbanes-Oxley Act of 2002 that provided for the creation of Fair Funds and for Commission review of disciplinary actions imposed by the Public Company Accounting Oversight Board. The Commission also adopted rules and rule amendments to clarify or modify a variety of aspects of administrative proceedings, including certain motions, petitions, and filings, service and form of filings, and procedures for the production or subpoena of documents.

Prior Commission Determination under 5 U.S.C. 610: The Commission determined in Rel. No. 34-49412 (March 12, 2004) that the revision related solely to agency organization, procedure, or practice, and that, therefore, the Administrative Procedure Act and the Regulatory Flexibility Act did not apply to the rule. The Commission received no comments on this determination

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Title: **Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date**

Citation: 17 CFR 240.13a-11; 17 CFR 240.15d-11; 17 CFR 249.308

Authority: 15 U.S.C. 77g, 77l, 77s, 78j, 78l, 78m, 78o, and 78w

Description: The Commission adopted rules and amendments to (i) expand the number of events that are reportable on Form 8-K, adding eight new items to the form, and transferring two items from the periodic reports, (ii) expand disclosures under two existing Form 8-K items, (iii) reorganize Form 8-K items into topical categories, (iv) shorten the Form 8-K filing deadline for most items to four business days after the occurrence of an event triggering the disclosure requirements of the form, and (v) adopt a limited safe harbor from liability for failure to file certain of the required Form 8-K reports.

Prior Commission Determination under 5 U.S.C. 610: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 33-8400 (March 16, 2004). The Commission considered comments received on the proposing release and the Initial Regulatory Flexibility Analysis prepared in Release No. 33-8106 (June 17, 2002) at that time.

* * * * *

Title: **Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings**

Citation: 17 CFR 239.15A; 17 CFR 239.17a; 17 CFR 239.17b; 17 CFR 239.17c; 17 CFR 274.11A; 17 CFR 274.11b; 17 CFR 274.11c; and 17 CFR 274.11d

Authority: 15 U.S.C. 77e, 77f, 77g, 77j, 77ss(a), 80a-3, 80a-22, 80a-24(a), 80a-29, and 80a-37

Description: The amendments require improved disclosure in fund prospectuses of a mutual fund's risks, policies, and procedures. In addition, the amendments clarify instructions to registration forms to require all mutual funds (other than money market funds) and insurance company managed separate accounts that offer variable annuities to explain in their prospectuses both the circumstances under which they will use fair value pricing and the effects of using fair value pricing. The amendments also require mutual funds and insurance company managed separate accounts that offer variable annuities to disclose their policies with respect to disclosure of portfolio holdings information.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the Commission's adoption of Release No. 33-8408 (Apr. 19, 2004). The Commission considered comments received on the proposing release and the Initial Regulatory Flexibility Analysis prepared in Release No. IC-26287 (Dec. 11, 2003) at that time.

* * * * *

Title: **Mandated Electronic Filing for Form ID**

Citation: 17 CFR 232.10; 17 CFR 239.63; 17 CFR 249.446, 17 CFR 259.602; 17 CFR 269.7; 17 CFR 274.402

Authority: 15 U.S.C. 77s, 77sss, 78c(b), 78m(a), 78w(a), 78ll(d),79t, 80a-29 and 80a-37

Description: The Commission adopted rule and form amendments to mandate the electronic filing of Form ID on a new on-line system.

Prior Commission Determination A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 33-8410 April 21, 2004). The Commission solicited comments concerning the proposing

Under 5 U.S.C. 601: release and the Initial Regulatory Flexibility Analysis prepared in Release No. 33-8399 (March 15, 2004) but received no comment letters on the analysis.

* * * * *

Title: **Foreign Bank Exemption from the Insider Lending Prohibition of Exchange Act Section 13(k)**

Citation: 17 CFR 240.13k-1

Authority: 15 U.S.C. 77f, 77g, 77h, 77j,77s, 78c, 78l, 78m, 78w, and 78mm

Description: The Commission adopted a rule that grants qualified foreign banks an exemption from the insider lending prohibition under Section 13(k) of the Securities Exchange Act of 1934.

Prior Commission Determination under 5 U.S.C. 610: Pursuant to Section 605(b) of the Regulatory Flexibility Act, the Commission certified that the rule would not have a significant economic impact on a substantial number of small entities. This certification was incorporated into the proposing release, Release No. 34-48481 (September 11, 2003). As stated in the adopting release, Release No. 34-49616 (April 26, 2004), the Commission received no comments concerning the impact on small entities or the Regulatory Flexibility Act Certification.

* * * * *

Title: **Disclosure of Breakpoint Discounts by Mutual Funds**

Citation: 17 CFR 239.15A; 17 CFR 274.11A

Authority: 15 U.S.C. 77e, 77f, 77g, 77j, 77s(a), 80a-8, 80a-24(a), 80a-29 and 80a-37

Description: The form amendments require an open-end management investment company to provide enhanced disclosure regarding breakpoint discounts on front-end sales loads. Under the amendments, an open-end management investment company is required to describe in its prospectus any arrangements that result in breakpoints in sales loads and to provide a brief summary of shareholder eligibility requirements.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the Commission's adoption of Release No. 33-8427 (June 7, 2004). The Commission considered comments received on the proposing release and the Initial Regulatory Flexibility Analysis prepared in Release No. 33-8347 (Dec. 17, 2003) at that time.

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Title:	**Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities**
Citation:	17 CFR 200.30-3, 17 CFR 240.15c3-1, 17 CFR 240.17a-4, 17 CFR 240.17a-5, 17 CFR 240.17a-11, 17 CFR 240.17h-1T, and 17 CFR 240.17h-2T.
Authority:	15 U.S.C. 78o(c), 78q(a), 78w, 78x(b) and 78mm.
Description:	The Commission adopted rule amendments that established a voluntary, alternative method of computing deductions to net capital for certain broker-dealers. This alternative method permits a broker-dealer to use mathematical models to calculate net capital requirements for market and derivatives-related credit risk. A broker-dealer using the alternative method of computing net capital is subject to enhanced net capital, early warning, recordkeeping, reporting, and certain other requirements, and must implement and document an internal risk management system.
Prior Commission Determination Under 5 U.S.C. 610:	Pursuant to section 605(b) of the Regulatory Flexibility Act, the Commission certified that the amendments would not have a significant economic impact on a substantial number of small entities. This certification was incorporated into the proposing release, Release No. 34-48690 (Oct. 24, 2003). As stated in the adopting release, Release No. 34-49830 (June 8, 2004), the Commission received no comments concerning the impact on small entities or the Regulatory Flexibility Act certification.

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Title:	**Disclosure Regarding Approval of Investment Advisory Contracts by Directors of Investment Companies**
Citation:	17 CFR 239.14; 17 CFR 239.15A; 17 CFR 239.17a; 17 CFR 274.11A; 17 CFR 274.11a-1; 17 CFR 274.11b; 17 CFR 240.14a-101
Authority:	15 U.S.C. 77e, 77f, 77g, 77j, 77s(a), 78n, 78w(a)(1), 80a-8, 80a-15, 80a-20, 80a-24(a), 80a-29 and 80a-37
Description:	The rule and form amendments require a registered management investment company to provide disclosure in its reports to shareholders regarding the material factors and the conclusions with respect to those factors that formed the basis for the board's approval of advisory contracts during the most recent fiscal half-year. The amendments are also designed

to encourage improved disclosure in proxy statements regarding the basis for the board's recommendation that shareholders approve an advisory contract.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the Commission's adoption of Release No. 34-49928 (June 23, 2004). The Commission considered comments received on the proposing release and the Initial Regulatory Flexibility Analysis prepared in Release No. 34-49014 (Feb. 11, 2004) at that time.

* * * * *

Title: **Collection Practices under Section 31 of the Exchange Act**

Citation: 17 CFR 200.30-3, 17 CFR 240.31

Authority: 15 U.S.C. 78f, 78o-3, 78q-1, 78s, 78w(a) and 78ee

Description: The rule established new procedures to govern the calculation, payment, and collection of fees and assessments on securities transactions owed by national securities exchanges and national securities associations to the Commission pursuant to Section 31 of the Securities Exchange Act of 1934. Under these new procedures, each exchange or association must provide the Commission with data on its securities transactions. The Commission calculates the amount of fees and assessments due based on the volume of these transactions and bills the exchange or association that amount.

Prior Commission Determination Under 5 U.S.C. 610: Pursuant to Section 605(b) of the Regulatory Flexibility Act, the Commission certified that Rule 31 and Form R31 would not have a significant economic impact on a substantial number of small businesses. This certification was set forth in the Proposing Release No. 34-49014 (January 20, 2004). As stated in the adopting release, Release No. 34-49928 (June 28, 2004), the Commission received no comments concerning the impact on small entities or the Regulatory Flexibility Act Certification.

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Title: **Investment Adviser Codes of Ethics**

Citation: 17 CFR 275.204A-1; 17 CFR 275.204-2; 17 CFR 279.1; 17 CFR 270.17j-1

Authority: 15 U.S.C. 77s(a), 77sss(a), 78a-37(a), 78w(a), 78bb(e)(2),79w(a), 80a-

17(j), 80a-37(a), 80b-2(a)(17), 80b-3(c)(1), 80b-4, 80b-4(a), 80b-6(4) and 80b-11(a)

Description: The rule and rule amendments require registered advisers to adopt codes of ethics. The codes of ethics must set forth standards of conduct expected of advisory personnel and address conflicts that arise from personal trading by advisory personnel. Among other things, the rule and rule amendments require advisers' supervised persons to report their personal securities transactions, including transactions in any mutual fund managed by the adviser. The rule and rule amendments are designed to promote compliance with fiduciary standards by advisers and their personnel.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the Commission's adoption of Release No. IA-2256 (July 2, 2004). The Commission considered comments received on the proposing release and the Initial Regulatory Flexibility Analysis prepared in Release No. IA-2209 (Jan. 20, 2004) at that time.

* * * * *

Title: **Covered Securities Pursuant to Section 18 of the Securities Act of 1933**

Citation: 17 CFR 230.146

Authority: 15 U.S.C. 77r(b)(1)(B) and 77s(a)

Description: The Commission amended a rule under Section 18 of the Securities Act of 1933 to designate options listed on the International Securities Exchange, Inc. as covered securities. Covered securities under Section 18 of the Securities Act are exempt from state law registration requirements.

Prior Commission Determination Under 5 U.S.C. 601: Pursuant to Section 605(b) of the Regulatory Flexibility Act, the Commission certified that amending Rule 146(b) would not have a significant economic impact on a substantial number of small entities. The certification was incorporated in the proposing release, Release No. 33-8404 (March 22, 2004). As stated in the adopting release, Release No. 33- 8442 (July 14, 2004), the Commission received no comments concerning the impact on small entities or the Regulatory Flexibility Act Certification.

* * * * *

Title: **Investment Company Governance**

Citation: 17 CFR 270.0-1(a); 17 CFR 270.10f-3; 17 CFR 270.12b-1(c); 17 CFR 270.15a-4(b)(2); 17 CFR 270.17a-7(f); 17 CFR 270.17a-8(a)(4); 17 CFR 270.17d-1(d)(7); 17 CFR 270.17e-1(c); 17 CFR 270.17g-1(j)(3); 17 CFR 270.18f-3(e); 17 CFR 270.23c-3(b)(8); 17 CFR 270.31a-2

Authority: 15 U.S.C., 80a-6(c), 80a-10(f), 80a-12(b), 80a-17(d), 80a-17(g), 80a-23(c), 80a-30(a), and 80a-37(a)

Description: A Federal appeals court vacated certain amendments adopted by the Commission to rules under the Investment Company Act. The amendments, first proposed on January 15, 2004, would have imposed two conditions on investment companies ("funds") relying on certain exemptive rules. First, fund boards would have to have been comprised of at least 75 percent independent directors. Second, the boards would have to have been chaired by an independent director. In June 2006 and December 2006, the Commission requested additional comment regarding the fund governance provisions.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 relating to the amendments to the exemptive rules and the Commission's rules on investment company governance in conjunction with the Commission's adoption of Release No. IC-26520 on July 27, 2004. Comments to the proposing release (Release No. IC-26323 (Jan. 24, 2004)) and any comments to the Initial Regulatory Flexibility Analysis were considered in connection with the Commission's adoption of Release No. IC-26520.

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Title: **Short Sales**

Citation: 17 CFR 242.200, 17 CFR 242.202T, 17 CFR 242.203

Authority: 15 U.S.C. 78b, 78c(b), 78i(h), 78j, 78k-1, 78o, 78q(a), 78q-1, 78w(a), and 78mm

Description: The Commission adopted new Regulation SHO, which defined ownership of securities, specified aggregation of long and short positions, and required broker-dealers to mark sales in all equity securities "long," "short," or "short exempt." Regulation SHO also included a temporary rule that established procedures for the Commission to suspend temporarily the operation of the "tick" test and any short sale price test of

any exchange or national securities association for specified securities. Regulation SHO also required short sellers in all equity securities to locate securities to borrow before selling, and also imposed additional delivery requirements on broker-dealers for securities in which a substantial number of failures to deliver had occurred. The Commission also adopted amendments that removed the shelf offering exception and issued interpretive guidance addressing sham transactions designed to evade Regulation M.

Prior Commission Determination Under 5 U.S.C. 610: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 34-50103 (July 28, 2004). The Commission solicited comment on the Initial Regulatory Flexibility Analysis prepared in the proposing release, Release No. 34-48709 (October 28, 2003), but received no comment on that analysis. The Commission did receive comments related to small business, and considered those comments in the adopting release.

* * * * *

Title: **Disclosure Regarding Portfolio Managers of Registered Management Investment Companies**

Citation: 17 CFR 239.14; 17 CFR 239.15A; 17 CFR 239.17a; 17 CFR 249.331; 17 CFR 270.30a-2; 17 CFR 274.11a-1; 17 CFR 274.11A; 17 CFR 274.11b; 17 CFR 274.128

Authority: 15 U.S.C. 77e, 77f, 77g, 77j, 77s(a), 78(j(b), 78m, 78n, 78o(d), 78w(a), 78mm,, 80a-8, 80a-24(a), , 80a-29, 80a-37, 80a-39

Description: The forms and rule amendments improve the disclosure provided by registered investment companies regarding their portfolio managers. The amendments extend the existing requirement that a registered management investment company provide basic information in its prospectus regarding its portfolio managers to include the members of management teams. The amendments also require a registered management investment company to disclose additional information about its portfolio managers, including other accounts that they manage, compensation structure, and ownership of securities in the investment company.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the Commission's adoption of Release No 33-8458 (Aug. 23, 2004). The Commission considered comments received on the proposing release and the Initial Regulatory Flexibility Analysis prepared in Release No. 33-8396 (Mar. 11, 2004) at that time.

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Title: **Rule 15c3-3 Reserve Requirements for Margin Related to Security Futures Products**

Citation: 17 CFR 200.30-3 and 17 CFR 240.15c3-3a

Authority: 15 U.S.C. 78o, 78q, 78w(a), and 78mm

Description: The Commission adopted amendments to the formula for determination of customer reserve requirements of broker-dealers under the Exchange Act to address issues related to customer margin for security futures products. The amendments permit a broker-dealer to include margin related to security futures products written, purchased, or sold in customer securities accounts and on deposit with a registered clearing agency or a derivatives clearing organization as a debit item in calculating its customer reserve requirement under specified conditions. The amendments were intended to help ensure that a broker-dealer is not required to fund its customer reserve requirements with proprietary assets.

Prior Commission Determination Under 5 U.S.C. 610: Pursuant to section 605(b) of the Regulatory Flexibility Act, the Commission certified that the amendments to Rule 15c3-3a would not have a significant impact on a substantial number of small entities. This certification was incorporated into the proposing release, Release No. 46492 (Sept. 12, 2002). As stated in the adopting release, Release No. 33-50295, the Commission received no comments concerning the impact on small entities or the Regulatory Flexibility Act certification.

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Title: **Prohibition on the Use of Brokerage Commissions to Finance Distribution**

Citation: 17 CFR 270.12b-1

Authority: 15 U.S.C. 80a-12(b) and 80a-37(a)

Description: The amendments amend the rule that governs the use of assets of open-end management investment companies (funds) to distribute their shares. The amended rule prohibits funds from paying for the distribution of their shares with brokerage commissions. The amendments are designed to end a practice that poses significant conflicts of interest and may be harmful to funds and fund shareholders.

Prior Commission A Final Regulatory Flexibility Analysis was prepared in accordance with 5

Determination Under 5 U.S.C. 601: U.S.C. 604 in conjunction with the Commission's adoption of Release No. IC-26591 (September 2, 2004). The Commission considered comments received on the proposing release and the Initial Regulatory Flexibility Analysis prepared in Release No. IC-26356 (Feb.24, 2004) at that time.

* * * * *

Title: **Proposed Rule Changes of Self-Regulatory Organizations**

Citation: 17 CFR 240.11Aa3-2 and 17 CFR 240.19b-4

Authority: 15 U.S.C. 78c, 78f, 78k-1, 78o-3, 78o-4, 78q-1, 78s(b), 78w(a), 78mm

Description: The Commission adopted rule amendments that require self-regulatory organizations (SROs) to file proposed rule changes electronically with the Commission, rather than in paper form. In addition, the Commission required SROs to post all proposed rule changes, as well as current and complete sets of their rules, on their Web sites. The Commission also required all participants in National Market System Plans (NMS Plans) to arrange for posting on a designated Web site a current and complete version of the NMS Plan.

Prior Commission Determination Under 5 U.S.C. 610: Pursuant to Section 605(b) of the Regulatory Flexibility Act, the Commission certified that amending Rule 19b-4 and Form 19b-4 would not have a significant economic impact on a substantial number of small businesses. This certification was incorporated in the proposing release, Release No. 49505 (March 30, 2004). As stated in the adopting release, Release No. 34-50486 (Oct.4, 2004), the Commission received no comments concerning the impact on small entities or the Regulatory Flexibility Act certification.

* * * * *

Title: **Disposal of Consumer Report Information**

Citation: 17 CFR 248.1; 17 CFR 248.2; 17 CFR 248.30

Authority: 15 U.S.C. 6801(b), 15 U.S.C. 1681w, 15 U.S.C. 78q, 78w, 78mm, 80a-30(a), 80a-37, 80b-4 and 80b-11

Description: The amendments to the rule under Regulation S-P require financial institutions to adopt policies and procedures to safeguard customer information. The amended rule implements the provision in section 216

of the Fair and Accurate Credit Transactions Act of 2003 requiring proper disposal of consumer report information and records. Section 216 directs the Commission and other federal agencies to adopt regulations requiring that any person who maintains or possesses consumer report information or any compilation of consumer report information derived from a consumer report for a business purpose must properly dispose of the information. The amendments also require the policies and procedures adopted under the safeguard rule to be in writing.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the Commission's adoption of Release No. 34-50781 (Dec. 2, 2004). The Commission considered comments received on the proposing release and the Initial Regulatory Flexibility Analysis prepared in Release No. 34-50361 (Sept. 14, 2004) at that time.

* * * * *

Title: **Issuer Restrictions or Prohibitions on Ownership by Securities Intermediaries**

Citation: 17 CFR 240.17Ad-20

Authority: 15 U.S.C. 78q-1(a)(1), 78q-1(a)(2), 78q-1(d), and 78w(a)

Description: The Commission adopted a new rule to prohibit registered transfer agents from effecting any transfer of any equity security registered under Section 12 or any equity security that subjects an issuer to reporting under Section 15(d) of the Exchange Act if such security is subject to any restriction or prohibition on transfer to or from a securities intermediary, such as clearing agencies, banks, or broker-dealers.

Prior Commission Determination Under 5 U.S.C. 610: A Final Regulatory Flexibility Analysis was prepared in accordance with 5 U.S.C. 604 in conjunction with the adoption of Release No. 34-50758A (December 7, 2004). The Commission solicited comment on the Initial Regulatory Flexibility Analysis prepared in the proposing release, Release No. 49809 (June 4, 2004), but received no comment on that analysis.

* * * * *

Title: **Asset-Backed Securities**

Citation: 17 CFR 210.1-02, 17 CFR 210-2.01, 17 CFR 210.2-02, 17 CFR 210.2-07, 17 CFR 229.10, 17 CFR 229.202, 17 CFR 229.308, 17 CFR 229.401, 17 CFR 229.406, 17 CFR 229.501, 17 CFR 229.503, 17 CFR 229.512, 17 CFR

229.601, 17 CFR 229.701, 17 CFR 229.1100 through 1123, 17 CFR 230.411, 17 CFR 230.434, 17 CFR 230.139a, 17 CFR 230.167, 17 CFR 230.190, 17 CFR 230.191, 17 CFR 230.426, 17 CFR 232.311, 17 CFR 232.312, 17 CFR 239.11, 17 CFR 239.12, 17 CFR 239.13, 17 CFR 239.18, 17 CFR 239.31, 17 CFR 239.32, 17 CFR 239.33, 17 CFR 240.10A-3, 17 CFR 240.12b-2, 17 CFR 240.12b-15, 17 CFR 240.12b-25, 17 CFR 240.13a-10, 17 CFR 240.13a-11, 17 CFR 240.13a-13, 17 CFR 240.13a-14, 17 CFR 240.13a-15, 17 CFR 240.13a-16, 17 CFR 240.15c2-8, 17 CFR 240.15d-10, 17 CFR 240.15d-11, 17 CFR 240.15d-13, 17 CFR 240.15d-14, 17 CFR 240.15d-15, 17 CFR 240.15d-16, 17 CFR 240.3a12-12, 17 CFR 240.3b-19, 17 CFR 240.13a-17, 17 CFR 240.13a-18, 17 CFR 240.15d-17, 17 CFR 240.15d-18, 17 CFR 240.15d-22, 17 CFR 240.15d-23, 17 CFR 242.100, 17 CFR 245.101, 17 CFR 249.220f, 17 CFR 249.240f, 17 CFR 249.308, 17 CFR 249.310, 17 CFR 249.312, and 17 CFR 249.322.

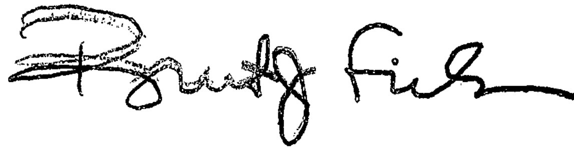
Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77q(a), 77s, 77s(a), 77sss(a), 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77jjj, 7nnn, 77sss, 78(b), 78c, 78c(b), 78g(c)(2), 78i(a), 78j, 78j-1, 78k-1(c), 78*l*, 78m, 78n, 78o, 78o(b), 78o(c), 78o(d), 78q, 78q(a), 78q(b), 78q(h), 78u-5, 78(w), 78w(a), 78dd-1, 78*ll*, 78*ll*(d), 78mm, 79e, 79e(b), 79f, 79f, 79j, 79j(a), 79*l*, 79m, 79n, 79q, 79t, 79t(a), 80a-8, 80a-20, 80a-23, 80a-24, 80a-26, 80a-29, 80a-30, 80a-31, 80a-37, 80a-37(a), 80b-3, 80b-11, 7201 et seq., 7202, 7262, and 18 U.S.C. 1350.

Description: The Commission adopted new and amended rules and forms to address comprehensively the registration, disclosure and reporting requirements for asset-backed securities under the Securities Act of 1933 and the Securities Exchange Act of 1934. The final rules and forms accomplish the following: update and clarify the Securities Act registration requirements for asset-backed securities offerings, including expanding the types of asset-backed securities that may be offered in delayed primary offerings on Form S-3; consolidate and codify existing interpretive positions that allow modified Exchange Act reporting that is more tailored and relevant to asset-backed securities; provide tailored disclosure guidance and requirements for Securities Act and Exchange Act filings involving asset-backed securities; and streamline and codify existing interpretive positions that permit the use of written communications in a registered offering of asset-backed securities in addition to the statutory registration statement prospectus.

Prior Commission Determination under 5 U.S.C. 610: Pursuant to Section 605(b) of the Regulatory Flexibility Act, the Commission certified that the new and amended rules and forms would not have a significant economic impact on a substantial number of small entities. This certification was incorporated into the proposing release, Release No. 33-8419 (May 3, 2004). As stated in the adopting release, Release No. 33-8518 (December 22, 2004) the Commission received no comments concerning the impact on small entities or the Regulatory Flexibility Act Certification.

By the Commission.

Dated: October 22, 2015



Brent J. Fields
Secretary

Commissioner Kwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76264 / October 26, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4243 / October 26, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16925

In the Matter of

NATIONAL ASSET MANAGEMENT, INC.,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against National Asset Management, Inc. ("NAM" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

Summary

These proceedings arise out of several disclosure and compliance-related violations during 2008 through 2012 by Commission-registered investment adviser National Asset Management, Inc. First, NAM failed to disclose to its advisory clients in writing or obtain their consent to over 21,000 securities trades executed in a principal capacity by NAM's affiliated broker-dealers. Second, NAM failed to report in its Commission filings and timely disclose to its clients the disciplinary histories of several of its associated persons. Third, NAM did not enforce its code of ethics when its CEO, several directors, and many of its employees failed to submit hundreds of required reports on their personal securities trading to NAM. Finally, NAM failed to adopt and implement compliance policies and procedures reasonably designed to prevent violations of certain provisions of the Advisers Act and the rules thereunder, and failed to conduct a required annual review of its compliance policies and procedures. NAM committed these failures while aware of the potential conflicts of interest its affiliated broker-dealers presented and its compliance responsibilities under the Advisers Act. Nevertheless, it failed to take reasonable steps to address these risks and responsibilities.

Respondent

1. National Asset Management, Inc. is a Washington corporation formed in 1994 and registered with the Commission as an investment adviser since 2005. Its principal place of business is in Seattle, Washington. As of May 2015, NAM had reported assets under management of approximately $1.3 billion and approximately 4,500 clients. NAM is a wholly owned subsidiary of a publicly traded parent company whose other subsidiaries include broker-dealers registered with the Commission. During the relevant period, certain individuals who were officers of the parent company also served as officers and/or directors of NAM and/or the broker-dealers, and the parent company controlled both NAM and the broker-dealers.

NAM Engaged in Thousands of Principal Trades Through its Affiliated Broker-Dealers Without Required Client Disclosure and Consent

2. Under Section 206(3) of the Advisers Act, it is unlawful for an investment adviser, directly or indirectly, "acting as principal for his own account, knowingly to sell any security to or purchase any security from a client . . . without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction." Section 206(3) applies where an investment adviser causes a client to enter into a transaction that is effected by a broker-dealer that controls, is controlled by, or is under common control with the investment adviser. Section 206(4) of the Advisers Act and Rule 206(4)-7(a) thereunder require investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules.

3. At all times during 2008 through 2012, NAM offered its clients several advisory programs. In certain of these programs (hereafter "the affiliated programs"), the introducing broker for the NAM clients was one of two broker-dealers ("BD-1" and "BD-2") that were wholly owned subsidiaries of NAM's parent company. NAM knew, as stated in its Form ADV, that BD-1 and BD-2 provided order execution services to the NAM clients in the affiliated programs and were capable of executing the clients' orders in a principal capacity. As of March 2012, approximately 55 percent of NAM's advisory assets under management were invested in the affiliated programs.

4. NAM was aware of both the potential conflicts of interest that principal transactions present and the fact that its affiliated broker-dealers provided order execution services for many of its clients. Nonetheless, NAM's compliance policies and procedures were not reasonably designed to prevent NAM's affiliated broker-dealers from selling or purchasing securities to or from NAM clients in violation of Section 206(3) of the Advisers Act.

5. In 2007, NAM made efforts to electronically route its client orders in a manner that ensured they were executed by an independent broker-dealer and not an affiliated broker-dealer. However, NAM never tested whether these efforts were effective.

6. In late 2008, BD-1 implemented a new electronic order management system it used to route orders for securities trades for execution. In addition to BD-1, BD-2 and two NAM directors (each also an officer of BD-1or BD-2) were aware of the implementation of BD-1's new system. However, no one at NAM, BD-1, or BD-2 took any steps to determine whether the new system would route NAM client orders such that NAM, through BD-1 or BD-2, would sell or purchase securities to or from its clients as a principal without prior written disclosure to and consent of the clients.

7. Consequently, after the new system was implemented in late 2008, and continuing through 2012, approximately 18,400 NAM client orders for equity securities trades were routed from BD-1 to BD-2 by the new system and then executed by BD-2 in a principal capacity. NAM did not disclose in writing to its clients that, through its affiliated broker-dealers, it would act as a principal for its own account in selling or purchasing the equity securities to or from the clients. Nor did it obtain consent from its clients to enter into these trades on a principal basis. BD-2 knew that it acted as a principal in executing the approximately 18,400 orders.

8. Also during late 2008 through 2012, NAM personnel periodically called or directly communicated by other means with the trading desks at BD-1 and BD-2 to submit NAM client orders for fixed income securities trades. BD-1 and BD-2 executed approximately 3,100 of these orders in a principal capacity. NAM did not disclose in writing to its clients that, through its affiliated broker-dealers, it would act as a principal for its own account in selling or purchasing the fixed income securities to or from the clients. Nor did it obtain consent from its clients to enter into these trades on a principal basis. BD-1 and BD-2 knew they acted as principal in executing the approximately 3,100 orders.

9. In early 2011, NAM implemented a trade review system that captured detailed information on each client securities trade. During 2011 and 2012, NAM required its supervisory staff to use the system to review and approve (if appropriate) all client trades on a daily basis. Although NAM knew that affiliated broker-dealers (BD-1 and BD-2) were providing order execution services for many NAM clients, the system it implemented lacked the capacity to identify or flag principal transactions.

10. Throughout the relevant period, NAM's compliance manual had no policies or procedures addressing principal transactions.

11. In late 2012, Commission staff conducting an examination of NAM notified NAM that they had discovered possible principal trades. After this notification, NAM identified to the examination staff the 21,500 principal trades in equity and fixed income securities described above. Thereafter, NAM reimbursed clients whose orders were executed on a principal basis without disclosure and consent approximately $385,000.

NAM Failed to Report and Disclose to Clients the Disciplinary History of Several of its Investment Adviser Representatives

12. Registered investment advisers are required to file Form ADV Part 1A with the Commission and maintain its accuracy through annual updates and other amendments. Among other things, Part 1A must report certain disciplinary actions taken against the adviser or its employees. During 2008 through 2012, NAM filed Part 1A amendments which omitted 19 disciplinary actions that were required to be reported. These actions ranged from a ten-day suspension and $2,500 fine imposed by FINRA against an investment adviser representative for conducting an outside business activity without prompt notice to his previous employer, to the indictment of an investment adviser representative for securities fraud committed at a previous employer.

13. As amended in 2010, Advisers Act Rule 204-3 requires registered investment advisers to provide clients and prospective clients with Form ADV Part 2B, also called the brochure supplement. Among other things, the brochure supplement discloses to each client certain disciplinary history, if any, of the investment adviser representative who advises that client. The deadline for NAM to deliver its first brochure supplements under the 2010 amendment was in February 2012. At that time, NAM had at least eight disciplinary events required to be disclosed in brochure supplements. NAM failed to deliver its brochure supplements to clients until January 2013, approximately eleven months late, and after the Commission's examination staff notified NAM it was not in compliance.

NAM Failed to Enforce Part of its Code of Ethics

14. Section 204A of the Advisers Act and Rule 204A-1 thereunder require registered investment advisers to establish, maintain, and enforce a written code of ethics. In part, the code of ethics must require the adviser's "access persons" (as defined in Rule 204A-1) to periodically

report their personal securities transactions to the adviser's chief compliance officer (or other designee). During 2008 through 2012, NAM's code of ethics required its access persons to submit reports each quarter identifying their personal securities transactions, or stating they had no transactions that quarter. During the same period, NAM failed to enforce its code of ethics because many of its access persons, including its CEO and several directors, failed to submit over 500 required quarterly reports.

NAM Failed to Conduct an Annual Compliance Review

15. Section 206(4) of the Advisers Act and Rule 206(4)-7(b) thereunder require registered investment advisers to review the adequacy and effectiveness of their compliance policies and procedures at least annually. For 2012, NAM failed to conduct the required review.

Violations

16. As a result of the conduct described above, NAM willfully[1] violated Section 206(3) of the Advisers Act.

17. As a result of the conduct described above, NAM willfully violated Section 207 of the Advisers Act, which makes it "unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission . . . or willfully to omit to state in any such application or report any material fact which is required to be stated therein."

18. As a result of the conduct described above, NAM willfully violated Section 204 of the Advisers Act and Rules 204-1 and 204-3 thereunder, which require registered investment advisers to amend Form ADV as prescribed by the Commission and timely deliver to clients and prospective clients brochure supplements that contain all information required by Part 2 of Form ADV.

19. As a result of the conduct described above, NAM willfully violated Section 204A of the Advisers Act and Rule 204A-1 thereunder, which require registered investment advisers to establish, maintain, and enforce a written code of ethics with provisions requiring that the adviser's access persons report, and that the adviser review, their personal securities transactions and holdings periodically.

20. As a result of the conduct described above, NAM willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7(a) and (b) thereunder, which require registered investment advisers to (i) adopt and implement written policies and procedures reasonably designed to prevent violation, by the adviser and its supervised persons, of the Advisers Act and

[1] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

rules thereunder, and (ii) review, no less frequently than annually, the adequacy of the policies and procedures and effectiveness of their implementation.

NAM's Remedial Efforts

21. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by NAM and cooperation afforded the Commission staff.

Undertakings

NAM has undertaken as follows:

22. Independent Compliance Consultant.

a. Within 30 days of the entry of this Order, NAM shall retain at its expense an Independent Compliance Consultant ("ICC") not unacceptable to the staff of the Commission;

b. NAM shall require the ICC to conduct a comprehensive review of NAM's policies and procedures with respect to (i) compliance with Section 206(3) of the Advisers Act; (ii) accuracy and completeness of disclosure and reporting in Forms ADV and timely distribution of Form ADV disclosures to clients; (iii) enforcement of code of ethics provisions on reporting of personal securities transactions; and (iv) ensuring completion of annual compliance reviews pursuant to Rule 206(4)-7(b);

c. NAM shall provide to the Commission staff, within thirty (30) days of retaining the ICC, a copy of an engagement letter detailing the ICC's responsibilities, which shall include the review described above in Paragraph 22.b;

d. NAM shall cooperate fully with the ICC and provide the ICC with access to any of NAM's files, books, records and personnel as are reasonably requested;

e. NAM shall require the ICC to complete his/her/its review and submit a written report ("Report") to NAM and the Commission staff within one hundred twenty (120) days of the entry of this Order. NAM shall require that the Report include a description of the review performed by the ICC, the conclusions reached, the ICC's recommendations for any changes in or improvements to NAM's policies and procedures, and a plan for implementing any such recommended changes or improvements;

f. Within ninety (90) days of receipt of the Report, NAM shall adopt and implement all recommendations contained in the Report; provided, however, that as to any recommendation that NAM considers to be, in whole or in part, unduly burdensome or impractical, NAM may submit in writing to the ICC and Commission staff, within thirty (30) days of receiving the Report, an alternative policy, practice, or procedure designed to achieve the same objective or purpose. Within forty-five (45) days of receiving the Report, NAM

and the ICC shall attempt in good faith to reach an agreement relating to each recommendation that NAM considers to be unduly burdensome or impractical. Within fifteen (15) days after the discussion and evaluation by NAM and the ICC, NAM shall require that the ICC inform NAM and the Commission staff of the ICC's final determination concerning any recommendation that NAM considers unduly burdensome or impractical, and NAM shall abide by the determinations of the ICC and adopt and implement all recommendations within the 90-day time period set forth in this paragraph;

g. Within fourteen (14) days of NAM's adoption of all of the recommendations that the ICC deems appropriate, NAM shall certify in writing to the ICC and Commission staff that NAM has adopted and implemented all of the ICC's recommendations;

h. To ensure the independence of the ICC, NAM shall not have the authority to terminate the ICC without prior written approval of Commission staff; NAM shall compensate the ICC and persons engaged to assist the ICC for services rendered pursuant to this Order at their reasonable and customary rates; and NAM shall not be in and shall not have an attorney-client relationship with the ICC and shall not invoke the attorney-client or any other doctrine or privilege to prevent the ICC from communicating with or transmitting any information, reports, or documents concerning the ICC's review of NAM to the Commission staff;

i. NAM shall require the ICC to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the ICC shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with NAM, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the ICC will require that any firm with which he/she/it is affiliated or of which he/she/it is a member, and any person engaged to assist the ICC in performance of his/her/its duties under this Order shall not, without prior written consent of the staff of the Commission, enter into any employment, consultant, attorney-client, auditing or other professional relationship with NAM, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement; and

j. NAM shall preserve for a period of not less than six (6) years from the date of this Order, the first two (2) years in an easily accessible place, any record of NAM's compliance with the undertakings set forth in this paragraph.

23. Cooperation of affiliates with ICC. NAM shall use its best efforts to cause its parent company and the parent company's other subsidiaries to provide such cooperation as may be reasonably needed to facilitate the ICC's performance of his/her/its duties.

24. Annual reports regarding principal trades. For three years, NAM shall submit to the staff of the Commission an annual written report assessing the effectiveness of NAM's policies and procedures on preventing violations of Section 206(3) of the Advisers Act. The first

report shall be due one year after NAM implements the ICC's recommendations pursuant to Paragraph 22.f above; the second report shall be due two years after the implementation; and the third report shall be due three years after the implementation.

25. Order Notification. Within ten (10) days of the entry of this Order, NAM shall post prominently on the homepage of NAM's website a summary of this Order in a form and location not unacceptable to the Commission staff, with a hyperlink to the entire Order. NAM shall maintain the posting and hyperlink on NAM's website for twelve (12) months from the entry of this Order. Within thirty (30) days of the date of the entry of this Order, NAM shall provide a copy of the Order to each of NAM's existing advisory clients as of date the entry of this Order via mail, email, or such other method as may be not unacceptable to the Commission staff, together with a cover letter in a form not unacceptable to the Commission staff. Furthermore, for twelve (12) months from the entry of this Order, to the extent that NAM is required to deliver a brochure to a client and/or prospective client pursuant to Rule 204-3 under the Advisers Act, NAM shall also provide a copy of this Order to such client and/or prospective client at the same time that NAM delivers the brochure.

26. Certification of Compliance. NAM shall certify, in writing, compliance with the undertaking(s) set forth above. The certification shall identify the undertaking(s), provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and NAM agrees to provide such evidence. The certification and supporting material shall be submitted to Tracy L. Davis, Assistant Regional Director in the Commission's San Francisco Regional Office, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

27. Deadlines. For good cause shown, Commission staff may extend any of the procedural deadlines relating to the undertakings. Deadlines shall be determined based on calendar days (rather than business days), except that if the last day falls on a weekend or federal holiday, the next business day shall be considered the last day.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest to impose the sanctions agreed to in NAM's Offer.

Accordingly, pursuant to Section 15(b)(6) of the Exchange Act and Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. NAM cease and desist from committing or causing any violations and any future violations of Sections 204, 204A, 206(3), 206(4), and 207 of the Advisers Act and Rules 204-1, 204-3, 204A-1, and 206(4)-7 promulgated thereunder.

B. NAM is censured.

C. NAM shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $200,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) NAM may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) NAM may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) NAM may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying National Asset Management, Inc. as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Erin L. Schneider, Associate Regional Director, Securities and Exchange Commission, 44 Montgomery Street, Suite 2800, San Francisco, CA 94104.

D. NAM shall comply with the undertakings enumerated in Paragraphs III.22 through III.27 above.

By the Commission.

Brent J. Fields
Secretary

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76261 / October 26, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16922

In the Matter of

DBRS, Inc.

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15E(d) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15E(d) and 21C of the Securities Exchange Act of 1934 (the "Exchange Act") against DBRS, Inc. ("DBRS" or "Respondent").

II.

In anticipation of the institution of these proceedings, DBRS has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, DBRS consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 15E(d) and 21C of the Exchange Act, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and DBRS's Offer, the Commission finds[1] that:

SUMMARY

1. DBRS is a nationally recognized statistical rating organization ("NRSRO") that provides initial credit ratings and conducts ratings surveillance of, among other securities, U.S. residential mortgage backed securities ("RMBS") and re-securitized real estate mortgage investment conduits ("Re-REMICs"). DBRS filed with the Commission annual certifications of its NRSRO application which stated, in part, that the firm would update its rating methodologies as necessary, and publicly disclose certain changes.

2. DBRS represented in its published April 2009 U.S. RMBS Surveillance Methodology ("2009 Surveillance Methodology") that DBRS would monitor each of its outstanding RMBS and Re-REMIC credit ratings by conducting a three-step quantitative analysis that utilized certain assumptions concerning the performance of the collateral for those securities. DBRS represented that "[a]s part of the surveillance process, each outstanding rating is reviewed by a rating committee on a monthly basis or more frequently, as circumstances warrant."[2] The 2009 Surveillance Methodology further represented that certain of the assumptions DBRS used to surveil its RMBS and Re-REMIC ratings would be updated to reflect market trends and that any changes to the assumptions would be disclosed on the firm's website before they were used.

3. DBRS's actual surveillance of its outstanding RMBS and Re-REMIC ratings materially differed from the process described in the 2009 Surveillance Methodology. First, DBRS did not perform all three steps of the disclosed quantitative analysis monthly. For RMBS transactions, DBRS performed only the first step, reviewing monthly remittance or performance data to identify underperforming loan pools, on a monthly basis. DBRS reviewed Re-REMIC transactions far less frequently due to their complexity and DBRS's lack of surveillance resources necessary to analyze Re-REMIC performance. DBRS performed the second and third steps of the quantitative analysis—deriving expected losses and running cash flow analyses—only when a surveillance rating committee would be convened, which was not monthly. DBRS did not have adequate staffing and technological resources to conduct monthly the second and third surveillance steps for each outstanding rating as called for in the surveillance methodology.

4. DBRS did not present each outstanding RMBS and Re-REMIC rating to a surveillance committee on a monthly basis as represented in the methodology. When DBRS convened a surveillance committee, it only reviewed a limited subset of all of DBRS's RMBS and Re-REMIC ratings outstanding at the time, not all ratings as described in the 2009 methodology.

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[1] The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

[2] DBRS convenes rating committees to determine ratings on newly issued securities as well as to monitor the firm's outstanding ratings on those securities. A committee convened to review outstanding ratings is referred to herein as a "surveillance committee."

5. A few months after it published the 2009 Surveillance Methodology, DBRS updated many of the loss severity assumptions, which were DBRS's estimates of the severity of loss in the event of borrowers defaulting on the mortgage loans that served as the collateral for the RMBS and Re-REMIC securities. DBRS made the loss severity assumptions more conservative to reflect the deterioration of the housing market at the time. Some of the changes to the loss severity assumptions resulted in material changes to certain ratings implied by DBRS's quantitative analysis. DBRS did not disclose publicly, as it represented in the methodology, the material updates to its surveillance assumptions until January 2011, after Staff from the SEC's Office of Compliance Inspections and Examinations raised the lack of disclosure of those updates with the firm.

6. DBRS did not amend its NRSRO application promptly to disclose that it had materially updated the loss severity assumptions that it used for surveillance. It also did not disclose that it did not surveil monthly its RMBS and Re-REMIC ratings as represented in its 2009 Surveillance Methodology.

7. In its 2010, 2011, and 2012 NRSRO Annual Certifications (the "Annual Certifications"), DBRS generally described its ratings and surveillance methodologies and referred the public to the methodologies posted on its website for a more detailed description of the initial ratings and surveillance processes. DBRS, in describing its U.S. RMBS surveillance methodology, did not disclose that it did not surveil its outstanding RMBS and Re-REMIC ratings according to the 2009 Surveillance Methodology and that it had materially updated the loss severity assumptions used in the 2009 Surveillance Methodology.

8. DBRS did not maintain adequate financial and managerial resources to surveil its outstanding RMBS and Re-REMIC ratings according to its 2009 Surveillance Methodology.

9. Lastly, in July and August 2010, DBRS downgraded 1,413 RMBS ratings, but did not make and retain a record of the rationale for material differences between ratings implied by the firm's quantitative model and the rating issued for 147 of those ratings downgrades.

RESPONDENT

10. DBRS, Inc. is a Delaware corporation headquartered in New York, New York and has been registered with the Commission as an NRSRO since 2007.

FACTS

11. DBRS publishes methodologies that describe the process by which it conducts surveillance of its outstanding U.S. RMBS ratings. In August 2008, DBRS published its U.S. RMBS Surveillance Methodology ("2008 Surveillance Methodology" and collectively with the 2009 Surveillance Methodology, the "2008 and 2009 Surveillance Methodologies"). In April 2009, DBRS revised that methodology and announced the updated 2009 Surveillance Methodology in a press release and posted it on the firm's website. DBRS management helped

draft and review the 2008 and 2009 Surveillance Methodologies and also approved the use and publication of the methodologies.

12. DBRS represented in the 2009 Surveillance Methodology that "each outstanding rating is reviewed by a rating committee on a monthly basis or more frequently, as circumstances warrant." That language, however, did not accurately reflect DBRS's surveillance practices.

13. The 2009 Surveillance Methodology represented that analysts would surveil each of DBRS's outstanding RMBS and Re-REMIC ratings by following a three-step quantitative analysis that utilized certain performance assumptions. The 2009 Surveillance Methodology represented that the quantitative analysis for each of the firm's RMBS and Re-REMIC ratings would then be reviewed by a surveillance committee monthly, or more frequently if circumstances warranted. The surveillance process also encompassed a review of qualitative factors.

14. The 2009 Surveillance Methodology further stated that certain of the assumptions that DBRS used to surveil its RMBS and Re-REMIC ratings would be updated to reflect market trends and that any changes to the assumptions would be disclosed on the firm's website prior to implementation.

15. While the 2009 Surveillance Methodology was in effect, DBRS did not surveil its outstanding RMBS and Re-REMIC ratings according to that methodology. DBRS did not apply the three-step quantitative process to each outstanding RMBS and Re-REMIC rating on a monthly basis, as represented.

16. Between April 2009 and February 2011, DBRS employed only one analyst who was principally responsible for the majority of surveillance tasks for the firm's outstanding RMBS and Re-REMIC ratings, which numbered over 5,000. For most of DBRS's outstanding RMBS ratings, the surveillance analyst reviewed the RMBS pool performance information monthly. While the analyst flagged under-performing RMBS pools for further review, the additional analytical steps were not completed until the analyst's supervisors decided to convene a surveillance committee, which in many cases was months later.

17. The DBRS surveillance analyst did not perform an analysis of the individually-rated RMBS tranches within the pools on a monthly basis. Such an analysis required DBRS to run cash flows on the individually-rated tranches. The cash flows were prepared only for the surveillance committee meetings, which did not occur monthly. From April 13, 2009, when DBRS published the 2009 Surveillance Methodology, until January 26, 2012, DBRS convened ten surveillance committee meetings to review outstanding RMBS and Re-REMIC ratings.

18. DBRS did not monitor the performance of Re-REMICs on a monthly basis due to the lack of adequate staffing and technological resources at DBRS to surveil them. The DBRS surveillance analyst tasked with surveilling outstanding Re-REMIC ratings lacked the experience and expertise necessary to adequately do so and the firm did not have in place computer systems to help with Re-REMIC surveillance. Thus, the DBRS surveillance analyst only surveilled Re-REMIC ratings when his/her supervisors or personnel from DBRS's rating group suggested that he/she monitor certain vintages and types.

19. From April 2009 to February 2011, when DBRS's surveillance analyst left the firm, he/she was unable to complete the entire three-step surveillance process for each of the firm's outstanding RMBS and Re-REMIC ratings each month. The analyst regularly raised his/her concerns about the lack of sufficient resources to conduct adequate surveillance with his/her supervisor. The supervisor, in turn, conveyed those concerns to the firm's senior management which did not initially authorize the hiring of additional personnel for RMBS and Re-REMIC surveillance.

20. As early as February 2011, DBRS's executive committee was made aware that DBRS was not surveilling its outstanding RMBS and Re-REMIC ratings according to its 2009 Surveillance Methodology. However, DBRS did not publicly disclose to investors at that time that it was not surveilling its outstanding ratings according to that methodology, which was in effect until January 2012, when DBRS published a new surveillance methodology;[3] nor did DBRS take action to surveil each outstanding RMBS and Re-REMIC rating according to the 2009 Surveillance Methodology.

21. On a monthly basis, DBRS published a Performance Analytic Report ("PAR") that contained the monthly remittance information for the collateral pools of the RMBS within which DBRS rated certain tranches. Until May 2010, the PAR reproduced DBRS's current credit rating for tranches within those RMBS that the firm rated. Based on the 2009 Surveillance Methodology and the monthly PARs (until May 2010), investors could reasonably have believed that DBRS had conducted the monthly surveillance as represented in the methodology, and that the ratings indicated in the PAR were the result of that analysis and a review by a surveillance committee. However, the PARs that contained ratings only restated DBRS's outstanding ratings, which were the result of the initial rating or a surveillance committee decision at some point in the past, not the product of a monthly surveillance committee review as described in the 2009 Surveillance Methodology.

22. In July 2009, DBRS updated almost all of the loss severity assumptions for the mortgage pool types and vintages that served as collateral for the RMBS and Re-REMIC securities the firm rated. Some of the loss severity assumptions changes had a material impact on a significant number of the cash flow results for RMBS tranches that DBRS rated. The following is a chart showing the loss severity assumptions published in the April 2009 Surveillance Methodology and DBRS's July 2009 updates to those assumptions:

[3] In January 2012, DBRS published a new surveillance methodology. That methodology stated, in part, that DBRS would present outstanding RMBS and Re-REMIC ratings to a surveillance committee at least annually.

	DBRS Loss Severity Assumptions											
	April 2009						July 2009					
Vintage	Sub-prime	Alt-A	Prime	HELOC	Option ARM	Second Lien	Sub-prime	Alt-A	Prime	HELOC	Option ARM	Second Lien
2008	55%	50%	45%	100%	65%	100%	70%	55%	50%	100%	60%	100%
2007	60%	55%	50%	100%	70%	100%	75%	60%	55%	100%	65%	100%
2006	55%	50%	45%	100%	65%	100%	75%	60%	50%	100%	65%	100%
2005	45%	45%	35%	100%	55%	100%	70%	55%	45%	100%	60%	100%
2004	45%	45%	30%	100%	55%	100%	65%	55%	45%	100%	55%	100%
2003 & earlier	40%	40%	25%	100%	50%	100%	60%	50%	40%	100%	55%	100%
<=2002	40%	40%	25%	100%	50%	100%	55%	45%	35%	100%	55%	100%
Second Lien	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

23. Despite the representation contained in the 2009 Surveillance Methodology that any "updates to assumptions will be disclosed on the DBRS website prior to implementation," DBRS did not disclose the loss severity assumption updates because the surveillance group was not familiar with the aforementioned representation in that methodology. Further, DBRS's compliance department did not review the firm's Surveillance Methodology to determine whether the firm was adhering to that methodology.

24. The 2009 instructions to Form NRSRO stated that "An Applicant/NRSRO may provide in Exhibit 2 the location on its Web site where additional information about the procedures and methodologies is located." Pursuant to those instructions, DBRS stated at least four times in the Exhibits 2 to the Annual Certifications that its methodologies were located on its website.

25. In the Exhibits 2 to the Annual Certifications, DBRS also represented that its methodologies were reviewed and updated, as necessary, on a regular basis. DBRS further represented that it would advise the public of certain changes to its methodologies. DBRS made that representation in the Annual Certifications even though it had already materially changed the 2009 Surveillance Methodology when it updated the loss severity assumptions in July 2009 and even though it did not conduct monthly surveillance committee meetings as described in that methodology.

26. DBRS also did not state in its Annual Certifications that it did not conduct surveillance of its outstanding RMBS and Re-REMIC ratings in accordance with the 2009 Surveillance Methodology and that it had updated the loss severity assumptions, and, therefore, the 2009 Surveillance Methodology that it posted on its website was materially inaccurate.

27. DBRS's quantitative model was a substantial component of its rating process. In July and August 2010, DBRS downgraded 1,413 RMBS ratings and 147 of those ratings were materially different from the ratings implied by DBRS's quantitative model. However, DBRS did not make and retain a record of the rationale for the material differences between the credit rating implied by DBRS's quantitative model and the final credit rating issued.

VIOLATIONS

28. Section 15E(d) of the Exchange Act provides that the Commission shall, by order, censure, place limitations on, suspend, or revoke the registration of any NRSRO if the Commission finds that such action is necessary for the protection of investors and in the public interest and that the NRSRO has, among other things, "fail[ed] to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity" (Section 15E(d)(1)(E)).

29. Pursuant to Sections 15E(a)(1)(A) and (a)(1)(B)(ii) of the Exchange Act, a credit rating agency that elects to be treated as an NRSRO "shall furnish to the Commission an application for registration, in such form as the Commission shall require" containing among other information, "the procedures and methodologies that [the NRSRO] uses in determining credit ratings."

30. By failing to amend its application, DBRS violated Section 15E(b)(1) of the Exchange Act and Rule 17g-1(e) thereunder, which require NRSROs to promptly amend such application "if any information or document provided therein becomes materially inaccurate."

31. By making material misstatements and omissions in its Annual Certifications, DBRS violated Section 15E(b)(2) of the Exchange Act and Rule 17g-1(f) thereunder, which require NRSROs, "not later than 90 days after the end of each calendar year," to file with the Commission an amendment to its registration "certifying that the information and documents in the application for registration ... continue to be accurate" and list "any material change that occurred to such information or documents during the previous calendar year."

32. As a result of the conduct described above, DBRS violated Section 15E(c)(3)(A) of the Exchange Act, which requires NRSROs to "establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings."

33. As a result of the conduct described above, DBRS violated Section 15E(d)(1)(E) of the Exchange Act by failing to "maintain adequate financial and managerial resources to consistently produce credit ratings with integrity."

34. As a result of the conduct described above, DBRS violated Section 17(a) of the Exchange Act and Rule 17g-2(a)(2)(iii) thereunder, which require NRSROs to make and retain "a record of the rationale for any material difference between the credit rating implied by" a quantitative model and the final credit rating issued for ratings of a security or money market instrument issued by an asset pool or as part of any asset-backed securities transaction, if the model was a substantial component in the process for determining the credit rating.

UNDERTAKINGS

DBRS has undertaken to:

35. DBRS, within thirty (30) days after the entry of this Order, will retain the services of an independent consultant (the "Independent Consultant") that is not unacceptable to the staff of the U.S. Securities and Exchange Commission's Division of Enforcement and Office of Credit Ratings ("Staff"). The Independent Consultant's compensation and expenses shall be borne exclusively by DBRS. Before DBRS retains the Independent Consultant, it will provide to the Staff a copy of the engagement letter detailing the Independent Consultant's responsibilities, which shall include the audit and reviews that the Independent Consultant shall make as described in this Order, together with an opportunity for the Staff to review the engagement letter and provide comments.

36. DBRS shall require that the Independent Consultant perform the following duties: (1) complete an audit of DBRS's U.S. RMBS[4] and U.S. asset-backed securities ("ABS") rating methodologies and models that the Staff will identify to DBRS and the Independent Consultant (these methodologies and models referenced are collectively referred to herein as the "Audit Sample"), to determine whether the firm is issuing and surveilling ratings in accordance with the current versions of those methodologies and models, except that, with regard to the U.S. RMBS rating methodologies and models, the audit shall include all versions of the methodologies and models in effect on January 1, 2013 or subsequently; and (2) conduct a review and make recommendations to DBRS concerning the findings of the Independent Consultant's audit and (i) the firm's internal controls with respect to the approval and publication of rating methodologies, including surveillance and models, as well as adherence to those methodologies and models; (ii) its staffing levels with respect to U.S. RMBS and U.S. ABS; (iii) its documentation of its rating activities including the development and revision of methodologies and models for U.S. RMBS ratings and surveillance; (iv) its document retention policy and practices; and (v) its compliance program.

37. DBRS shall require the Independent Consultant, within one hundred eighty (180) days after the entry of this Order, to submit a written and dated report of its findings (the "Report") to DBRS's board of directors and senior management and the Staff. DBRS shall require that the Report include a description of the review performed, the names of the individuals who performed the review, the results of the audit of the Audit Sample, as well as the Independent Consultant's conclusions and recommendations concerning (i) the firm's internal controls with respect to the approval and publication of rating methodologies, including surveillance and models, as well as adherence to those methodologies and models; (ii) its staffing levels with respect to U.S. RMBS and U.S. ABS; (iii) its documentation of its rating activities including the development and revision of methodologies and models for U.S. RMBS ratings and surveillance; (iv) its document retention policy and practices; and (v) its compliance program. DBRS shall have a reasonable opportunity to comment on the Independent Consultant's review and proposed report prior to its submission to the Staff, including a reasonable opportunity to comment on any and all conclusions

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[4] "RMBS" as used in these Undertakings includes both RMBS and Re-REMICs.

and recommendations. In addition, DBRS may request that the Independent Consultant seek confidential treatment from the Commission to the extent that the report concerns proprietary commercial and financial information of DBRS.

38. DBRS shall adopt all recommendations contained in the Report within sixty (60) days of the date of the Report; provided, however, that within forty-five (45) days after the date of the Report, DBRS shall in writing advise the Independent Consultant and the Staff of any recommendations that it considers to be unduly burdensome, impractical, or inappropriate ("Disputed Recommendations"). DBRS need not adopt any Disputed Recommendations at that time but shall propose in writing to the Independent Consultant, with a copy sent to the Staff, an alternative policy, procedure, or system designed to achieve the same objective or purpose.

39. DBRS and the Independent Consultant shall attempt in good faith to reach an agreement with respect to any Disputed Recommendations within sixty (60) days after the date of the Report. Within fifteen (15) days after the conclusion of the discussion and evaluation between DBRS and the Independent Consultant, the Independent Consultant shall inform DBRS and the Staff in writing of the Independent Consultant's final determination concerning any Disputed Recommendations. Unless otherwise agreed with the Staff, DBRS shall abide by the determinations of the Independent Consultant, and the final agreement between DBRS and the Independent Consultant or final determination of the Independent Consultant concerning such Disputed Recommendations shall be documented in a Supplemental Report. Within sixty (60) days after final agreement between DBRS and the Independent Consultant or final determination of the Independent Consultant (in each case as to all Disputed Recommendations), whichever occurs first, unless otherwise agreed with the Staff, DBRS shall adopt and implement all of the recommendations in the Supplemental Report that the Independent Consultant deems appropriate.

40. Within sixty (60) days of DBRS's adoption of all of the recommendations in the Report and the Supplemental Report that the Independent Consultant deems appropriate, as determined pursuant to the procedures set forth herein, DBRS shall certify in writing to the Independent Consultant and the Staff that it has adopted and implemented all of the Independent Consultant's recommendations in the Report and the Supplemental Report. This certification(s) from DBRS to the Staff shall be made under penalty of perjury. Within fourteen (14) days after DBRS submits its certification to the Independent Consultant and the Staff, the Independent Consultant shall begin conducting a review as it deems appropriate to verify that DBRS has appropriately implemented the recommendations in the Report and the Supplemental Report. The Independent Consultant shall, within forty-five (45) days after DBRS submits it certification to the Independent Consultant and the Staff, confirm to the Staff that DBRS has adopted and implemented all of the Independent Consultant's recommendations in the Report and the Supplemental Report. Unless otherwise directed by the Staff, all Reports and Supplemental Reports, certifications, and other documents required to be provided to the Staff shall be sent to Rita Bolger, Assistant Director, Office of Credit Ratings, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY 10281-1022, and Gerald W. Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6561-A, or such other address as the Staff may provide.

41. DBRS shall cooperate fully with the Independent Consultant and shall provide the Independent Consultant with access to such of its files, books, records, and personnel as are reasonably requested by the Independent Consultant for review.

42. DBRS shall require the Independent Consultant to enter into an agreement that provides for the period of engagement and for a period of two (2) years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with DBRS, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which the Independent Consultant is affiliated or of which the Independent Consultant is a member, and any person engaged to assist the Independent Consultant in the performance of the Independent Consultant's duties under this Order shall not, without prior written consent of the Staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with DBRS, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two (2) years after the engagements.

43. To ensure the independence of the Independent Consultant, DBRS: (1) shall not have the authority to terminate the Independent Consultant or substitute another independent consultant for the initial Independent Consultant without the prior written approval of the Staff; and (2) shall compensate the Independent Consultant and persons engaged to assist the Independent Consultant for services rendered pursuant to this Order at their reasonable and customary rates.

44. Within 180 days of the entry of this Order, or as otherwise agreed to with the Commission's Office of Credit Ratings, DBRS shall adopt, implement, maintain and document policies, procedures, practices and internal controls that address the recommendations and issues identified in the September 10, 2014 summary letter concerning the completed 2014 Section 15E Examination of DBRS conducted by the Commission's Office of Credit Ratings ("2014 DBRS Exam").

45. DBRS shall submit a report, approved and signed under penalty of perjury by the President and the Designated Compliance Officer of DBRS, to Rita Bolger, Assistant Director, Office of Credit Ratings, Securities and Exchange Commission, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY 10281-1022, and Gerald W. Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Mailstop 6561-A, Washington, DC 20549, which details the new policies, procedures, practices, and internal controls adopted, and the actions taken to implement, maintain, and document the new policies, procedures, practices, and internal controls that address the recommendations and issues identified in the 2014 Exam no later than sixty (60) days after the completion of the undertakings described in paragraph forty-four (44) above. The Staff may make reasonable requests for further evidence of compliance and DBRS agrees to provide such evidence.

46. DBRS shall preserve for a period of not less than six (6) years from the end of the fiscal year last used, the first two years in an easily accessible place, any record of its compliance with the undertakings set forth herein.

47. For good cause shown, the Staff may extend any of the procedural dates relating to the undertakings. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, and for the protection of investors to impose the sanctions agreed to in DBRS's Offer.

Accordingly, pursuant to Sections 15E(d) and 21C of the Exchange Act, it is hereby ORDERED that:

A. DBRS cease and desist from committing or causing any violations and any future violations of Sections 15E(b)(1), 15E(b)(2), 15E(c)(3)(A), 15E(d)(1)(E), and 17(a) of the Exchange Act and Exchange Act Rules 17g-1(e), 17g-1(f), and 17g-2(a)(2)(iii) thereunder.

B. DBRS is hereby censured.

C. DBRS shall, within 30 days of the entry of this Order, pay disgorgement which represents profits gained as a result of the conduct described herein of $2,742,000 and prejudgment interest of $147,482, and a civil money penalty in the amount of $2,925,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and/or 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying DBRS as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Gerald W. Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-6561-A.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

E. Respondent shall comply with the undertakings enumerated in paragraphs 35-47 above.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar Not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9967 / October 27, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76275 / October 27, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3716 / October 27, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16927

In the Matter of **THE ST. JOE COMPANY,** **Wm. BRITTON GREENE,** **WILLIAM S. McCALMONT,** **JANNA L. CONNOLLY, CPA,** **J. BRIAN SALTER, CPA, and** **PHILLIP B. JONES, CPA,** **Respondents.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS, CEASE-AND-DESIST ORDERS AND PENALTIES**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against The St. Joe Company, Wm. Britton Greene, William S. McCalmont, Janna L. Connolly, CPA, J. Brian Salter, CPA, and Phillip B. Jones, CPA (collectively,

11 of 21

"Respondents"), and additionally as to McCalmont, Connolly, Salter and Jones, pursuant to Exchange Act Section 4C[1] and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.[2]

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement ("Offers"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, and except as provided in Section V. herein, Respondents consent to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Sections 4C and 21C of the Securities Exchange Act of 1934, and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions, Cease-and-Desist Orders and Penalties ("Order"), as set forth below.

II.

On the basis of this Order and Respondents' Offers, the Commission finds[3] that:

A. Overview

The St. Joe Company, an NYSE-listed real estate developer, timberland owner, and resort operator, its former senior management, and others, committed or caused violations of the federal securities laws, resulting in materially overstated earnings and assets during 2009 and 2010.[4] The underlying improper conduct comprised, *first*, failing in two respects to comply with Generally Accepted Accounting Principles ("GAAP") in the impairment testing of the Company's real estate development assets; *second*, after discovering the broader of the aforementioned GAAP lapses in October 2010, (i) failing to identify or correct any resulting errors in prior-period financial statements and (ii) improperly using assumptions based on conditions not existing as of the quarter ended

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[1] Section 4C provides, in relevant part, that:

The Commission may ... deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

[2] Rule 102(e)(1)(iii) provides, in pertinent part, that:

The Commission may ... deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

[3] The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

[4] These violations stemmed from the Company's historical accounting and disclosure practices relating to its valuation and impairment of real estate development assets which occurred prior to the 2011 replacement of the Company's Board of Directors and resignation of the Chief Executive Officer, Chief Financial Officer, and Chief Accounting Officer.

September 30, 2010 in conducting that quarter's impairment testing for certain real estate developments; *third*, applying an unreasonable sales price assumption to undeveloped beachfront land in one of the Company's largest real estate developments in the fourth quarter of 2010; and *fourth*, failing to specifically disclose, in its 2010 Form 10-K, that the Company had decided not to proceed with the material development and planning of two of its largest real estate developments, and had instead determined to bulk-sell the related undeveloped land in the future. In the course of the foregoing, and by their respective acts and omissions detailed below, the Respondents committed or caused various respective violations of the antifraud, internal controls, books-and-records, periodic reporting and other provisions of the federal securities laws.

B. Respondents

The St. Joe Company ("St. Joe" or "the Company") is a Florida corporation headquartered in WaterSound, Florida. The Company is a residential and commercial real estate developer, rural and timberland owner, and resort operator. St. Joe's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange act and listed on the New York Stock Exchange ("NYSE") under the ticker symbol "JOE." At all relevant times, St. Joe's fiscal year coincided with the calendar year.

Wm. Britton Greene ("Greene"), age 61, resides in Winter Park, Florida. He served as St. Joe's Chief Operating Officer ("COO") from August 2006, and its Chief Executive Officer ("CEO") from May 2008, until his resignation on February 25, 2011.

William S. McCalmont ("McCalmont"), age 59, resides in Santa Rosa Beach, Florida. He served as St. Joe's Chief Financial Officer ("CFO") from May 2007 until his resignation on April 11, 2011. McCalmont has never been a Certified Public Accountant ("CPA"), but obtained a Chartered Financial Analyst designation ("CFA") in 1986, which is now inactive. From 2000 until October 19, 2015, McCalmont served on the Audit Committee of another public company.

Janna L. Connolly ("Connolly"), age 59, resides in Destin, Florida. She served as St. Joe's Chief Accounting Officer ("CAO") from 1996 until April 11, 2011, when she succeeded McCalmont as the Company's CFO, and continued in that position until her resignation on May 7, 2012. Connolly has been licensed as a CPA by the State of Florida since 1980.

J. Brian Salter ("Salter"), age 45, resides in WaterSound, Florida. He was St. Joe's Manager of Finance from 2005 until July 2, 2010, when he was promoted to Director of Accounting and Finance. Salter continued in that position until May 17, 2011, when he was promoted to Vice President of Finance and Accounting. Salter is currently the Company's Senior Vice President of Finance and Investments. Salter has been licensed as a CPA by the State of Florida since 1996.

Phillip B. Jones ("Jones"), age 46, resides in Jacksonville, Florida. He was St. Joe's Director of Accounting from 2006 until leaving the Company on June 30, 2010. Jones has been licensed as a CPA by the State of Florida since 2002. He is currently employed as Vice President of Revenue for a private company.

C. FACTS

1. Applicable GAAP and Controls Environment

Throughout the period relevant to this Order, i.e. January 1, 2009 through March 3, 2011 (the "Relevant Period"), St. Joe was one of the largest real estate development companies in Florida. With virtually all of its assets, income and revenue tied to real estate, it was, during the Relevant Period, of central importance that those responsible for St. Joe's financial reporting and internal accounting controls have a command of, and properly apply, the GAAP applicable to its real estate assets (in addition, of course, to all other relevant GAAP). *Accounting Standards Codification* 360-10 (formerly FAS 144) ("ASC 360") provides that long-lived assets to be held and used, including assets under development, be tested for impairment whenever events or changes in circumstances indicate that such an asset's carrying amount may not be recoverable ("Triggering Events");[5] ASC-360 also specifies both how to carry out, and how to apply the results of, such testing.

During the Relevant Period and pursuant to St. Joe's internal accounting controls and policies and procedures, responsibility for impairment testing was shared among Respondents Greene, McCalmont, Connolly, Salter and/or Jones. For their part, during the Relevant Period and pursuant to the Company's policies, former CEO Greene, former CFO McCalmont, and former CAO Connolly were each required to review and approve the impairment testing that was used for financial reporting purposes. As Directors of Accounting and pursuant to the Company's controls, Jones (for all of 2009 as well as the first six months of 2010) and Salter (from July 2, 2010 through the balance of the Relevant Period) were responsible for testing St. Joe's long-lived real estate developments for impairment on a quarterly basis.[6]

In addition, Greene, McCalmont and Connolly,[7] as members of St. Joe's Investment Committee, were responsible for approving all business assumptions and forecasted undiscounted cash flows that were, among other things, used in the Company's impairment testing. Throughout the Relevant Period, St. Joe's business plans and forecasted undiscounted cash flows for specific residential real estate developments were captured in comprehensive "economic models" which reflected assumptions concerning the future plans for each development, including annualized pricing, appreciation rates, specific costs, and detailed expected sales time frames for specific types of home sites. Pursuant to the Company's internal policy, these economic models were updated at least annually by the Company's finance department and real estate development project managers.

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[5] Such events or changes in circumstances include, among other things, a significant adverse change in business climate impacting the relevant assets. *See* ASC 360-10-35-2. These events were present across all of St. Joe's developments during the Relevant Period, due to, among other things, economic recession, a significant downturn in the Florida real estate market, and a major oil spill in the Gulf of Mexico.

[6] During the Relevant Period, St. Joe conducted quarterly impairment testing because it considered the financial crisis and the 2010 Gulf oil spill to be ongoing Triggering Events.

[7] Connolly became a member of the Investment Committee in Q1 2010.

2. St. Joe Deviated From GAAP

During 2009 and 2010, the Company failed in two respects to conform with GAAP—with one lapse impacting multiple periods and the other a single project and period—and each resulting in an overstatement of the Company's earnings and assets at the time.

a. Failure to Include all Necessary Costs in Impairment Testing

During all of 2009 and continuing through its second quarter of 2010, the Company's impairment testing failed to include all cash outflows necessary to develop, and that were expected to arise as a direct result of the use and disposition of, St. Joe's real estate developments.[8] In particular, the Company based its impairment testing on what it termed "Relative Sales Value" worksheets, or "RSVs," which were a *partial summary* of the cash flows found in the Company's more comprehensive approved economic models. Thus, using the RSVs as the basis for the Company's impairment testing resulted in the exclusion of certain necessary non-capitalized cash outflows associated with its real estate developments. Had these additional required cash outflows been included in the Company's impairment testing, the Company would have been required to take impairment charges on three of its largest real estate developments during the Relevant Period, namely, the projects called Victoria Park, Southwood, and WaterColor. Combined, the impairments not taken on these projects amounted to at least $55 million in Q1 2009 and $19 million in Q4 2009, and resulted in materially misstated financial statements during those same periods, which continued through the remainder of the Relevant Period.[9]

As Directors of Accounting, Jones (during all of 2009 as well as the first six months of 2010), and Salter (from July 2, 2010 through the balance of the Relevant Period) were responsible for preparing the Company's quarterly impairment testing in connection with the Company's preparation of annual and quarterly financial statements. Each should have known that the Company's quarterly impairment testing failed to comply with GAAP because the RSVs did not include all cash outflows necessary to develop each project.

For their part, Greene, McCalmont and Connolly were responsible for reviewing and approving the Company's quarterly impairment testing. Additionally, as members of the Investment Committee, Greene, McCalmont and Connolly were also responsible for reviewing and approving all updates to the detailed business assumptions and cash flows in each of St. Joe's real estate development projects' economic models. Greene, McCalmont and Connolly each failed to prevent or detect the inconsistencies between the cash flows used in the RSVs for impairment testing and the corresponding complete cash flows in the economic models. Each also failed to ensure that all necessary costs be considered in the impairment testing which each reviewed and approved. As a result, each failed to prevent the overstatements in earnings and assets that resulted from the Company's use of incomplete cash outflows in its impairment testing.

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[8] ASC 360-10-35-29; ASC 360-10-35-34.

[9] The Company reported a $67.8 million impairment in connection with the sale of its Victoria Park real estate asset in Q4 2009. Accordingly, had the Company properly taken a $55 million impairment on the Victoria Park asset in Q1 2009, its reported Q4 2009 impairment of Victoria Park would have been reduced.

b. Failure to Consider Alternative Courses of Action

The Company failed to apply the pertinent GAAP in another respect in the Fall of 2009, with this lapse materially impacting a single project and reporting period. In particular, in performing and approving the Company's quarterly impairment testing of its Victoria Park project as a long-lived asset to be held and used in connection with preparing the Company's Q3 2009 financial statements, Greene, McCalmont, and Connolly gave no consideration to the likelihood of selling that project in bulk by December 31, 2009.[10] They each omitted any such consideration despite St. Joe having made substantial efforts to pursue and achieve a sale. Instead, the Q3 2009 impairment test of Victoria Park was improperly performed using only the estimated cash flows expected from the long-term development of the project.

In the Spring of 2009, the Company's Investment Committee (which then included Greene and McCalmont) approved the sale of Victoria Park in bulk at a substantial loss if such a transaction could be closed by December 31, 2009.[11] Immediately thereafter, the Company began pursuing the sale of Victoria Park and, during its third quarter (which encompassed June through September), received numerous letters of intent from buyers offering to purchase the property for prices ranging from $9 million to $15 million. Before the end of the quarter, St. Joe decided to pursue a sale to Company A, while maintaining contact with another interested party (hereinafter "Company B") as a potential back-up buyer. On October 1, 2009, during St. Joe's quarter-end close process for Q3 2009, Company A signed a contract to purchase Victoria Park for $15 million. On October 30, 2009, however, Company A withdrew from the transaction, at which time McCalmont informed St. Joe's independent auditor and Audit Committee of Company A's withdrawal. As a result of Company A's disengagement, St. Joe immediately pursued its contingency plan with the back-up buyer, Company B. Only one day after Company A's withdrawal, St. Joe scheduled a meeting with Company B to negotiate the sale of the development, and only four days after Company A's withdrawal, St. Joe sent Company B a draft purchase agreement. Further, in anticipation of a sale and in order to accelerate the timing of a sale, St. Joe had, by October 2009, prepared documentation that it felt would likely be requested by a buyer. As a result of St. Joe's maintaining Company B as a potential contingency purchaser, early preparation of documentation, and immediate follow-up with Company B, Company B entered into a purchase and sale agreement, subject to diligence, to purchase Victoria Park for $11 million on November 12, 2009, two weeks after Company A withdrew. The transaction closed on December 15, 2009, and on that day the Company filed a Form 8-K announcing the sale of Victoria Park.

During the four days between Company A's withdrawal from the transaction on October 30th and St. Joe's November 3, 2009 filing of its Q3 2009 Form 10-Q, St. Joe performed impairment testing on Victoria Park as an asset to be held and used (under development) without considering the

[10] In performing an impairment test, estimated undiscounted cash flows should consider the likelihood of all possible outcomes associated with any alternative courses of action under consideration for asset. ASC 360-10-35-30.

[11] St. Joe was pursuing this sale in order to take advantage of a tax-loss carryback benefit then available to the Company for losses occurring before the end of 2009. This tax-loss carryback benefit could have been obtained only if the sale of Victoria Park were completed before the end of the 2009 calendar year.

likelihood of a potential sale of the project by the end of 2009.[12] Instead, St. Joe considered only the single course of action of St. Joe's fully developing the property through 2026. Had St. Joe considered the undiscounted cash flows associated with even a small likelihood of selling Victoria Park by year end 2009, and had it—pursuant to ASC 360—incorporated such likelihood into its impairment testing, it would have been required to impair Victoria Park by at least $55 million in its Q3 2009 filing, a material amount.[13]

In performing procedures related to the Company's Q3 2009 impairment testing for Victoria Park, the Company's independent auditors relied on representations made by Greene, McCalmont, and Connolly in a management representation letter associated with their Q3 2009 review that the probability of selling Victoria Park by year end 2009 was "highly improbable, such that it [was] essentially nil." While McCalmont informed the independent auditors of the existence of Company B as a potential back-up buyer, neither he, nor any of the other executives, informed the auditors of the extensive steps St. Joe had taken towards consummating a sale with Company B, including the fact that a draft purchase agreement was sent to Company B on the same day that Greene, McCalmont, Connolly signed the management representation letter. Accordingly, St. Joe's failure to perform the Q3 2009 impairment testing of Victoria Park in accordance with GAAP went undetected by the Company's independent auditors.

3. Failures in the Wake of Discovering the Incorrect Accounting

On October 13, 2010, a short-seller gave a public presentation alleging that St. Joe was overvaluing its real estate development assets and failing to take material impairment charges. Following the presentation, there was increased focus within the Company on its impairment testing. Although the Company's impairment testing, as prepared by Salter and reviewed and approved by Greene, McCalmont and Connolly, had continued—up to and including the day of the short-seller presentation—to improperly utilize RSVs, Salter at some point came to realize that this RSV-based method of impairment testing had been improper because it failed to include all necessary cash outflows. Salter subsequently caused the Company to change its impairment testing methodology going forward to one properly based on cash flows in the Company's comprehensive economic models, which included additional necessary cash outflows. Greene, McCalmont, Connolly and Salter nonetheless did not identify or correct any errors in St. Joe's prior-period financials that resulted from the faulty methodology. Salter also improperly used assumptions generated after the quarter ended September 30, 2010 in connection with at least one real estate development in conducting that particular quarter's impairment testing.

a. Failure to Review Prior Periods

Greene, McCalmont, Connolly and Salter failed to review or effectively cause a review of St. Joe's accounting for prior periods, and also failed to identify, correct or cause to be corrected the

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[12] The updated Victoria Park model was not subjected to the Company's established Investment Committee or impairment testing processes, as Greene, McCalmont, and Connolly knew.

[13] The $67.8 million Victoria Park impairment charge (referenced in note 9, *supra*), was taken by St. Joe in Q4 2009 to reflect the finalized sale of Victoria Park to Company B at a significant loss.

resulting errors in previously issued financial statements.[14] While Salter recognized past flaws in St. Joe's impairment testing process and changed the Company's impairment testing methodology to one properly including additional necessary cash outflows, he failed to review the impairment accounting for prior periods. For his part, Greene also had concerns over prior period impairment testing independent of Salter's discovery of the improper accounting. Greene expressed these concerns to McCalmont and Connolly within a few days following the short-seller presentation, and asked McCalmont to confirm that St. Joe's impairment procedures were compliant in prior periods before St. Joe filed its Q3 2010 financials. McCalmont nevertheless did not review prior periods, and Greene failed to follow up with McCalmont on the issue. For her part, Connolly also failed to conduct any review of prior period accounting.

Had Salter, McCalmont or Connolly reviewed the impairment testing for prior periods, or had Greene caused such a review to take place, they would have discovered that St. Joe had improperly failed to record at least $74 million in impairments, as described above, associated with three of its real estate developments from approximately Q1 2009 through at least Q2 2010. As a result, the aforementioned errors were not corrected in the Company's relevant previously issued financial statements.

b. Failure to Use Existing Approved Assumptions For Q3 2010 Impairment Testing

As noted above, the Company's faulty RSV-based impairment testing had persisted until the very day of the short-seller presentation. In particular, on October 13, 2010, Greene, McCalmont and Connolly had performed the final management review of St. Joe's Q3 2010 impairment testing, which Salter had prepared using the improper RSV methodology. Had this impairment testing been performed properly during the October 13, 2010 review, however, by including all necessary future cash outflows, a material impairment would have been required for at least one of the Company's real estate developments.

Following the short-seller presentation, the Company's auditors asked for all of St. Joe's economic models for its real estate developments in connection with the auditors' review of, among other things, St. Joe's impairment testing for the quarter ended September 30, 2010. In response, Salter sent at least one economic model reflecting materially updated assumptions adopted subsequent to the Company's internal October 13, 2010 impairment review.[15] These updated assumptions should not have been used in conducting the impairment testing associated with preparing the third quarter financial statements because the assumptions were based on conditions not existing as of September 30, 2010.[16] Had St. Joe tested the economic models with assumptions

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[14] See ASC 250-10-45-23.

[15] The updated economic model was not subjected to the Company's established Investment Committee process, as Salter knew.

[16] Evidence about conditions that did not exist at the balance sheet date should not be recognized in the financial statements issued as of the balance sheet date. Instead, the entity should consider whether the nature of the new evidence should be disclosed to keep the financial statements from being misleading. See ASC 855-10-25-3 and ASC 855-10-50-2.

adopted as of September 30, 2010, it would have been required to account for approximately $15 million in impairments in its Q3 2010 Form 10-Q.[17]

4. Applying Unreasonably High Beachfront Pricing for Impairment Purposes

Windmark Beach II ("Windmark II"), located in Port St. Joe, Florida, was St. Joe's largest real estate development in terms of capital expenditures during 2009 and 2010, with a book value in St. Joe's public filings of over $165 million, including commercial and resort operations. Windmark II was also a primary target of the October 13, 2010 short-seller presentation, which heavily criticized the project's lack of development and stated that Windmark II was overvalued.

In Q4 2010, St. Joe adopted a new business plan for the Windmark II development, referred to as a "bulk sale" strategy, whereby St. Joe would cease all material development of the project, retain all undeveloped land until 2020, and sell it in bulk at that time. The new bulk-sale economic model, however, also assigned an unreasonably high valuation to certain undeveloped beachfront land in Windmark II. Specifically, the new valuation of the undeveloped beachfront land was based on a price of $6,000 per-linear foot as of 2010. The valuation's future bulk-sale price, in the year 2020, was over $7,600 per-linear foot, or $1.4 million per acre, based on an assumed annual appreciation of 3%. Greene approved these prices despite evidence then existing and known to him indicating a substantially lower value.[18] The Company's Vice President of Development refused to sign the portion of the Windmark II model with an undeveloped beachfront price above $3,500 per linear foot. As a result, Greene signed off on the Windmark II bulk undeveloped beachfront portion of the updated Windmark II economic model. For their part, although McCalmont and Connolly were both members of the Investment Committee approving economic models at the time and had responsibility for approving quarterly impairment testing, neither raised any concerns or otherwise took any steps to test the reasonableness of this pricing assumption.

The unreasonable $6,000 per-linear foot undeveloped beachfront pricing in the revised Windmark II economic model had the effect of generating sufficient notional cash flows to render the project recoverable and thus not require any impairment charge in Q4 2010. Had St. Joe performed an impairment test using, instead, a reasonable valuation based on comparable sales and other available evidence, the Windmark II real estate development would not have been recoverable, and the Company would have been required to take an impairment charge of at least $80 million in Q4 2010.

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[17] Moreover, St. Joe's independent auditors were not made aware of the fact that the updated economic model employed assumptions not based on conditions existing as of the end of the third quarter 2010.

[18] During 2010, there were only two beachfront home site sales in Windmark II. Both sales had a price-per-linear-foot of less than $2,000. Furthermore, St. Joe personnel assembled comparable property sales from other non-St. Joe projects, and, out of the 21 sales in question, only one was priced at or above $6,000 per linear foot, and only one was priced greater than $1 million per acre. It does not appear that any of this evidence—all available at the time—was considered in estimating cash flows for the impairment test for Windmark II.

5. Failing to Disclose Significant Change in Business Strategy

St. Joe's 2010 Form 10-K contained material misstatements and omissions concerning its development plans for two of its largest real estate projects, Windmark II and Southwood. In Q4 2010, St. Joe's Investment Committee (then consisting of Greene, McCalmont and Connolly) adopted new "bulk sale" strategies and economic models for both these developments. These new strategies constituted a significant shift for the Company that halted all material future development at both sites and instead consisted of long term retention of the undeveloped land and selling it, undeveloped, in the future.

St. Joe's disclosures concerning the Windmark II and Southwood developments in relevant sections of its 2010 10-K, however, failed to mention this significant change in strategy. Instead, as to Windmark II, St. Joe represented (Item 1, *Business* of the Company), that "[p]lans for [Windmark II] include approximately 1,516 residential units and 76,000 square feet of commercial space," and that the community would include "approximately 14 miles of walkways and boardwalks, including a 3.5 mile boardwalk." By contrast, the Company's approved economic model for Windmark II, as of December 31, 2010, provided for total residential development of 191 home sites – comprising just 13% of the development promised in the 10-K.

As to Southwood, St. Joe's 2010 10-K represented (in Item 1, *Business* of the Company) that Southwood remained "[p]lanned to include approximately 4,770 residential units." By contrast, the Company's approved economic model for Southwood, as of December 31, 2010, called for ceasing all future material parcel development and selling the undeveloped land through 2020.[19]

Greene and McCalmont, in certifying the Company's 2010 Form 10-K in their capacities as CEO and CFO, respectively, and during a time of heighted public scrutiny over St. Joe's real estate development assets, should have known that the Company's disclosures concerning continued development plans at Windmark II and Southwood were misleading because they failed to disclose the Company's Investment Committee-approved plans to cease material residential development and sell undeveloped land in bulk. Further, in their Sarbanes-Oxley 302 certifications, Greene and McCalmont both represented that they reviewed the Form 10-K and that, based on their knowledge, the report did not contain any material misstatements and omissions.

6. Inadequate Books and Records

During the Relevant Period, St. Joe failed to maintain adequate books-and-records concerning its impairment testing of real estate developments. Specifically, during the Relevant Period, St. Joe failed to sufficiently perform the following: maintain adequate records of quarterly impairment testing reviewed as part of its quarterly and annual accounting close process; document support for assumptions used in undiscounted cash flows used in impairment testing; document its processes and procedures concerning impairment testing; maintain the integrity of the economic models and RSVs used in connection with past impairment testing; and document identified errors in past impairment testing. Importantly, St. Joe's books-and-records failures during the Relevant Period adversely

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[19] The remaining development planned for Southwood was the building of "backbone" roads and connections to general utility services—development that was required as a condition of the Community Development District loans that St. Joe had received for the project.

impacted the SEC investigation leading to this Order, including causing unreasonably prolonged uncertainty concerning the Company's historic impairment testing procedures and causing substantial delays to, and otherwise unnecessary steps in, that investigation.[20]

7. Later Developments

Following the Relevant Period, St. Joe made significant changes in personnel at both the management and Board of Directors level, referenced in note 4 above. In addition, in the fourth quarter of 2011, with Salter's assistance, St. Joe's new Board and management (which included Connolly as CFO at the time), citing the adoption of a new business strategy, recognized aggregate impairment losses of over $374 million associated with its investments in real estate. These impairments included more than $126 million to Windmark II and more than $17 million to Southwood. Collectively, the impairments taken by the Company in Q4 2011 resulted in reductions to St. Joe's investment in real estate, and to its total asset value, of more than 50% and more than 35%, respectively.

Findings

Based on the foregoing, the Commission finds that Respondent The St. Joe Company violated Securities Act Sections 17(a)(2) and (3) and Exchange Act Sections 13(a), 13(b)(2)(A) and (B), and Exchange Act Rules 12b-20, 13a-1. 13a-11 and 13a-13.

Based on the foregoing, the Commission further finds: (1) that Respondent Greene violated and Respondents McCalmont, Connolly and Salter willfully[21] violated Securities Act Sections 17(a)(2) and (3), Exchange Act Section 13(b)(5), and Exchange Act Rules 13b2-1 and 13b2-2; (2) that Respondents Greene, McCalmont, Connolly, Salter and Jones caused St. Joe's violations of Exchange Act Sections 13(a), 13(b)(2)(A) and (B), and Exchange Act Rules 12b-20, 13a-1, 13a-11 and 13a-13; (3) that Respondent Greene violated and Respondent McCalmont willfully violated Exchange Act Rule 13a-14; (4) that Respondents McCalmont, Connolly, Salter and Jones also willfully violated the federal securities laws or rules and regulations thereunder pursuant to Section 4C of the Exchange Act and Rule 102(e)(1)(iii) of the Commission's Rules of Practice; and (5) that Respondent Jones willfully violated Exchange Act Rule 13b2-1 and caused St. Joe's violation of Securities Act Section 17(a)(2).

III.

In determining to accept Respondent St. Joe's Offer, the Commission considered remedial steps taken by the Company since the conduct detailed herein, including enhancements to its

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[20] Since the Relevant Period, the Company, under the direction of its newly constituted Board and senior management, has undertaken significant measures to strengthen its policies and procedures for maintaining books and records.

[21] The use of the word "willful" (both here and throughout the Findings section of this Order) does not reflect a finding that the Respondents acted with the intention to violate the law or knowledge that they were doing so. As used in the governing provisions of law, "willfully" means only that the actor "intentionally committed the act which constitutes the violation." *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965); *see also Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000). "There is no requirement that the actor also be aware that he is violating one of the Rules or Acts . . . ." *Tager*, 344 F.2d at 8.

impairment testing, accounting, internal controls, and books-and-records policies and procedures, together with its replacement of its executive officers and Board.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offers.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Pursuant to Securities Act Section 8A, Respondents St. Joe, Greene, McCalmont, Connolly, and Salter shall cease and desist from committing or causing any violations and any future violations of Securities Act Sections 17(a)(2) and (3), and Respondent Jones shall cease and desist from committing or causing any violations and any future violations of Securities Act Section 17(a)(2).

B. Pursuant to Exchange Act Section 21C, Respondents St. Joe, Greene, McCalmont, Connolly, Salter and Jones shall cease and desist from committing or causing any violations and any future violations of Exchange Act Sections 13(a), 13(b)(2)(A) and (B), and Exchange Act Rules 12b-20, 13a-1, 13a-11 and 13a-13; Respondents Greene, McCalmont, Connolly and Salter shall further cease and desist from committing or causing any violations and any future violations of Exchange Act Section 13(b)(5) and Exchange Act Rules 13b2-1 and 13b2-2; Respondents Greene and McCalmont shall further cease and desist from committing or causing any violations and any future violations of Exchange Act Rule 13a-14; and, finally, Respondent Jones shall further cease and desist from committing or causing any violations and any future violations of Exchange Act Rule 13b2-1.

C. Respondent St. Joe shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $2,750,000, to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If payment of this civil penalty is not timely made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

D. Respondent Greene shall, within ten (10) days of the entry of this Order, pay (i) disgorgement of $400,000 plus prejudgment interest of $52,300, for a total of $452,300, and (ii) a civil money penalty in the amount of $120,000, to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If payment of disgorgement is not timely made, additional interest shall accrue pursuant to SEC Rule of Practice 600. If payment of the civil penalty is not timely made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

E. Respondent McCalmont shall, within ten (10) days of the entry of this Order, pay (i) disgorgement of $180,000 plus prejudgment interest of $22,868, for a total of $202,868, and (ii) a civil money penalty in the amount of $120,000, to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If payment of disgorgement is not timely made, additional interest shall accrue pursuant to SEC Rule of Practice 600. If payment of the civil penalty is not timely made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

F. Respondent Connolly shall, within ten (10) days of the entry of this Order, pay (i) disgorgement of $60,000 plus prejudgment interest of $10,896, for a total of $70,896, and (ii) a civil money penalty in the amount of $70,000, to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If payment of disgorgement is not timely made, additional interest shall accrue pursuant to SEC Rule of Practice 600. If payment of the civil penalty is not timely made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

G. Respondent Salter shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $25,000, to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If payment of this civil penalty is not timely made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

H. All payments required by this Order must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Respondent as a Respondent in these proceedings, and the file number of these proceedings. A copy of the cover letter and check or money order, or documentation of whatever other form of payment is used, must be simultaneously sent to Stephen L. Cohen, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549.

I. Respondents McCalmont, Connolly, Salter and Jones are each denied the privilege of appearing and practicing before the Commission as an accountant.

J. After three (3) years from the date of this Order, Respondents Connolly and Salter may, and after two (2) years from the date of this Order, Respondent Jones may request that the Commission consider his or her reinstatement by submitting an application (Attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

(1) A preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission.

Such an application must satisfy the Commission that Respondent's work in his/her practice before the Commission will be reviewed either by the independent audit committee of the public company for which he/she works or in some other acceptable manner, as long as he/she practices before the Commission in this capacity; and/or

(2) An independent accountant. Such an application must satisfy the Commission that:

(a) Respondent, or the public accounting firm with which he/she is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Respondent, or the registered public accounting firm with which he/she is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in the respondent's or the firm's quality control system that would indicate that the respondent will not receive appropriate supervision;

(c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

(d) Respondent acknowledges his/her responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

K. The Commission will consider an application by Respondents Connolly, Salter, and Jones to resume appearing or practicing before the Commission provided that his/her state CPA license is current and he/she has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to the applying Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

L. After two (2) years from the date of this order, Respondent McCalmont may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as an accountant.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code [11 U.S.C. § 523], the findings in this Order are true and admitted by Respondents Greene, McCalmont, Connolly and Salter, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by each of the aforementioned Respondents

under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by said Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code [11 U.S.C. §523(a)(19)].

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4244 / October 27, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16926

In the Matter of

ROBERT BURTON,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Robert Burton ("Respondent" or "Burton").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. From at least 2007 through June, 2013, Burton—an individual who resided in Massachusetts—was associated with an unregistered investment advisor, and acted as an investment adviser when he owned and operated a business under various names, including, but not limited to, Pinnacle Financial Consulting, LLC, Pinnacle Strategic Investments, LLC, Pinnacle Asset and Capital Management LLC, Pinnacle Financial and Legal Solutions, LLC, Pinnacle Management Group, LLC, and Pinnacle Holdings, LLC (collectively, "Pinnacle"). Pinnacle provided various financial services to clients, including tax preparation, investment advising, loan modification, debt consolidation, and bankruptcy petition preparation.

12 of 21

B. RESPONDENT'S CRIMINAL CONVICTION

2. On August 21, 2014, before the United States District Court for the District of Massachusetts, in United States v. Robert Burton, Case No. 13-cr-10292, Burton pled guilty to five counts of securities fraud, in violation of 15 U.S.C. §§ 78j(b) and 78ff and in violation of 17 C.F.R. § 240.10b-5; two counts of procuring false tax returns in violation of 26 U.S.C. § 7206(2); and four counts of subscribing false tax returns, in violation of 26 U.S.C. § 7206(1). On December 23, 2014, the Court entered judgment in the criminal case and sentenced Burton to a prison term of 48 months followed by three years of supervised release, and ordered Burton to make restitution in the amount of $159,500.

3. In connection with his guilty plea, Burton admitted that, between 2007 and June 2013, Burton, through Pinnacle, obtained not less than $150,000 from various investors by falsely representing that he would invest such monies on behalf of those investors. In actuality, Burton did not invest the monies as promised, and, upon receiving funds from investors, Burton routinely deposited the money into his business bank accounts and subsequently paid business and personal expenses with those funds. His victims included, among others, an active duty Army chaplain, to whom Burton represented that Burton was a financial advisor who would open an IRA on his behalf, and a husband and wife who sought mortgage modification services from Burton and subsequently liquidated their Fidelity investments retirement account to give $40,000 to Burton. Two other victims gave Burton $40,000 and $25,000 respectively for investment. Burton concealed the misappropriation of investor funds by, among other things, providing investors with false account information and investment updates (including fabricated printouts purporting to detail holdings in various publicly traded stocks) and checks that ultimately bounced. Burton even provided some of his victims with log-in credentials for a website to view falsified account balances and purported holdings in the "Pinnacle Strategic Investments Ram 2100 Fund," the "US Currency Fund," and the "Pinnacle Debt Portfolio 2020." Burton also willfully advised the preparation and presentation of federal Individual Income Tax Returns (Forms 1040), which tax returns, as Burton knew and believed, were fraudulent and false as to material matters. Burton also signed tax returns under penalties of perjury that he did not believe to be true and correct as to certain material matters.

C. ENTRY OF CIVIL INJUNCTION AGAINST RESPONDENT

4. On March 17, 2015, the Suffolk County (Massachusetts) Superior Court, in Commonwealth v. Pinnacle Financial Consulting, LLC, Civil Action No. 13-0812B, entered a final judgment and permanent injunction against defendants Pinnacle and Burton, finding that those defendants committed numerous violations of the Massachusetts Consumer Protection Act, which included making misrepresentations regarding investment related services, loan modification services, and bankruptcy petition preparation services; engaging in the unauthorized practice of law; failing to provide promised services to consumers; and converting fees and other monies paid to them by consumers. The court assessed damages of $1,906,840.45 (consisting of restitution in the amount of $1,241,840.45 and civil penalties of $665,000) and enjoined Burton and Pinnacle

from engaging in investment advising services, loan modification services, bankruptcy petition preparation services, and the practice of law.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default, and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent as provided for in the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness

or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76280 / October 27, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4245 / October 27, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16929

In the Matter of

JOHN D'AURIA,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against John D'Auria ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940 ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that

1. From March 2009 through December 2011, D'Auria was a registered representative of Harvest Capital LLC, a broker-dealer registered with the Commission. From June 2009 through December 2011, D'Auria was an associated person of state-registered investment adviser Harvest Capital Advisors, LLC. From December 2011 through 2014, D'Auria acted as an unregistered investment adviser. D'Auria was previously a registered representative with MML Investors Services, Inc. from January 2008 through December 2008, and Ameriprise Financial Services, Inc. from June 2006 through December 2007. D'Auria is a resident of East Haven, Connecticut.

2. On July 13, 2015, D'Auria pled guilty to one count of wire fraud in violation of Title 18 United States Code, Section 1343 before the United States District Court for the District of Connecticut, in United States v. John D'Auria, Case No. 3:15-cr-00121-MPS. On July 13, 2015, the U.S. District Court Judge accepted D'Auria's guilty plea.

3. In connection with that plea, Respondent admitted that:

(a) In or about 2011, D'Auria ceased to be associated with a registered investment adviser;

(b) Beginning in or about 2010 and continuing to in or about 2014, D'Auria engaged in a scheme to defraud investors who had provided him with investment funds by failing to invest the funds as represented and by using the majority of the investment funds for his personal use;

(c) D'Auria provided some investors with false valuation numbers and false documentation that fraudulently suggested that the investors' investments had greatly appreciated in value, while D'Auria knew this information was false without disclosing this fact to his investors; and

(d) As a result of D'Auria's fraudulent scheme, D'Auria defrauded approximately nine investors of approximately $2.4 million.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent D'Auria's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act, and Section 203(f) of the Advisers Act, that Respondent D'Auria be, and hereby is

Barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

Pursuant to Section 15(b)(6) of the Exchange Act, Respondent D'Auria be, and hereby is, barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Brent J. Fields
Secretary

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9969 / October 28, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76286 / October 28, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31882 / October 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16931

In the Matter of **HAL S. TUNICK** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 , SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Hal S. Tunick ("Tunick" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these

proceedings, which are admitted, and except as provided herein in Section V, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that

Summary

These proceedings arise out of a fraudulent scheme perpetrated by Hal S. Tunick ("Tunick"), a former principal of and co-head of the equities trading desk at Rochdale Securities LLC ("Rochdale"), a now defunct registered broker-dealer in Connecticut. From at least 2010 through November 14, 2012 ("relevant period"), while he was associated with Rochdale, Tunick violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by needlessly inserting his longstanding customer, a proprietary trader at a San Diego, California-based firm (the "Customer"), into the filling of other customers' orders, often at a profit to the Customer, thereby failing to seek to obtain best execution on those orders by causing orders to be filled at prices that were worse than those readily available in the market. As a result of Tunick's misconduct, other Rochdale customers generally paid higher average prices on purchase orders or received lower average prices on sale orders than they otherwise would have paid (or received) had Tunick's Customer not been involved. Tunick knowingly put the interest of his Customer ahead of the interest of Rochdale's other customers. Also as a result of Tunick's conduct, Rochdale essentially earned double trading commissions: one for executing trades by Tunick's Customer and another for executing the original Rochdale customer order.

Respondent

1. **Hal S. Tunick**, age 56, resides in Chappaqua, New York. Tunick, currently unemployed and not associated with a registered broker-dealer, was a registered representative at Rafferty Capital Markets, LLC, a broker-dealer registered with the Commission, from November 19, 2012 until July 23, 2014. Prior to that, Tunick was a registered representative at Rochdale from 1995 until November 2012. From 2005 until November 14, 2012, he was the co-head of the equities trading desk at Rochdale as well as a minority owner of the firm.

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Other Relevant Entity

2. **Rochdale Securities LLC** is a defunct broker-dealer, formerly registered with the Commission from 1986 until April 26, 2013, with its principal place of business in Stamford, Connecticut. Rochdale's membership with FINRA was cancelled effective April 23, 2013, and its registration with the State of Connecticut was revoked by consent effective August 12, 2013.

Duty of Best Execution

3. The duty of "best execution" requires a broker-dealer to seek to obtain the most favorable terms reasonably available under the circumstances for a customer's transaction. As part of this duty, a broker-dealer must conduct a regular and rigorous review of its practices in light of market and technology changes, and may need to assess which competing markets, market makers, or electronic communications networks offer the most favorable terms for customers' orders. In addition to considering the price of a security, a broker-dealer should take into account other factors such as account order size, trading characteristics of the security, speed of execution, clearing costs, and the cost and difficulty of executing an order in a particular market. Tunick was aware of his obligation to execute Rochdale customer trades consistent with Rochdale's duty of best execution. Arranging for his Customer to participate in filling other Rochdale customer orders failed to comply with the duty of best execution and constituted a scheme to defraud the other customers.

The Violative Conduct

4. During the relevant period, Tunick improperly arranged for certain Rochdale customer securities orders to be filled by Tunick's Customer, a proprietary trader at a San Diego, California-based firm. Tunick's Customer held an account at Rochdale, and Tunick routinely passed other customer order information to his Customer so that the Customer could arrange to submit orders through his Rochdale account to fill, at least in part, the original Rochdale customer order often at a profit to the Customer. Tunick thereby knowingly put the interest of his Customer ahead of the interest of Rochdale's other customers.

5. When Tunick received a purchase order from certain customers, Tunick, for no purpose other than to generate commissions, instructed his Customer by instant message to purchase the relevant securities elsewhere and sell them through his account at Rochdale to satisfy the original customer's order, at least in part. Tunick's Customer then: (1) purchased the securities through an account held away from Rochdale at a third party broker-dealer and (2) subsequently sold the position through his account at Rochdale, often at a profit.[2] Rochdale, through Tunick,

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[2] Tunick's Customer typically day traded and generally did not previously own the securities he sold through his account at Rochdale.

would fill at least a part of the original customer's purchase order by crossing[3] the sale order from his Customer's Rochdale account with the original customer's purchase order, generally causing the other Rochdale customer to pay a purchase price higher than he or she otherwise would have paid had Tunick's Customer not been involved. Tunick, at times, even advised his Customer to submit a higher sale price than the Customer initially requested.

6. For example, on September 30, 2010, Tunick received a customer order to purchase 20,300 shares of ABC Co. ("ABC"). For no purpose other than to generate commissions, Tunick then instructed his Customer to purchase 10,000 shares of ABC through an account at a third-party broker-dealer and then to submit an order to sell these shares through his account at Rochdale. Tunick's Customer purchased these shares at approximately $54.89 per share. Tunick's Customer thereafter submitted an order to sell the 10,000 shares through his account at Rochdale at a price of $55.03 per share. Market data reflects that at this time (approximately 10:00 a.m.), offers (sale orders) for more than 5,000 shares of ABC were available in the open market at an average price of $54.98 per share. Despite this, Tunick instructed his Customer to increase his order to sell at $55.03 by two cents, to $55.05 per share, which Tunick crossed with the pending customer order to purchase shares of ABC. Tunick's Customer thereby locked in a profit by following Tunick's instructions, while at the same time causing the other Rochdale customer to purchase the shares from Tunick's Customer at a higher price than he or she otherwise would have paid in the open market had Tunick's Customer not been involved. Moreover, Tunick was able to effectively double commissions to Rochdale, assessing commissions on both the Customer's order to sell the stock through his account at Rochdale and the original Rochdale customer order to buy the stock.

7. Similarly, when Tunick received a sale order from certain Rochdale customers, Tunick, for no purpose other than to generate commissions, instructed his Customer by instant message to purchase the relevant securities through his account at Rochdale. Tunick's Customer then: (1) purchased the securities through his account at Rochdale and (2) subsequently sold (or sold short, depending on the sequence) his position through an account held away from Rochdale at a third party broker-dealer, again often at a profit to the Customer and resulting in double commissions to Rochdale. As with the prior example, Tunick filled at least some of the original customer's sale order by crossing the shares from the original customer's Rochdale account with the Customer's Rochdale account.

8. For example, on June 1, 2010, Tunick received a customer order to sell 30,000 shares of DEF Co. ("DEF"). For no purpose other than to generate commissions, Tunick provided his Customer with information about that customer order to enable his Customer to purchase the shares through his account at Rochdale so that Tunick could cross the trade with the original customer. Tunick's Customer purchased 10,000 shares of DEF through his account at Rochdale. Market data reflects that at the time of the Customer's purchase (approximately 10:30 a.m.), bids (purchase orders) for 2,400 shares of DEF were available in the open market at an average price of

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[3] In this context, "crossing" refers to a trade execution in which a broker buys securities on behalf of one customer's account (here, the longstanding customer/seller) and sells the same securities on behalf of another customer's account (here, the original customer/buyer).

$20.15 per share. Despite this, Tunick reduced the purchase price by $0.05 per share and executed his Customer's 10,000 share purchase at $20.10 per share, thereby causing the other Rochdale customer to sell the shares to Tunick's Customer at a lower price than he or she otherwise would have obtained in the open market had Tunick's Customer not been involved. Tunick's Customer sold these shares through an account at a third-party broker-dealer at approximately $20.17 per share. Moreover, Tunick was able to effectively double commissions to Rochdale, assessing commissions on both the Customer's order to purchase the stock and the original Rochdale customer's order to sell the stock.

9. During the relevant period, Tunick knowingly unnecessarily involved his Customer in more than 250 transactions, allowing his Customer to profit in more than 95% of those instances.

10. From approximately 2010 through 2012, Tunick's firm, Rochdale, earned more than $130,000 in combined commissions on these trades from both Tunick's Customer and Rochdale's other customers.

Violations

11. As a result of the conduct described above, Tunick willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, and for the protection of investors to impose the sanctions agreed to in Respondent Tunick's Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Tunick cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Tunick be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal

underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $125,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Hal S. Tunick as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Michele T. Perillo, Division of

Enforcement, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110.

E. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9968 / October 28, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76285 / October 28, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31881 / October 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16930

In the Matter of

PATRICK R. BURKE

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 , SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Patrick R. Burke ("Burke" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act

Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that

Summary

These proceedings arise out of a fraudulent scheme perpetrated by Patrick R. Burke ("Burke"), a former registered representative at Rochdale Securities LLC ("Rochdale"), a now defunct registered broker-dealer in Connecticut. From at least 2010 through November 15, 2012 ("relevant period"), while he was associated with Rochdale, Burke violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder by needlessly inserting his longstanding customer, a proprietary trader at a New York City-based firm (the "Customer"), into the filling of other customers' orders, often at a profit to the Customer, thereby failing to seek to obtain best execution on those orders by causing orders to be filled at prices that were worse than those available in the market. As a result of Burke's misconduct, certain other Rochdale customers generally paid higher average prices on purchase orders or received lower average prices on sale orders than they otherwise would have paid (or received) had Burke's Customer not been involved. Burke knowingly put the interest of his Customer ahead of the interest of certain other Rochdale customers. Also as a result of Burke's conduct, Rochdale essentially earned double trading commissions: one for executing trades by Burke's Customer and another for executing the original Rochdale customer order.

Respondent

1. **Patrick R. Burke**, age 49, resides in Wilton, Connecticut. Burke, currently not associated with a registered broker-dealer, was a registered representative at Rafferty Capital Markets, LLC, a broker-dealer registered with the Commission, from November 15, 2012 until September 4, 2014. Prior to that, Burke was a registered representative at Rochdale since August 4, 1998.

Other Relevant Entity

2. **Rochdale Securities LLC** is a defunct broker-dealer, formerly registered with the Commission from 1986 until April 26, 2013, with its principal place of business in Stamford, Connecticut. Rochdale's membership with FINRA was cancelled effective April 23, 2013, and its

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

registration with the State of Connecticut was revoked by consent effective August 12, 2013.

Duty of Best Execution

3. The duty of "best execution" requires a broker-dealer to seek to obtain the most favorable terms reasonably available under the circumstances for a customer's transaction. As part of this duty, a broker-dealer must conduct a regular and rigorous review of its practices in light of market and technology changes, and may need to assess which competing markets, market makers, or electronic communications networks offer the most favorable terms for customers' orders. In addition to considering the price of a security, a broker-dealer should take into account other factors such as account order size, trading characteristics of the security, speed of execution, clearing costs, and the cost and difficulty of executing an order in a particular market. Burke was aware of his obligation to execute Rochdale customer trades consistent with Rochdale's duty of best execution. Arranging for his Customer to participate in filling other Rochdale customer orders failed to comply with Rochdale's duty of best execution and constituted a scheme to defraud other Rochdale customers.

The Violative Conduct

4. During the relevant period, on certain occasions, Burke improperly arranged for certain Rochdale customer securities orders to be filled by Burke's Customer, a proprietary trader at a New York City-based firm. Burke's Customer held an account at Rochdale, and Burke on certain occasions passed other customer order information to his Customer so that the Customer could arrange to submit orders through his Rochdale account to fill, at least in part, the original Rochdale customer order, often at a profit to the Customer. At other times, Burke exercised discretionary trading authority in the Customer's Rochdale account and routed orders through the Customer's account, often at a profit to the Customer. Burke thereby knowingly put the interest of his Customer ahead of the interest of Rochdale's other customers.

5. In certain instances, when Burke received a purchase order from certain customers, Burke, for no purpose other than to generate commissions, arranged for his Customer to purchase the relevant securities elsewhere and sell them through his account at Rochdale to satisfy the original customer's order, at least in part. Burke's Customer then (1) purchased the securities through an account held away from Rochdale at a third party broker-dealer and (2) subsequently sold the position through his account at Rochdale, often at a profit.[2] Rochdale, through Burke, would fill at least a part of the original customer's purchase order by crossing[3] the sale order from his Customer's Rochdale account with the original customer's purchase order, generally causing the

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[2] Burke's Customer typically day traded and generally did not previously own the securities he sold through his account at Rochdale.

[3] In this context, "crossing" refers to a trade execution in which a broker buys securities on behalf of one customer's account (here, the longstanding customer/seller) and sells the same securities on behalf of another customer's account (here, the original customer/buyer).

other Rochdale customer to pay a purchase price higher than otherwise would have been paid had Burke's Customer not been involved. Similarly, on certain occasions, when Burke received a sale order from certain Rochdale customers, Burke, for no purpose other than to generate commissions, arranged for his Customer to purchase at least some of the relevant securities through his account at Rochdale. Burke's Customer then (1) purchased (or sold short, depending on the sequence) the securities through his account at Rochdale and (2) subsequently sold (or bought to cover a short position, depending on the sequence) his position through an account held away from Rochdale at a third party broker-dealer, again often at a profit to the Customer. Burke similarly filled at least some of the original customer's sale order by crossing the shares from the original customer's Rochdale account with the Customer's Rochdale account. Burke thereby failed to seek to obtain best execution by needlessly inserting his Customer into the filling of customers' orders, and, in doing so, Burke generally enabled his Customer to earn a profit on these trades. Burke also was able to effectively double commissions to Rochdale, assessing commissions on both the Customer's trade and the original Rochdale customer's order.

6. For example, on January 23, 2012 prior to the market open, Burke received a customer order to sell 14,284 shares of ABC Co. ("ABC"). For no purpose other than to generate commissions, Burke provided his Customer with information about that customer order to enable his Customer to short sell shares of ABC through a third-party account and subsequently cover the short sale by purchasing the ABC shares through his account at Rochdale so that Burke could cross the trade with the original customer. Burke's Customer then sold short 12,600 shares of ABC through a third-party account at approximately $5.65 per share. The other Rochdale customer likely would have received a similar price had Burke sold that customer's shares directly into the open market. Then Burke caused his Customer to subsequently purchase 12,600 shares through his Rochdale account from the other Rochdale customer at approximately $5.60 per share. Burke thereby caused the other Rochdale customer to sell the shares to Burke's Customer at a lower price than he or she otherwise would have obtained in the open market had Burke's Customer not been involved. Moreover, Burke was able to effectively double commissions to Rochdale, assessing commissions on both the Customer's order to purchase the stock and the original Rochdale customer's order to sell the stock.

7. On other occasions, Burke used his discretionary authority to trade in the Customer's Rochdale account. If the other Rochdale customer entered a purchase order, Burke (1) used the Customer's Rochdale account to purchase the securities through a third-party brokerage account and (2) subsequently sold the position to the other Rochdale customer using the Customer's Rochdale account to cross the trade. Similarly, if the other Rochdale customer entered a sale order, Burke (1) purchased the securities from the other customer using the Customer's Rochdale account and (2) subsequently sold the position out of the Customer's account through a third party broker-dealer. As with the above example, Burke filled at least some of the original customer's order by crossing the shares from the original customer's Rochdale account with the Customer's Rochdale account. Burke thereby failed to seek to obtain best execution by needlessly inserting his Customer into the filling of other customers' orders, and, in doing so, Burke generally enabled his Customer to earn a profit on these trades. Burke also was able to effectively double commissions to Rochdale, assessing commissions on both the trade through the Customer's account and the original Rochdale

customer's order.

8. For example, on April 15, 2010, Burke received a Rochdale customer order to sell 86,469 shares of DEF Co. ("DEF") and 195,056 shares of GHI Co. ("GHI"). Burke used the Customer's Rochdale account to purchase 7,000 shares of DEF from the other Rochdale customer at approximately $61.42 per share and 5,000 shares of GHI at approximately $46.71 per share. Market data reflects that at the time Burke used the Customer's account to purchase the 7,000 shares of DEF from the other Rochdale customer (approximately 2:33 p.m.), bids (purchase orders) for 22,500 shares of DEF were available in the open market at an average price of $61.46 per share. Similarly, at the time Burke used the Customer's account to purchase 5,000 shares of GHI from the other Rochdale customer (approximately 2:44 p.m.), market data reflects that bids for 5,800 shares of GHI were available in the open market at an average price of $46.72. Burke thereby caused the other Rochdale customer to sell the shares to Burke's Customer at a lower price than he or she otherwise would have obtained in the open market had Burke's Customer not been involved. Moreover, Burke was able to effectively double commissions to Rochdale, assessing commissions on both the Customer's order to purchase the stock and the original Rochdale customer's order to sell the stock.

9. During the relevant period, Burke knowingly unnecessarily involved his Customer in approximately 100 transactions, enabling his Customer to profit in more than 90% of those instances.

10. From approximately 2010 through 2012, Burke earned approximately $6,300 in combined commissions on these trades from both Burke's Customer and Rochdale's other customers, and Rochdale earned approximately $21,000 in combined commissions on these trades.

Violations

11. As a result of the conduct described above, Burke willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, and for the protection of investors to impose the sanctions agreed to in Respondent Burke's Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Burke cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Burke be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock,

with the right to apply for reentry after five (5) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent shall, within 10 days of the entry of this Order, pay disgorgement, which represents profits gained as a result of the conduct described herein of $6,300.00, prejudgment interest of $659.07, and civil penalties of $50,000, for a total payment of $56,959.07 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717 and SEC Rule of Practice 600. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Patrick R. Burke as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Michele T. Perillo, Division of Enforcement, Securities and Exchange Commission, 33 Arch Street, 23rd Floor, Boston, MA 02110.

E. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree

or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76287 / October 28, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4246 / October 28, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31883 / October 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16932

In the Matter of **Gary M. Arford,** **Respondent**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Gary M. Arford ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondent consents

to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

Summary

1. Between approximately December 2010 and October 2013, Respondent acted as an investment adviser to a private fund (the "Fund"), providing advice primarily with respect to real estate-related investments. While serving in that role, he defrauded the Fund and its investors in at least four ways. First, he induced the Fund to commit a total of $4 million to an investment in a company that was purportedly planning to build and operate a hotel on undeveloped land in a Seattle suburb by misrepresenting and concealing material facts about the company's debt and the encumbrances on its undeveloped property. Second, after obtaining the Fund's investment commitment, Respondent took personal ownership of the company's undeveloped property, and then pledged it as collateral for personal debts. Third, Respondent induced the Fund to continue fulfilling its investment commitment by concealing his personal ownership and use of the company's undeveloped property and by misrepresenting and hiding material facts about the use of Fund assets and the status of the project. And finally, Respondent misappropriated Fund assets for purposes unrelated to the Fund's intended investment. In so doing, Respondent violated Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8(a)(2) thereunder.

Respondent

2. Gary M. Arford, age 60, is a resident of Edmonds, Washington. Beginning in December 2010 and continuing throughout the relevant period, he personally acted as a "sub-adviser" to the Fund. As such, he received compensation from the Fund to provide advice concerning certain investments, particularly real estate-related investments. During the period at issue, Respondent also was the president of an SEC-registered investment adviser, which he founded, and was a registered representative associated with two SEC-registered broker-dealers.

Other Relevant Parties

3. "The Fund" is a private fund organized as a Colorado limited liability company and managed by another Colorado LLC, which, in turn, is controlled by an individual referred to herein as the "Fund Principal."

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

4. "Suburban Hotel" refers to a Washington limited liability company established in 2007 for the purpose of building and operating a hotel on an undeveloped parcel in a suburb of Seattle, Washington. Respondent was one of Suburban Hotel's original investors.

5. "City Hotel" refers to a Washington limited liability company established in 2007 for the purpose of building and operating a hotel on an undeveloped parcel within the city limits of Seattle, Washington. Respondent was also an early investor in City Hotel.

Facts

A. *Respondent Acted as an Investment Adviser to the Fund*

6. As part of discussions about the formation of the Fund in around December 2010, Respondent and the Fund Principal agreed that Respondent would personally serve as "sub-adviser" to the Fund, and, as such, would advise the Fund as to certain investments, particularly real estate opportunities.

7. The Fund Principal and Respondent also agreed that Respondent would receive one-half of the management and performance fees paid by the Fund. All told, the Fund paid Respondent approximately $226,700 in advisory fees.

8. Respondent, for compensation, engaged in the business of furnishing investment advice about securities to the Fund and, accordingly, was an investment adviser under Section 202(a)(11) of the Advisers Act.

B. *Respondent Induced the Fund to Invest in Suburban Hotel by Misleading the Fund about Suburban Hotel's Debts and the Encumbrances on its Property*

9. At the time of the Fund's formation, Respondent was an investor in both Suburban Hotel and City Hotel, and he recommended that the Fund consider investing in one or both projects. In early 2011, the Fund Principal visited both sites, and after conferring with Respondent, agreed that the Fund should invest in Suburban Hotel, but not in City Hotel.

10. By early March 2011, Respondent had increased his stake in Suburban Hotel to 88% and had assumed effective control over the project. Days later, following additional communications with the Fund Principal, Respondent secured a formal written commitment from the Fund to invest a total of $4 million in Suburban Hotel. In return, Respondent, on behalf of himself and Suburban Hotel agreed: (1) to transfer to the Fund a 24% "preferred" interest in Suburban Hotel; and (2) to assign to the Fund the original bank note and deed of trust on the Suburban Hotel property (the "Suburban Property"), both of which Respondent had personally acquired through a transaction with the original lender in December 2010.

11. The Fund made its first payment under the agreement on March 15, 2011 and continued to make periodic deposits to Suburban Hotel until it fulfilled the $4 million investment commitment in April 2013.

12. In communications with the Fund Principal about the Fund's potential investment in Suburban Hotel, Respondent assured the Fund Principal that the Fund's investment ultimately

would pay off a single outstanding loan, leaving the Suburban Property "free and clear." Therefore, Respondent represented, even if the project never broke ground, he would be able to generate a profit for the Fund and himself simply by selling the Suburban Property, which Respondent represented had appraised for substantially more than the Fund had committed to invest. In one email, for example, Respondent wrote, "[w]orst case scenario is that we have to pay off the property . . . . This is now as low risk as anything I have ever been involved with."

13. In fact, Respondent knew, but concealed from the Fund, that Suburban Hotel was in *default* on an approximately $1.25 million loan from a construction and financing firm (the "Construction Lender"). Moreover, that debt, which Respondent had personally guaranteed, was growing each day with unpaid interest and fees and was secured by a deed of trust on the Suburban Property. Hence, contrary to Respondent's assurances to the Fund Principal, repayment of the single loan that Respondent *did* disclose would not necessarily leave the Suburban Property "free and clear." Rather, so long as the debt owed to Construction Lender remained unpaid (which it did), Suburban Hotel would be unable to sell the property without repaying that debt.

C. *In an Effort to Rescue the City Hotel Project, Respondent Took Personal Ownership of the Suburban Property, and then Pledged it as Collateral for Personal Debts*

14. In the spring of 2012, Respondent's other hotel project, *City* Hotel, was on the verge of financial collapse. City Hotel was in default on its bank loan (repayment of which Respondent had personally guaranteed), the outstanding loan balance (with unpaid interest and fees) stood at approximately $3.4 million, and the bank (the "City Hotel Lender") had scheduled a foreclosure sale of City Hotel's undeveloped land (the "City Property").

15. In late May 2012, in an effort to prevent foreclosure on the City Property, Respondent reached an agreement with City Hotel Lender under which they agreed that: Respondent would make a partial loan payment of $1.85 million to City Hotel Lender in exchange for the bank postponing the foreclosure sale; the bank would assign its rights to Respondent if he paid the remaining loan balance (approximately $1.4 million) before August 24, 2012; but the bank would have the right to proceed with foreclosure if Respondent failed to pay off the balance by the August deadline.

16. To obtain financing for his first payment to City Hotel Lender, Respondent caused *Suburban* Hotel to convey the Suburban Property to him in his personal capacity, leaving Suburban Hotel with no assets other than cash supplied by the Fund. Then, in June 2012, Respondent pledged the Suburban Property as collateral for a $2.4 million loan from a hard money lender ("Hard Money Lender"), the net proceeds of which he used to make his $1.85 million down payment to City Hotel Lender, leaving a balance of approximately $1.4 million on the City Hotel loan.

17. At the same time, Respondent gave a new second-position deed of trust on the Suburban Property to *Construction* Lender as collateral for a confession of judgment, which Construction Lender required him to sign in exchange for allowing Hard Money Lender to take a priority position on the Suburban Property.

18. In short, having induced the Fund to invest in Suburban Hotel, Respondent conveyed Suburban Hotel's only asset to himself, and then used it to secure personal debts to Hard Money Lender and Construction Lender, all in an effort to rescue the *City* Property – in which the Fund had no interest and in which the Fund Principal had specifically declined to invest – from foreclosure. Respondent disclosed none of these actions to the Fund.

D. *Respondent Used the Fund's Assets to Pay Off the City Hotel Loan and Acquire the City Property*

19. As of late July 2012, Respondent had not raised the roughly $1.4 million still owed to City Hotel Lender, and a new foreclosure date for the City Property was pending.

20. On July 31, 2012, Respondent sent an email to the Fund Principal, telling him he needed $1.4 million from the Fund for "development costs, plans, etc." associated with Suburban Hotel.

21. On August 10, 2012, per Respondent's request, the Fund wired $1.4 million to Suburban Hotel's bank account, which Respondent controlled. The following business day, Respondent wired nearly all those funds to City Hotel Lender, thereby paying off the City Hotel loan, eliminating any liability he might otherwise have had on his personal guarantee of that loan, and acquiring the bank's rights under the original note and deed of trust on the City Property.

22. On August 16, 2012, Respondent personally acquired the City Property in a previously-scheduled foreclosure sale, using as his bid the payments he had already made to City Hotel Lender (including the $1.39 million that had come from the Fund).

23. Respondent disclosed none of these actions to the Fund and, in fact, continued to request that the Fund make periodic deposits to Suburban Hotel in furtherance of the Fund's investment commitment to that company.

E. *Respondent Used Fund Assets to Make Settlement Payments to Construction Lender and Used Proceeds from the Sale of the Suburban Property to Pay Off Personal Debts*

24. The confession of judgment that Respondent signed with Construction Lender in June 2012 required a repayment of approximately $1 million by late September 2012, with the remaining balance due by December 31, 2012. In February 2013, Construction Lender, having not received those required payments, filed Respondent's confession of judgment in Washington state court and obtained a formal judgment against him.

25. On or about March 18, 2013, Respondent and Construction Lender reached a settlement agreement concerning Respondent's debt. Under the agreement, Respondent promised: (1) to pay Construction Lender $190,000 immediately; (2) to sell the Suburban Property (on which Respondent had signed a contract of sale but had not closed); (3) to pay Construction Lender $1.2 million from the sales proceeds; and (4) to pay Construction Lender approximately $260,000 thereafter.

26. On or about March 19, 2013, Respondent made his first $190,000 settlement payment to Construction Lender, using funds that had been furnished by the Fund for Suburban

Hotel. On or about March 26, 2013, he sold the Suburban Property, paying most of the proceeds to Hard Money Lender (approximately $2.4 million) and Construction Lender ($1.2 million). Following the sale, Respondent used additional cash from the Fund to make his final settlement payments to Construction Lender.

27. In August 2013, approximately five months after the fact, Respondent disclosed to the Fund that he had sold the Suburban Property, but otherwise did not disclose the facts described in paragraphs 24 – 26 above.

F. *Respondent Misappropriated Fund Assets*

28. Throughout the relevant period, nearly all of the cash deposited into Suburban Hotel's bank account, which Respondent controlled, came from the Fund. As noted above, without disclosure to the Fund, Respondent used the Fund's cash to pay off the City Hotel loan and to make settlement payments to Construction Lender. In addition:

a. Between April 2011 and October 2013, Respondent paid approximately $382,000 to cover consulting fees, lending fees, and other expenses relating to the City Hotel project.

b. In late 2012, Respondent used approximately $10,700 to make loan advances to a personal friend.

c. Between January and May 2013, Respondent wrote checks totaling $380,000 to another entity that he controlled, and then used those funds for purposes unrelated to Suburban Hotel.

d. In June and July 2013, Respondent used $242,000 to cover payments related to a land development project in Steamboat Springs, Colorado.

29. Respondent induced the Fund to continue providing cash to finance these unauthorized payments by failing to disclose and affirmatively misrepresenting material facts. For example:

a. During the second half of 2012, Respondent sought periodic cash infusions from the Fund without disclosing that he had transferred the Suburban Property to himself and had further encumbered it to secure his debt to Hard Money Lender on the City Hotel project and his confession of judgment to Construction Lender.

b. In late 2012, Respondent sought additional cash from the Fund "to finish paying off the debt" and "go forward" with construction on the Suburban Property, even though he had already signed a contract to *sell* the property.

c. In April 2013, Respondent requested that the Fund provide "the balance of the $4 million" investment commitment to Suburban Hotel

without disclosing that he had sold the Suburban Property the previous month.

G. *The Current Status of the Fund's Investment*

30. In September 2013, Respondent advised the Fund Principal that he had unilaterally replaced the Fund's investment in Suburban Hotel with an equivalent investment in a new entity he had established as a vehicle for the *City* Hotel project. Development of the City Property did not proceed, however.

31. On or about May 15, 2015, the City of Seattle (the "City") filed an eminent domain proceeding with respect to the City Property in the Superior Court of Washington, King County (the "Superior Court"), foreclosing further development efforts.

32. In late July 2015, the City deposited $7,300,000 into the registry of the Superior Court, pursuant to a stipulation among the parties to the eminent domain proceeding.

33. On or about July 31, 2015, the Superior Court ordered the release of approximately $1.7 million from the funds deposited by the City to satisfy an outstanding mortgage secured by the City Property and taxes owed on the property.

34. On or about August 8, 2015, Respondent and the Fund entered into an agreement requiring Respondent, upon approval by the Superior Court, to make certain payments to the Fund from the funds on deposit with the Superior Court.

Violations

35. By virtue of the conduct described above, Respondent willfully violated Section 206(1) of the Advisers Act, which prohibits an investment adviser from employing any device, scheme, or artifice to defraud any client.

36. By virtue of the same conduct, Respondent willfully violated Section 206(2) of the Advisers Act, which prohibits an adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

37. By misappropriating Fund assets, Respondent also willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8(a)(2) thereunder, which prohibits an adviser to a pooled investment vehicle from engaging in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Section 15(b) of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder.

B. Respondent be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent shall pay disgorgement, prejudgment interest, and a civil penalty as follows:

1. Disgorgement and Prejudgment Interest

a. Respondent shall pay to the Securities and Exchange Commission disgorgement of $4,226,684, together with prejudgment interest of $21,256 (for a total of $4,247,940), within 360 days of the entry of this Order; *provided* that any payment that Respondent makes to the Fund, and that is reflected by evidence acceptable to the Commission staff, will be credited, dollar-for-dollar, towards the satisfaction of Respondent's disgorgement and prejudgment interest obligations.

b. The Commission will hold funds, if any, paid to the Commission pursuant to Respondent's disgorgement and prejudgment interest obligations in an account at the United States Treasury pending a decision whether the Commission, in its discretion, will seek to distribute funds or transfer them to the general fund of the United States Treasury, subject to Section 21F(g)(3) of the Exchange Act.

2. Civil Penalty

a. Respondent shall pay a civil penalty of $150,000 to the United States Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Section 21F(g)(3) of the Exchange Act.

b. Payment of the civil penalty shall be made in the following installments: $20,000 within 10 days of the entry of this Order; $30,000 within 90 days of the entry of this Order; and $100,000 within 360 days of the entry of this Order.

If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or, as to any unpaid civil penalty, pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application.

Payment to the Commission must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Gary M. Arford as the Respondent in these proceedings and identifying the file number of these proceedings. A copy of the cover letter and check or money order must be sent to:

Kurt L. Gottschall
Assistant Regional Director, Asset Management Unit
Securities and Exchange Commission
1961 Stout Street, Suite 1700
Denver, CO 80294-1961.

E. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

Chair White
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 76304 / October 29, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4247 / October 29, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16934

In the Matter of **SEAN M. MEADOWS,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Sean M. Meadows ("Meadows" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange

Act of 1934 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that

1. From at least 2007 through at least April 2014, Meadows was the president of Meadows Financial Group, LLC ("MFG"). MFG provided financial planning and portfolio management services to its clients. It had its principal place of business in Minneapolis, Minnesota and was registered with the State of Minnesota as an Investment Adviser until 2010.

2. On December 10, 2014, Meadows pleaded guilty to charges of mail fraud, wire fraud, money laundering, and transactions involving fraud proceeds in the criminal case entitled USA v. Sean M. Meadows, No. 14-cr-251 SRN/JSM, in the United States District Court for the District of Minnesota. The court accepted Meadows's guilty plea and, on June 26, 2015, a judgment in the criminal case was entered against Meadows. He was sentenced to 25 years in prison.

3. The counts of the criminal indictment to which Meadows pleaded guilty alleged, inter alia, that Meadows fraudulently solicited money from investors through promises that he would use the invested funds to purchase bonds or other legitimate investments when, in fact, he intended to and did use the invested funds to pay personal expenses and make Ponzi-type payments to other investors.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Meadows's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act, and Section 203(f) of the Advisers Act, that Respondent Meadows be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission,

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9970 / October 29, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76305 / October 29, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-15973

In the Matter of **TONEY ANAYA,** **Respondent.**	**ORDER CONCERNING CIVIL PENALTY AND TERMINATING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS**

I.

The Securities and Exchange Commission ("Commission") instituted an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order and Notice of Hearing against Toney Anaya ("Anaya") on July 16, 2014 ("Order Instituting Proceedings").

In anticipation of those proceedings, Anaya submitted an Offer of Settlement in which, among other things, he agreed to additional proceedings in these proceedings to determine what, if any, civil penalties pursuant to Section 8A(g) of the Securities Act and Section 21B(a) of the Exchange Act against him are in the public interest, in light of his cooperation in this matter.

II.

In connection with the anticipated additional proceedings, Anaya has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Anaya consents to the entry of this Order Concerning Civil Penalty and Terminating Administrative and Cease-and-Desist Proceedings ("Order"), as set forth below.

III.

On the basis of this Order and Anaya's Offer, the Commission finds[1] that, in the view of the Division of Enforcement ("Division"), Anaya fully complied with his obligations under a cooperation agreement entered into by him and the Division.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to accept Anaya's Offer.

Accordingly, pursuant to Section 8A of the Securities Act and Section 15(b)(6) of the Exchange Act, it is hereby ORDERED that:

A. These proceedings are terminated.

B. Anaya acknowledges that the Commission is not imposing a civil penalty based upon his substantial cooperation in a Commission investigation and related enforcement action. If at any time following the entry of the Order, the Division obtains information indicating that Anaya knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding, the Division may, at its sole discretion and with prior notice to Anaya, petition the Commission to reopen this matter and seek an order directing that Anaya pay a civil money penalty. Anaya may contest by way of defense in any resulting administrative proceeding whether he knowingly provided materially false or misleading information, but may not: (1) contest the findings in the Order Instituting Proceedings; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

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1 The findings herein are made pursuant to Anaya's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9971 / October 29, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 76306 / October 29, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4248 / October 29, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31885 / October 29, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-11818

In the Matter of

Banc of America Capital Management, LLC, BACAP Distributors, LLC, and Banc of America Securities, LLC,

Respondents.

ORDER MODIFYING ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940

I.

On February 9, 2005, the Securities and Exchange Commission ("Commission") issued an Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("2005 Order"),[1] against Banc of America Capital Management, LLC, now known as BofA Advisors, LLC ("BACAP"), BACAP Distributors, LLC, now known as BofA Distributors, Inc. ("BACAP Distributors") and Banc of America

[1] See Securities Act Rel. No. 8538, February 9, 2005, Admin. Proc. File No. 3-11818.

Securities, LLC ("BAS") (collectively, "Respondents").

II.

Respondents consented to the entry of the 2005 Order. Among other things, the 2005 Order required Respondents to cease and desist from further violations of the federal securities laws, directed Respondents to pay disgorgement and civil money penalties, and imposed certain compliance undertakings on Respondents.

III.

Respondents BACAP and BACAP Distributors (collectively, the "BACM Entities") have submitted an Amended Offer of Settlement ("Offer") proposing that the Commission eliminate the undertakings by the BACM Entities that: (1) each of the Nations Funds mutual funds hold a shareholders meeting every five years to elect its board of trustees pursuant to Paragraph 134(g) of the 2005 Order; (2) each of the Nations Funds mutual funds designate an independent compliance officer reporting to its board of trustees pursuant to Paragraph 134(h) of the 2005 Order; and (3) the BACM Entities maintain an Internal Compliance Controls Committee in accordance with Paragraph 137(b) of the 2005 Order.

Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings in the 2005 Order, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, the BACM Entities consent to the entry of this Order Modifying Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Sections 9(b) and 9(f) of the Investment Company Act of 1940, as set forth below.

IV.

The Commission deems it appropriate and in the public interest to amend the 2005 Order as agreed to in the BACM Entities' Offer.

Accordingly, IT IS HEREBY ORDERED that:

A. Paragraph 134(g) of the 2005 Order is amended as follows to order:

In 2005 and 2011, each of the Nations Funds mutual funds will hold a meeting of shareholders at which the Board of Trustees will be elected.

B. Paragraph 134(h) of the 2005 Order is amended as follows to order:

Until at least December 31, 2014, each of the Nations Funds mutual funds will designate

an independent compliance officer reporting to its Board of Trustees as being responsible for assisting the Board of Trustees and any of its committees in monitoring compliance by BACAP and BACAP Distributors with the federal securities laws, BACAP's fiduciary duties to fund shareholders, and their Code of Ethics in all matters relevant to the operation of the Nations Funds. The duties of this person will include reviewing all compliance reports furnished to the Board of Trustees or its committees by BACAP and/or BACAP Distributors, attending meetings of BACAP's Internal Compliance Controls Committee and BACAP Distributors' Internal Compliance Controls Committee to be established pursuant to BACAP's and BACAP Distributors' undertakings set forth in Section IV of the 2005 Order, serving as liaison between the Board of Trustees and its committees and the Chief Compliance Officer of BACAP and BACAP Distributors, making such recommendations to the Board of Trustees regarding BACAP's and BACAP Distributors' compliance procedures as may appear advisable from time to time, and promptly reporting to the Board of Trustees any material breach of fiduciary duty, breach of the Code of Ethics and/or violation of the federal securities laws of which he or she becomes aware in the course of carrying out his or her duties.

C. Paragraph 137(b) of the 2005 Order is amended as follows to order:

Until at least December 31, 2014, BACAP and BACAP Distributors shall establish an Internal Compliance Controls Committee to be chaired by either BACAP's Chief Compliance Officer or BACAP Distributors' Chief Compliance Officer, which Committee shall have as its members senior executives of BACAP's and BACAP Distributors' operating businesses. Notice of all meetings of the Internal Compliance Controls Committee shall be given to the independent trustees of the Nations Funds mutual funds, who shall be invited to attend and participate in such meetings. The Internal Compliance Controls Committee shall review compliance issues throughout the business of BACAP and BACAP Distributors, endeavor to develop solutions to those issues as they may arise from time to time, and oversee implementation of those solutions. The Internal Compliance Controls Committee shall provide reports on internal compliance matters to the Audit Committee of the Board of Trustees of the Nations Funds mutual funds with such frequency as the independent trustees of such funds may instruct, and in any event at least quarterly. BACAP and BACAP Distributors shall also provide to the Board of Managers of BACAP and the Board of Managers of BACAP Distributors the same reports of the Code of

Ethics Oversight Committee and the Internal Compliance Controls Committee that it provides to the Audit Committee of the Board of Trustees of the Nations Funds mutual funds.

D. All other provisions of the 2005 Order, as amended by the Order Modifying Order dated August 30, 2011,[2] remain in effect.

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

2 See Securities Act Rel. No. 9254, August 30, 2011, Admin. Proc. File No. 3-11818.

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-76322)

October 30, 2015

Order Exempting Certain Large Traders from the Self-Identification Requirements of Rule 13h-1 Under the Securities Exchange Act of 1934, and Exempting Certain Broker-Dealers From the Recordkeeping, Reporting, and Monitoring Responsibilities Under the Rule

On July 27, 2011, the Securities and Exchange Commission ("Commission") adopted Rule 13h-1 (the "Rule") under the Securities Exchange Act of 1934 ("Exchange Act") to assist the Commission in both identifying and obtaining information on market participants that conduct a substantial amount of trading activity, as measured by volume or market value, in U.S. securities (such persons are referred to as "large traders").[1] The Rule requires certain large traders to identify themselves to the Commission by filing Form 13H and separately requires certain broker-dealers to maintain records of large trader transaction information and report such information to the Commission upon request as well as monitor customer trading to help promote compliance with the Rule by traders. Since December 1, 2011, persons whose trading activity reached or exceeded the identifying activity level specified in the Rule have been required to identify themselves to the Commission by filing Form 13H through the Commission's EDGAR system. The Commission implemented the broker-dealer recordkeeping, reporting, and monitoring requirements of the Rule in phases through a series of exemptive orders establishing certain delayed compliance dates,[2] and currently certain broker-dealers are required to keep records of and report to the Commission upon request transaction data for

1 See Securities Exchange Act Release No. 64976 (July 27, 2011), 76 FR 46960 (Aug. 3, 2011) ("Adopting Release"). The effective date of Rule 13h-1 was October 3, 2011.

2 See Securities Exchange Act Release Nos. 70150 (August 8, 2013), 78 FR 49556 (August 14, 2013) (establishing Phase Two and providing for Phase Three); 69281 (April 3, 2013), 78 FR 20960 (April 8, 2013) (extension of the compliance date); and 66839 (April 20, 2012), 77 FR 25007 (April 26, 2012) (establishing Phase One).

certain of their customers that are either a large trader or an Unidentified Large Trader.[3] Most recently, the Commission established a compliance date of November 1, 2013 for Phase Two of the Rule, which, among other things, implemented the recordkeeping and reporting responsibilities for an additional category of traders and also implemented the monitoring requirements under the Rule to require certain broker-dealers to monitor their customers' trading activity in order to promote awareness of and foster compliance with the self-identification requirements of the Rule.[4] At that time, the Commission stated that the compliance date for Phase Three of the Rule would be November 1, 2015.[5]

The Commission has received a request from the Financial Information Forum ("FIF") to exempt options traders from the requirements of the Rule conditioned upon such traders not exceeding the "identifying activity level" (i.e., the threshold at which a person triggers the self-identification requirements of the Rule) as calculated based on the gross premium of the options trades.[6] FIF asserts that such relief would appropriately limit the identification requirements of

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3 Rule 13h-1(a)(9) defines "Unidentified Large Trader" as "each person who has not complied with the identification requirements of paragraphs (b)(1) and (b)(2) of this rule that a registered broker-dealer knows or has reason to know is a large trader." The Rule provides that, for purposes of determining whether a registered broker-dealer has reason to know that a person is a large trader, "a registered broker-dealer need take into account only transactions in NMS securities effected by or through such broker-dealer." Rule 13h-1(a)(9).

4 See Securities Exchange Act Release No. 70150, supra note 2 (establishing the November 1, 2013 compliance date for customer monitoring responsibilities). See also note 27, infra, and accompanying text.

5 Phase Three includes all of the remaining requirements of Rule 13h-1 that were not implemented in either Phase One or Phase Two. In particular, Phase Three would require reporting of execution time on trades for additional categories of persons beyond those covered in Phases One and Two.

6 See Letter from Mary Lou VonKaenel, Managing Director, FIF, to Stephen Luparello, Director of the Division of Trading and Markets, Commission, dated March 27, 2015 ("FIF Letter"), available at: http://www.sec.gov/comments/s7-10-10/s71010.shtml.

the Rule by exempting from the Rule a class of persons whose options trading is unlikely to have a market impact.[7] In addition, FIF requested that the Commission permanently exempt broker-dealers from the recordkeeping and reporting requirements of Phase Three of the Rule, or alternatively postpone the compliance date of the Phase Three requirements until November 1, 2020.[8] The Securities Industry and Financial Markets Association ("SIFMA") also has requested that the Commission permanently exempt broker-dealers from the recordkeeping and reporting requirements of Phase Three of the Rule, or alternatively postpone the compliance date of the Phase Three requirements until November 1, 2020.[9]

For the reasons explained below, the Commission believes that providing exemptive relief for equity options traders and deferring Phase Three are appropriate. Accordingly, the Commission is: (1) conditionally exempting equity options market participants from the self-identification requirements of the Rule if they have not met or exceeded the alternative threshold described below that is applicable to equity options trading;[10] and (2) temporarily exempting broker-dealers until November 1, 2017 from the remaining recordkeeping and reporting obligations of the Rule beyond those established in Phases One and Two.[11]

Currently, the fair market value of equity options is calculated based on the value of the underlying securities. See Rule 13h-1(c)(1)(i).

7 See FIF Letter, supra note 6, at 2-3.

8 See FIF Letter, supra note 6, at 3.

9 See Letter from Theodore R. Lazo, Managing Director and Associate General Counsel, SIFMA to Stephen Luparello, Director of the Division of Trading and Markets, Commission, dated April 9, 2015 ("SIFMA Letter"), available at: http://www.sec.gov/comments/s7-10-10/s71010.shtml.

10 As discussed below, with respect to any persons that previously registered as a large trader on account of their equity options transactions, this exemption relieves those persons from continued compliance with the periodic filing obligations as long as they do not otherwise meet or exceed the identifying activity level in the future.

11 Phases One and Two are discussed below. See infra text accompanying notes 53 and 54.

I. Background

A. Large Trader Status

The Rule defines a large trader as a person who "directly or indirectly, including through other persons controlled by such person, exercises investment discretion over one or more accounts and effects transactions for the purchase or sale of any NMS security for or on behalf of such accounts, by or through one or more registered broker-dealers, in an aggregate amount equal to or greater than the identifying activity level" (emphasis added).[12] The identifying activity level contains daily and monthly share volume and fair market value thresholds, namely: aggregate transactions in NMS securities that are equal to or greater than (1) during a calendar day, either 2 million shares or shares with a fair market value of $20 million; or (2) during a calendar month, either 20 million shares or shares with a fair market value of $200 million.[13]

In establishing the current identifying activity level for equity derivative securities, the Commission stated that the Rule was intended to focus on the potential impact of options transactions on the market for the underlying security.[14]

Specifically, for equity options,

- share volume is calculated by multiplying the number of contracts by the option contract's specified multiplier; and

- fair market value is calculated using the value of the securities underlying the option.[15]

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12 See Rule 13h-1(a)(1).

13 See Rule 13h-1(a)(7).

14 See Adopting Release, supra note 1, 76 FR at 46967 (noting that this focus reflected and was consistent with Section 13(h) of the Exchange Act).

15 Examples of how to calculate the identifying activity for options transactions were provided in the Adopting Release, supra note 1, 76 FR at 46967. In contrast, for index options, share volume is not calculated because index options do not overlie shares and

At the time the Commission adopted Rule 13h-1, the Commission stated that this approach was consistent with Section 13(h)(1) of the Exchange Act, which sought to promote the Commission's ability to "monitor[] the impact on the securities markets of securities transactions involving a substantial volume or a large fair market value or exercise value…" in that the methodology considers the equivalent exercise value of the options on the date of purchase.[16] This approach eliminates the need to track and separately consider exercise and instead preemptively identifies traders whose options trading may be of a sufficient magnitude to potentially affect the underlying stock if the positions are exercised.

B. The Requirements of Rule 13h-1

1. Large Trader Self-Identification

As noted above, the Rule requires large traders to self-identify to the Commission on Form 13H and periodically update their Form 13H submission,[17] obtain a unique large trader identification number ("LTID") from the Commission,[18] and provide this number to their brokers and identify each account to which the LTID applies.[19] These large trader responsibilities are referred to collectively as the "Self-Identification Requirements."

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fair market value is calculated by multiplying together the index multiplier, the number of options, and the price per contract.

16 See Adopting Release, supra note 1, 76 FR at 46967, text accompanying n.65.

17 See Rule 13h-1(b)(1)(i)-(iii). Form 13H and all updates to it are filed electronically through the Commission's EDGAR system.

18 When a large trader files its initial Form 13H filing through EDGAR, the system sends an automatically generated confirmation email acknowledging acceptance of the filing. That email also contains the unique 8-digit LTID number assigned to the large trader.

19 See Rule 13h-1(b)(2). See also Large Trader Adopting Release, supra note 1, 76 FR at 46971 ("the requirements that a large trader provide its LTID to all registered broker-dealers who effect transactions on its behalf, and identify each account to which it applies, are ongoing responsibilities that must be discharged promptly").

2. Broker-Dealers' Recordkeeping and Reporting Responsibilities Regarding Unidentified Large Traders and the Customer Monitoring Safe Harbor

Under Rules 13h-1(d) and (e), registered broker-dealers are responsible for, among other things, keeping records of and reporting to the Commission upon request data for their customers that are large traders or Unidentified Large Traders.[20] Specifically, Rule 13h-1 requires that every registered broker-dealer maintain records of data specified in paragraphs (d)(2) and (d)(3) of the Rule ("Transaction Data"), including the applicable LTID(s) and execution time on each component trade, for all transactions effected directly or indirectly by or through: (1) an account such broker-dealer carries for a large trader or an Unidentified Large Trader; or (2) if the broker-dealer is a large trader, any proprietary or other account over which such broker-dealer exercises investment discretion. Additionally, where a non-broker-dealer carries an account for a large trader or an Unidentified Large Trader under the Rule, the broker-dealer effecting transactions directly or indirectly for such large trader or Unidentified Large Trader must maintain records of all Transaction Data.[21] These recordkeeping obligations are referred to collectively as the "Recordkeeping Responsibilities." The Rule also requires that, upon Commission request, every registered broker-dealer that is itself a large trader or carries an account for a large trader or an Unidentified Large Trader must electronically report Transaction Data to the Commission through the Electronic Blue Sheets ("EBS") system for all transactions, equal to or greater than the reporting activity level, effected directly or indirectly by or through accounts carried by such broker-dealer for large traders or Unidentified Large Traders.[22] Additionally, where a non-broker-dealer carries an account for a large trader or an Unidentified Large Trader, the broker-

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20 See note 3, supra.

21 See Rule 13h-1(d)(1)(iii).

22 See Rule 13h-1(e).

dealer effecting such transactions directly or indirectly for a large trader or Unidentified Large Trader must electronically report Transaction Data to the Commission through the EBS system.[23] The Rule requires that reporting broker-dealers submit the requested Transaction Data no later than the day and time specified in the Commission's request.[24] These reporting obligations are referred to collectively as the "Reporting Responsibilities." The Commission has implemented the Recordkeeping and Reporting Responsibilities in phases, as discussed in greater detail below.[25]

Rule 13h-1(f) provides a safe harbor that is designed to reduce broker-dealers' recordkeeping and reporting burdens with respect to Unidentified Large Traders by, among other things, providing relief for when a broker-dealer shall be deemed to know or have reason to know that a person is a large trader and thus subject to reporting obligations related to Unidentified Large Traders under Rule 13h-1. Under the safe harbor, a registered broker-dealer is deemed not to know or have reason to know that a person is a large trader if it does not have actual knowledge that a person is a large trader and it establishes policies and procedures reasonably designed to identify customers whose transactions at the broker-dealer equal or exceed the identifying activity level and, if so, to treat such persons as Unidentified Large Traders and notify them of their potential reporting obligations under this Rule.[26] Collectively, these broker-dealer undertakings are referred to as the "Customer Monitoring Obligations." The Customer Monitoring Obligations are intended to promote awareness of and foster compliance

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23 See id.

24 See id.

25 See Section II.D, infra.

26 See Rule 13h-1(f).

with the Rule among persons who might not otherwise be aware of the large trader reporting requirements.[27]

As noted above, the Commission previously granted broker-dealers temporary exemptions from the Customer Monitoring Obligations.[28] As of November 1, 2013, to avail themselves of the safe harbor, broker-dealers with recordkeeping and reporting responsibilities were required to implement the Customer Monitoring Obligations.

II. Exemptive Relief

Pursuant to Section 13(h)(6) of the Exchange Act and Rule 13h-1(g) thereunder,[29] the Commission, by order, may exempt from the provisions of Rule 13h-1, upon specified terms and conditions or for stated periods, any person or class of persons or any transaction or class of transactions from the provisions of Rule 13h-1 to the extent that such exemption is consistent with the purposes of the Exchange Act.

FIF requests that the Commission grant exemptive relief for options traders that would be conditioned upon such traders' activity not exceeding the Rule's identifying activity threshold based on the gross premiums paid for the options as opposed to the value of the underlying stock at the time of the trade.[30] FIF notes that some of its members, particularly brokers with retail customers, have identified through their Customer Monitoring Obligations a number of retail customers that met or exceeded the threshold based primarily on such customers' equity options

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27 See Adopting Release, supra note 1, 76 FR at 46997.

28 See Securities Exchange Act Release Nos. 66839 and 69281, supra note 2.

29 See 15 U.S.C. 78m and 17 CFR 240.13h-1(g), respectively.

30 FIF requests that the alternative "options premium" threshold be consistent with Rule 13h-1(a)(7), which establishes the daily and monthly market value thresholds of the identifying activity level as $20 million and $200 million, respectively. See FIF Letter, supra note 6, at 2.

trading, particularly in deep out-of-the-money options on high priced underlying stocks.[31] According to FIF, customers that meet the "underlying value" threshold rarely exercise their options, and many of them would be unable to do so based on their account balances.[32] FIF argues that exemptive relief for all options traders conditioned upon a premium-based threshold calculation would appropriately focus the Rule on traders who are more significant participants in the U.S. securities markets and who are more likely to trade options at levels and in a manner that could have a market impact.[33]

In addition, both FIF and SIMFA request that the Commission permanently exempt broker-dealers from the additional recordkeeping and reporting requirements of Phase Three of the Rule, which have not yet been implemented.[34] In the alternative, FIF requests an extension of Phase Three by an additional five years[35] and SIFMA requests an extension to the earlier of full implementation of a Consolidated Audit Trail ("CAT") or November 1, 2020.[36] Both FIF and SIFMA stated that their request would allow firms to focus their resources on implementing a CAT.[37]

A. Exemption from the Self-Identification Requirements for Equity Options Traders

As discussed above, the current identifying activity level methodology for equity options was designed to focus on the potential impact of options transactions on the market for the

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31 See FIF Letter, supra note 6, at 1.

32 See FIF Letter, supra note 6, at 2.

33 See FIF Letter, supra note 6, at 2-3.

34 See FIF Letter, supra note 6, at 3 and SIFMA Letter, supra note 9, at 2-3.

35 See FIF Letter, supra note 6, at 3.

36 See SIFMA Letter, supra note 9, at 2. See also Rule 613; Securities Exchange Act Release No. 67457 (July 18, 2012), 77 FR 45722 (Aug. 1, 2012).

37 See FIF Letter, supra note 6, at 3 and SIFMA Letter, supra note 9, at 2.

underlying securities. Based on its experience and the experience of its member firms, however, FIF suggests that the current methodology designates as large traders some persons who rarely exercise their options and whose aggregate equity options transactions, considering the actual premium paid for the options, are not of a large enough fair market value to have an impact either on the options market or the underlying equities markets.

In particular, FIF notes that this issue appears to be especially pronounced for market participants, particularly individual non-professional investors, who transact in deep out-of-the money options on high-priced securities.[38] While such transactions may have large exercise values, the premium paid for the options may be modest due to the deep-out-of-the-money nature of the contract, and, importantly, exercise among these traders is very infrequent, according to FIF. FIF's members reported that, among their customers that became large traders as a result of options transactions, such customers very rarely exercised their options,[39] and FIF asserts that many may have lacked the resources to do so.[40] In other words, the current methodology for calculating the fair market value of equity options has resulted in the self-identification as large traders of a number of investors who trade equity options, yet such investors' activity is unlikely

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38 See FIF Letter, supra note 6, at 1.

39 FIF reports that it surveyed its members and found that customers that became large traders as a result of options transactions ("Equity Options LT Customers") exercised their options less than 2% of the time on average. See FIF Letter, supra note 6, at 2.

40 FIF states that, "[g]iven the account size associated with this class of investor it is unlikely that they would have the ability to exercise these out of the money options." See id. To support this conclusion, FIF provides anecdotal data: a firm with approximately 2,000 Equity Options LT Customers reported that the average account value was $835,000. Another FIF member firm reported that: the average account size for 90% of its Equity Options LT Customers was less than $555,000; the average value across all Equity Options LT Customer accounts was $2.5 million; and excluding the top 50% of its Equity Options LT Customer accounts, the average account size was under $56,000. See id. FIF suggests that without sufficient assets or collateral, such customers would not be able to outright purchase or otherwise finance their acquisition of the underlying securities in an amount that equals or exceeds the $20 million threshold.

to have a material impact either on the options market or the underlying equities markets for the purposes of Rule 13h-1.

In order to alleviate the burdens on these persons without undermining the purposes of Section 13(h), the Commission hereby is providing a conditional exemption from the Self-Identification Requirements for persons that trade equity options if: (1) the aggregate value of their equity option transactions based on premium paid,[41] combined with the aggregate value of their transactions in all other NMS securities (if any), does not reach or exceed the current fair market value thresholds of the identifying activity level; and (2) they also do not reach or exceed the share volume thresholds of the identifying activity level.[42] Accordingly, this exemptive relief makes the calculation of fair market value for equity options consistent with how index options are valued under the identifying activity level.[43]

This relief utilizes the existing fair market value thresholds of the identifying activity level and references premium paid instead of the price of the underlying at the time of the trade.[44] The Commission is persuaded that valuing equity options using premium paid and applying the existing fair market value thresholds appropriately focuses the Rule on persons whose transactions are more likely to have a market impact and therefore warrant triggering the

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41 To calculate premium paid for an options trade, multiply together the number of options contracts involved, the premium paid, and the applicable multiplier. For an example, see infra Section II.A.3.

42 Neither FIF nor SIFMA have requested exemptive relief for persons who become large traders as a result of reaching the identifying activity level share volume thresholds applicable to equity options, and the Commission is not herein granting such relief.

43 See Rule 13h-1(c)(1)(ii) (concerning the fair market value of index options). See also Adopting Release, supra note 1, 76 FR at 46967 (noting, in footnote 64 and the accompanying text, how to determine the fair market value of index (and equity) options).

44 See Rule 13h-1(c)(1)(i) (concerning the fair market value of equity securities underlying transactions in stock options).

Self-Identification Requirements. In particular, as FIF has stated, the current methodology impacts a number of equity options traders, many of whom reach the threshold by purchasing options that are deep out of the money and who do not otherwise trade in an amount required to reach the identifying activity level. When these options expire out of the money and are not exercised, the position does not result in any trading in the underlying securities, and thus valuing such options with reference to the price of the underlying security is unlikely to be a useful method to identify traders with the potential to have a market impact on the underlying equities.[45] Using premium paid to value equity options instead will focus the identification requirement on options traders who trade options in larger amounts that thus may be more likely to have a market impact regardless of whether the positions are ultimately exercised. In addition, employing the existing fair market value thresholds to the new premium-based methodology for equity options allows all trading in NMS securities to be easily aggregated for purposes of determining large trader status.[46] For these reasons, the Commission believes that calculating the

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45 Only purchases and sales of equity options and not transactions in the underlying securities pursuant to exercises or assignments count toward the identifying activity level. See Rule 13h-1(a)(6). Purchases and sales pursuant to exercises or assignments were expressly excluded from the identifying activity level calculation to avoid double-counting. See Adopting Release, supra note 1, 76 FR at 46967. The Commission notes that traders may trigger the Self-Identification Requirements when they trade out of the position they obtained by exercising their options.

46 Further, as noted above, for purposes of the identifying activity level under Rule 13h-1(c)(i) and (ii), fair market value of equity options is calculated differently than that for index options; the fair market value of equity options is calculated based on the value of the underlying security, while the fair market value of index options is calculated based on the premium paid for the contract. As a result, it is easier to reach the identifying activity level by transacting in options on an exchange-traded fund overlying a securities index than it is to transact in index options on the same securities index. This relief harmonizes the fair market value calculations for equity options overlying index-tracking securities (such as index-based exchange traded funds) with the calculations for index options, thereby eliminating the Self-Identification Requirements as a consideration for investors choosing between options products with comparable exposures.

fair market value for equity options by referencing the premium paid for the options is a better overall indicator, for purposes of Rule 13h-1, of potential market impact and provides appropriate relief to equity options traders. Accordingly, the Commission finds the exemptive relief to be consistent with the purposes of the Exchange Act.

Applying the Threshold Permitted by this Conditional Exemption. Equity Option Transactions Example. For example, during a calendar day, a person purchases 200 call options on ABC stock, each with a 100 multiplier, for a premium of $15 per share, where the underlying stock is trading at $1,000 at the time of the transaction. This transaction reaches the identifying activity level under the current calculation methodology,[47] pursuant to which the options are valued as follows: 200 contracts x 100 shares per contract x $1,000 (the market price of the underlying stock at the time of the trade) = $20 million. Therefore, this transaction would cause the person to qualify as a large trader. However, under this exemptive relief, the fair market value of the options trade would be calculated as follows: 200 contracts x 100 shares per contract x $15 premium price = $300,000. In this case, the transaction price of $300,000 is less than the identifying activity level of $20 million. Further, the daily share volume would be calculated as follows: 200 contracts x 100 shares of the underlying per contract = 20,000 shares, which also is less than the identifying activity level of 2 million shares. Therefore, the person would qualify for this exemption from the Self-Identification Requirements and would not be required to register as a large trader on the basis of this particular options trade alone.

"Mixed" Transactions Example. By way of another example, consider a person that, during a calendar day, (1) purchases: (a) 100 call options, each with a 100 multiplier, for a premium of $15 per share, where the underlying stock is trading at $1,000 at the time of the

47 The daily market value threshold of the identifying activity level is $20 million.

transaction; and (b) 100 contracts of puts on an index, where each option uses a $100 multiplier, for $50 per unit; and (2) sells 100,000 shares of an exchange-traded fund ("ETF") for $100 per share. Under the current method, the fair market value of each transaction would be calculated as follows:

- 100 call option contracts x 100 (contract multiplier) x $1,000 (price of the underlying stock) = $10 million
- 100 index puts x $100 (contract multiplier) x $50 (price per unit) = $500,000
- 100,000 ETF shares x $100 (price per share) = $10 million

Collectively, for purposes of the identifying activity level, the transactions would be valued at $20,500,000 ($10 million + $500,000 + $10 million), which is greater than the daily value threshold ($20 million). Accordingly, the person would be required to self-identify to the Commission as a large trader.

To determine whether the large trader qualifies for this exemptive relief, the equity options would be valued as follows:

- 100 call option contracts x 100 (contract multiplier) x $15 (premium price) = $150,000
- 100 index puts x $100 (contract multiplier) x $50 (price per unit) = $500,000
- 100,000 ETF shares x $100 (price per share) = $10 million

The person qualifies for exemption from the Self-Identification Requirements (i.e., does not have to identify as a large trader based on this day's transactions alone) because: (1) the daily share volume threshold of the identifying activity level (2 million shares) is not reached;[48] and (2) the value of the equity options under the alternative methodology ($150,000), when combined with

[48] The share volume calculation of the three transactions is as follows: (100 call option contracts x 100 contract multiplier) + 0 (index options have no underlying shares) + 100,000 ETF shares = 110,000 shares.

the fair market value of the index option and ETF transactions ($500,000 and $10 million, respectively), is less than the daily identifying activity level threshold ($20 million).[49]

B. Broker-Dealers May Update Their Monitoring Safe Harbor Policies and Procedures to Use the New Methodology

Paragraph (f) of Rule 13h-1 provides a safe harbor to reduce broker-dealers' burdens in connection with monitoring their customers' trading for purposes of identifying possible large traders. To take advantage of the safe harbor, broker-dealers must have policies and procedures reasonably designed to identify persons who have reached or exceeded the identifying activity level[50] but not identified themselves to the broker-dealer as a large trader, treat such persons as Unidentified Large Traders, and inform such persons of the obligations under Rule 13h-1. A broker-dealer that updates its policies and procedures to reflect the terms of the exemptive relief described above will be able to avail itself of the monitoring safe harbor.

C. Relief for Equity Options Large Traders Who Already Self-Identified

For any person that previously reached the identifying activity level as a result of the fair market value of their equity options transactions and previously self-identified to the Commission as a large trader, but who otherwise does not presently meet the identifying activity level as calculated under the exemptive relief provided herein, the Commission finds that it is consistent with the purposes of the Exchange Act to allow such person to file for inactive status without waiting the required full calendar year provided in paragraph (b)(3)(iii) of Rule 13h-1.

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49 $150,000 + $500,000 + $10 million = $10,650,000, which is less than the daily market threshold of the identifying activity level ($20 million).

50 See Rule 13h-1(f)(1).

To take advantage of this relief, a large trader must file for inactive status by submitting Form 13H electronically through EDGAR.[51] After filing for inactive status, the large trader is relieved from the Self-Identification Requirements, and thereafter is not required to file any further amendments or annual updates to Form 13H through EDGAR, unless and until the large trader subsequently effects transactions that reach or exceed the identifying activity level, accounting for the relief granted herein for calculating equity options activity. If a large trader that has filed for inactive status later reaches or exceeds the identifying activity level, using premium paid to calculate the fair market value of subsequent equity options transactions, then the large trader must promptly file Form 13H with the Commission for reactivated status and promptly thereafter notify its broker-dealers of its reactivated status and update them regarding the applicability of the large trader's LTID and the accounts to which it applies.

D. Temporary Exemption from Phase Three of the Recordkeeping and Reporting Responsibilities

As noted above, the Commission has implemented the Recordkeeping and Reporting Responsibilities applicable to clearing brokers for large traders in phases. In Phase One, which began on November 30, 2012, the Commission required clearing brokers for large traders (including the large trader itself if it is a self-clearing broker-dealer) to keep records and report Transaction Data for large traders' transactions that were either (1) proprietary trades by a U.S. registered broker-dealer; or (2) effected through a "sponsored access" arrangement;[52] otherwise,

51 The specific form type in EDGAR to file for inactive status is Form 13H-I. After filing for inactive status, the large trader also may inform the broker-dealers through which it transacts of its inactive status. Broker-dealers are not required to keep records of transactions by inactive large trader customers after receiving notice of inactive status from such trader with respect to transactions effected subsequent to such notification. See Adopting Release, supra note 1, 76 FR at 46976.

52 See Securities Exchange Act Release No. 66839, supra note 2, 77 FR at 25008-9. A sponsored access arrangement is one where a broker-dealer permits a customer to enter

broker-dealers were temporarily exempted from the Recordkeeping and Reporting Responsibilities.[53] In Phase Two, which began on November 1, 2013, the Commission again temporarily exempted broker-dealers, until November 1, 2015, from the Recordkeeping and Reporting Responsibilities, except for: (1) the clearing broker-dealer for a large trader, with respect to (a) proprietary transactions by a large trader broker-dealer; (b) transactions effected pursuant to a "sponsored access" arrangement; and (c) transactions effected pursuant to a "direct market access" arrangement; and (2) a broker-dealer that carries an account for a large trader, with respect to transactions other than those set forth above, and for Transaction Data other than the execution time.[54] The Commission also established Phase Three, which requires full compliance with the Recordkeeping and Reporting Responsibilities for all applicable broker-dealers starting November 1, 2015.[55]

When the Commission adopted the Rule, it characterized the large trader reporting requirements as "relatively modest steps" to "address the Commission's near-term need for access to more information about large traders and their trading activities…."[56] After the Commission adopted the Rule, industry commenters began to identify specific implementation challenges and offered more detailed estimates of the cost of full compliance with the

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orders into a trading center without using the broker-dealer's trading system (i.e., using the customer's own technology or that of a third party provider). At the time, FIF indicated that broker-dealer compliance would be easier for sponsored access customers because those arrangements typically are distinct from all other business lines of the broker-dealer, with infrastructure that processes this order flow that is separate from the platforms that handle other client and proprietary flows. See id., 77 FR at 25008, n.16.

53 See id., 77 FR at 25010.

54 See Securities Exchange Act Release No. 70150, supra note 2, 78 FR at 49558-9.

55 See id., 78 FR at 49560.

56 See Adopting Release, supra note 1, 76 FR at 46963.

Recordkeeping and Reporting Responsibilities. Such concerns led the Commission to implement the Recordkeeping and Reporting Responsibilities in phases.[57]

Additionally, since adopting the Rule, the Commission adopted Rule 613, which directed the self-regulatory organizations ("SROs") to jointly submit a plan to create a comprehensive CAT that would allow regulators to efficiently and accurately track all activity throughout the U.S. markets in National Market System (NMS) securities.[58] When the Commission adopted that rule, it stated that, while certain aspects of Rule 13h–1 are not addressed by Rule 613, Rule 613 may supersede certain of the broker-dealer Recordkeeping and Reporting Responsibilities of Rule 13h-1.[59] Specifically, the Commission stated: "[t]o the extent that . . . data reported to the central repository under Rule 613 obviates the need for the EBS system, the Commission expects that the separate [trade] reporting requirements of Rule 13h-1 related to the EBS system would be eliminated."[60]

The SROs submitted the initial CAT NMS plan to the Commission on September 30, 2014, and filed an amended plan on February 27, 2015.[61] As of the date of this Order, an NMS plan for a CAT has not yet been published for notice and comment. Accordingly, the Commission continues to rely on, among other things, information available through the

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57 See note 2, supra.

58 Among other things, Rule 613 requires the self-regulatory organizations to jointly submit an NMS plan to create, implement and maintain a consolidated audit trail, and specifies the type of data to be collected and reported to a central repository.

59 See Securities Exchange Act Release No. 67457 (July 18, 2012), 77 FR 45722, 45734 (August 1, 2012).

60 Id., text accompanying n.95.

61 Pursuant to Rule 613, the SROs were required to file the CAT NMS Plan on or before April 28, 2013. At the SROs' request, the Commission granted exemptions to extend the deadline for filing the CAT NMS Plan to December 6, 2013, and then to September 30, 2014. See Securities Exchange Act Release Nos. 69060 (Mar. 7, 2013), 78 FR 15771 (Mar. 12, 2013) and 71018 (Dec. 6, 2013), 78 FR 75669 (Dec. 12, 2013).

Recordkeeping and Reporting Responsibilities as implemented through Phases One and Two. In light of the fact that there is no approved CAT NMS plan, the Commission is hesitant at this time to require broker-dealers to incur the costs associated with the remaining Phase Three Large Trader data while the timing of a CAT remains unclear.

However, the Commission finds that it is consistent with the purposes of the Exchange Act to delay Phase Three, temporarily exempting broker-dealers until November 1, 2017 from the Recordkeeping and Reporting Responsibilities, except for: (1) the clearing broker-dealer for a large trader, with respect to (a) proprietary transactions by a large trader broker-dealer; (b) transactions effected pursuant to a "sponsored access" arrangement; and (c) transactions effected pursuant to a "direct market access" arrangement; and (2) a broker-dealer that carries an account for a large trader, with respect to transactions other than those set forth above, and for Transaction Data other than the execution time. While FIF and SIFMA have requested a permanent exemption, or alternatively an additional 5-year deferment of the compliance date for Phase Three,[62] the Commission believes at this time that a 2-year extension of the Phase Three compliance date provides sufficient time for the Commission to consider whether to revisit compliance with all of the Recordkeeping and Reporting Responsibilities. Specifically, two years will give the Commission enough time to evaluate future developments, including any investment in or progress on a CAT.[63]

III. Conclusion

IT IS HEREBY ORDERED, pursuant to Section 13(h)(6) of the Exchange Act and Rule 13h-1(g) thereunder, that:

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[62] See FIF Letter, supra note 6, at 3 and SIFMA Letter, supra note 9, at 2-3.

[63] See note 60, supra, and accompanying text.

(1) Persons transacting in equity options are exempt from the Self-Identification Requirements if: (1) the aggregate value of their equity option transactions, calculated based on premium paid, combined with the aggregate value of their transactions in all other NMS securities (if any), does not reach or exceed the fair market value thresholds of the identifying activity level; and (2) they also do not reach or exceed the share volume thresholds of the identifying activity level.

(2) A large trader whose transactions in NMS securities since October 3, 2011 reached the identifying activity level one or more times because of the fair market value of its equity options transactions and who would have qualified in each instance for relief under this exemption is exempt from its responsibilities under Rule 13h-1(b)(1)(ii), 13h-1(b)(1)(iii), and 13h-1(b)(2), if such trader files for inactive status by submitting Form 13H and does not subsequently effect transactions that reach or exceed the identifying activity threshold using premium paid to calculate the fair market value of equity options transactions.

(3) Broker-dealers are exempted temporarily until November 1, 2017 from the recordkeeping and reporting requirements of Rule 13h-1(d) and (e), except for (1) clearing broker-dealers for large traders with respect to (a) proprietary transactions by a large trader broker-dealer, (b) transactions effected pursuant to a "sponsored access" arrangement, and (c) transactions effected pursuant to a "direct market access" arrangement; and, for other types of transactions, (2) broker-dealers that carry an account for a large trader for Transaction Data other than the execution time.

By the Commission.

Jill M. Peterson
Assistant Secretary

Commissioner Piwowar Disapproved

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 200, 227, 232, 239, 240 and 249

[RELEASE NOS. 33-9974; 34-76324; File No. S7-09-13]

RIN 3235-AL37

CROWDFUNDING

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is adopting new Regulation Crowdfunding under the Securities Act of 1933 and the Securities Exchange Act of 1934 to implement the requirements of Title III of the Jumpstart Our Business Startups Act. Regulation Crowdfunding prescribes rules governing the offer and sale of securities under new Section 4(a)(6) of the Securities Act of 1933. Regulation Crowdfunding also provides a framework for the regulation of registered funding portals and broker-dealers that issuers are required to use as intermediaries in the offer and sale of securities in reliance on Section 4(a)(6). In addition, Regulation Crowdfunding conditionally exempts securities sold pursuant to Section 4(a)(6) from the registration requirements of Section 12(g) of the Securities Exchange Act of 1934.

DATES: The final rules and forms are effective [insert date 180 days after publication in the Federal Register], except § 227.400, Form Funding Portal and the amendments to Form ID are effective January 29, 2016.

FOR FURTHER INFORMATION CONTACT: With regard to requirements for issuers, Eduardo Aleman, Julie Davis, or Amy Reischauer, Division of Corporation Finance, at (202) 551-3460, and with regard to requirements for intermediaries, Joseph Furey, Joanne Rutkowski,

20a of 21

Timothy White, Devin Ryan, or Erin Galipeau, Division of Trading and Markets, at (202) 551-5550, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

Table of Contents

I. INTRODUCTION 6

A. Background 6

B. Title III of the JOBS Act 8

II. FINAL RULES IMPLEMENTING REGULATION CROWDFUNDING 10

A. Crowdfunding Exemption 14

1. Limit on Capital Raised 15
2. Investment Limits 21
3. Transaction Conducted Through an Intermediary 29
4. Exclusion of Certain Issuers from Eligibility under Section 4(a)(6) 33

B. Issuer Requirements 41

1. Disclosure Requirements 41
2. Ongoing Reporting Requirements 117
3. Form C and Filing Requirements 128
4. Prohibition on Advertising Terms of the Offering 138
5. Compensation of Persons Promoting the Offering 145
6. Other Issuer Requirements 148

C. Intermediary Requirements 153

1. Definitions of Funding Portals and Associated Persons 153
2. General Requirements for Intermediaries 156
3. Measures to Reduce Risk of Fraud 168
4. Account Opening 185
5. Requirements with Respect to Transactions 203
6. Completion of Offerings, Cancellations and Reconfirmations 240
7. Payments to Third Parties 246

D. Additional Funding Portal Requirements 249

1. Registration Requirement 249
2. Exemption from Broker-Dealer Registration 273
3. Safe Harbor for Certain Activities 277
4. Compliance 311
5. Records to be Created and Maintained by Funding Portals 319

E. Miscellaneous Provisions 326

1. Insignificant Deviations from Regulation Crowdfunding 326
2. Restrictions on Resales 329
3. Information Available to States 333
4. Exemption from Section 12(g) 333
5. Scope of Statutory Liability 339
6. Disqualification Provisions 343
7. Secondary Market Trading 352

III. ECONOMIC ANALYSIS 355

A. Baseline 357
1. Current Methods of Raising up to $1 Million of Capital 357
2. Current Sources of Funding for Startups and Small Businesses that Could Be Substitutes or Complements to Crowdfunding 363
3. Current Crowdfunding Practices 373
4. Survival Rates for Startups and Small Businesses 376
5. Market Participants 378

B. Analysis of Final Rules 386
1. Broad Economic Considerations 387
2. Crowdfunding Exemption 394
3. Issuer Requirements 405
4. Intermediary Requirements 443
5. Additional Funding Portal Requirements 470
6. Insignificant Deviations 485
7. Relationship with State Law 487
8. Exemption from Section 12(g) 488
9. Disqualification 491

IV. PAPERWORK REDUCTION ACT 497

A. Background 497

B. Estimate of Issuers and Intermediaries 499
1. Issuers 499
2. Intermediaries that are Registered Brokers 500
3. Funding Portals 501

C. Estimate of Burdens 502
1. Issuers 502
2. Brokers and Funding Portals 510

D. Collections of Information are Mandatory 533
E. Confidentiality 533
F. Retention Period of Recordkeeping Requirements 533
V. FINAL REGULATORY FLEXIBILITY ACT ANALYSIS 534
A. Need for the Rule 534
B. Significant Issues Raised by Public Comments 535
C. Small Entities Subject to the Rules 538
D. Projected Reporting, Recordkeeping and other Compliance Requirements 539
E. Agency Action to Minimize Effect on Small Entities 541
1. Issuers 541
2. Intermediaries 544
VI. STATUTORY AUTHORITY AND TEXT OF PROPOSED REGULATION 546
EXHIBIT A 668

I. INTRODUCTION

A. Background

Crowdfunding is a relatively new and evolving method of using the Internet to raise capital to support a wide range of ideas and ventures. An entity or individual raising funds through crowdfunding typically seeks small individual contributions from a large number of people. Individuals interested in the crowdfunding campaign – members of the "crowd" – may share information about the project, cause, idea or business with each other and use the information to decide whether to fund the campaign based on the collective "wisdom of the crowd."

The Jumpstart Our Business Startups Act (the "JOBS Act"),[1] enacted on April 5, 2012, establishes a regulatory structure for startups and small businesses to raise capital through securities offerings using the Internet through crowdfunding. The crowdfunding provisions of the JOBS Act were intended to help provide startups and small businesses with capital by making relatively low dollar offerings of securities, featuring relatively low dollar investments by the "crowd," less costly.[2] Congress included a number of provisions intended to protect investors who engage in these transactions,[3] including investment limits, required disclosures by issuers,

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1 Pub. L. No. 112-106, 126 Stat. 306 (2012).

2 *See, e.g.*, congressional statements regarding crowdfunding bills that were precursors to the JOBS Act: 157 CONG. REC. S8458-02 (daily ed. Dec. 8, 2011) (statement of Sen. Jeff Merkley) ("Low-dollar investments from ordinary Americans may help fill the void, providing a new avenue of funding to the small businesses that are the engine of job creation. The CROWDFUND Act would provide startup companies and other small businesses with a new way to raise capital from ordinary investors in a more transparent and regulated marketplace."); 157 CONG. REC. H7295-01 (daily ed. Nov. 3, 2011) (statement of Rep. Patrick McHenry) ("[H]igh net worth individuals can invest in businesses before the average family can. And that small business is limited on the amount of equity stakes they can provide investors and limited in the number of investors they can get. So, clearly, something has to be done to open these capital markets to the average investor[.]").

3 *See, e.g.*, congressional statements regarding crowdfunding bills that were precursors to the JOBS Act: 158 CONG. REC. S1781 (daily ed. Mar. 19, 2012) (statement of Sen. Carl Levin) ("Our bill creates new opportunities for crowdfunding but establishes basic regulatory oversight, liability, and disclosure rules that

and a requirement to use regulated intermediaries. The provisions also permit Internet-based platforms to facilitate the offer and sale of securities in crowdfunding transactions without having to register with the Commission as brokers.

In the United States, crowdfunding generally has not involved the offer of a share in any financial returns or profits that the fundraiser may expect to generate from business activities financed through crowdfunding. Such a profit or revenue-sharing model – sometimes referred to as the "equity model" of crowdfunding – could trigger the application of the federal securities laws because it likely would involve the offer and sale of a security. Under the Securities Act of 1933 ("Securities Act"), the offer and sale of securities is required to be registered unless an exemption is available. Some observers have stated that registered offerings are not feasible for raising smaller amounts of capital, as is done in a typical crowdfunding transaction, because of the costs of conducting a registered offering and the resulting ongoing reporting obligations under the Securities Exchange Act of 1934 ("Exchange Act") that may arise as a result of the offering. Limitations under existing regulations, including purchaser qualification requirements for offering exemptions that permit general solicitation and general advertising, have made private placement exemptions generally unavailable for crowdfunding transactions, which are intended to involve a large number of investors[4] and not be limited to investors that meet specific qualifications.[5]

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will give investors the confidence to participate in this promising emerging source of money for growing companies.").

4 In this release, "investors" includes investors and potential investors, as the context requires. *See* Rule 100(d) of Regulation Crowdfunding.

5 *See Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings*, Release No. 33-9415 (July 10, 2013) [78 FR 44771 (July 24, 2013)] (adopting rules to implement Title II of the Jumpstart Our Business Startups Act) ("Rule 506(c) Adopting Release"). Title II of the JOBS Act directed the Commission to amend Rule 506 of Regulation D to permit general solicitation or general advertising in offerings made under Rule 506, provided that all purchasers of the securities are accredited investors. Accredited investors include natural persons who meet certain income or net worth thresholds. Although this rule facilitates the type of broad solicitation emblematic of crowdfunding,

Moreover, someone who operates a website to effect the purchase and sale of securities for the account of others generally would, under pre-existing regulations, be required to register with the Commission as a broker-dealer and comply with the laws and regulations applicable to broker-dealers.[6] A person that operates such a website only for the purchase of securities of startups and small businesses, however, may find it impractical in view of the limited nature of that person's activities and business to register as a broker-dealer and operate under the full set of regulatory obligations that apply to broker-dealers.

B. Title III of the JOBS Act

Title III of the JOBS Act ("Title III") added new Securities Act Section 4(a)(6),[7] which provides an exemption from the registration requirements of Securities Act Section 5[8] for certain crowdfunding transactions. To qualify for the exemption under Section 4(a)(6), crowdfunding transactions by an issuer (including all entities controlled by or under common control with the issuer) must meet specified requirements, including the following:

- the amount raised must not exceed $1 million in a 12-month period;
- individual investments in all crowdfunding issuers in a 12-month period are limited to:
    - the greater of $2,000 or 5 percent of annual income or net worth, if annual income or net worth of the investor is less than $100,000; and

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crowdfunding is premised on permitting sales of securities to any interested person, not just to investors who meet specific qualifications, such as accredited investors.

6 Exchange Act Section 15(a)(1) generally makes it unlawful for a broker or dealer to effect any transactions in, or induce the purchase or sale of, any security unless that broker or dealer is registered with the Commission pursuant to Exchange Act Section 15(b). 15 U.S.C. 78o(a). *See* discussion in Section II.D.2. Because brokers and dealers both register as broker-dealers (i.e., there is no separate "broker" or "dealer" registration under Exchange Act Section 15(b)), we use the term "broker-dealer" in this release.

7 15 U.S.C. 77d(a)(6).

8 15 U.S.C. 77e.

- 10 percent of annual income or net worth (not to exceed an amount sold of $100,000), if annual income or net worth of the investor is $100,000 or more; and

- transactions must be conducted through an intermediary that either is registered as a broker-dealer or is registered as a new type of entity called a "funding portal."

In addition, Title III:

- adds Securities Act Section 4A,[9] which requires, among other things, that issuers and intermediaries that facilitate transactions between issuers and investors in reliance on Section 4(a)(6) provide certain information to investors and potential investors, take other actions and provide notices and other information to the Commission;
- adds Exchange Act Section 3(h),[10] which requires the Commission to adopt rules to exempt, either conditionally or unconditionally, "funding portals" from having to register as a broker-dealer pursuant to Exchange Act Section 15(a)(1);[11]
- mandates that the Commission establish disqualification provisions under which an issuer would not be able to avail itself of the Section 4(a)(6) exemption if the issuer or an intermediary was subject to a disqualifying event; and
- adds Exchange Act Section 12(g)(6),[12] which requires the Commission to adopt rules to exempt from the registration requirements of Section 12(g),[13] either conditionally or unconditionally, securities acquired pursuant to an offering made in reliance on Section 4(a)(6).

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[9] 15 U.S.C. 77a.

[10] 15 U.S.C. 78c(h).

[11] 15 U.S.C. 78o(a)(1).

[12] 15 U.S.C. 78l(g)(6).

[13] 15 U.S.C. 78l(g).

On October 23, 2013, we proposed new rules and forms to implement Title III of the JOBS Act.[14] We received over 485 comment letters on the Proposing Release, including from professional and trade associations, investor organizations, law firms, investment companies and investment advisers, broker-dealers, potential funding portals, members of Congress, the Commission's Investor Advisory Committee,[15] state securities regulators, government agencies, potential issuers, accountants, individuals and other interested parties. We have reviewed and considered all of the comments that we received on the Proposing Release and on Title III of the JOBS Act.[16] In this release, we are adopting new rules and forms to implement Sections 4(a)(6) and 4A and Exchange Act Sections 3(h) and 12(g)(6). The rules are described in detail below.

II. FINAL RULES IMPLEMENTING REGULATION CROWDFUNDING

Regulation Crowdfunding, among other things, permits individuals to invest in securities-based crowdfunding transactions subject to certain thresholds, limits the amount of money an issuer can raise under the crowdfunding exemption, requires issuers to disclose certain information about their offers, and creates a regulatory framework for the intermediaries that facilitate the crowdfunding transactions. As an overview, under the final rules:

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[14] *See* Rel. No. 33-9470 (Oct. 23, 2013) [78 FR 66427 (Nov. 5, 2013)] (the "Proposing Release"), *available at*: http://www.sec.gov/rules/proposed/2013/33-9470.pdf.

[15] The SEC Investor Advisory Committee ("Investor Advisory Committee") was established in April 2012 pursuant to Section 911 of the Dodd-Frank Wall Street Reform and Consumer Protection Act [Pub. L. No. 111-203, sec. 911, 124 Stat. 1376, 1822 (July 21, 2010)] (the "Dodd-Frank Act") to advise the Commission on regulatory priorities, the regulation of securities products, trading strategies, fee structures, the effectiveness of disclosure, initiatives to protect investor interests and to promote investor confidence and the integrity of the securities marketplace. The Dodd-Frank Act authorizes the Investor Advisory Committee to submit findings and recommendations for review and consideration by the Commission.

[16] To facilitate public input on JOBS Act rulemaking before the issuance of rule proposals, the Commission invited members of the public to make their views known on various JOBS Act initiatives in advance of any rulemaking by submitting comment letters to the Commission's website at http://www.sec.gov/spotlight/jobsactcomments.shtml. The comment letters relating to Title III of the JOBS Act submitted in response to this invitation are located at http://www.sec.gov/comments/jobs-title-ii/jobs-title-iii.shtml.

- An issuer is permitted to raise a maximum aggregate amount of $1 million through crowdfunding offerings in a 12-month period;
- Individual investors, over the course of a 12-month period, are permitted to invest in the aggregate across all crowdfunding offerings up to:
  - If either their annual income or net worth is less than $100,000, then the greater of:
    - $2,000 or
    - 5 percent of the lesser of their annual income or net worth.
  - If both their annual income and net worth are equal to or more than $100,000, then 10 percent of the lesser of their annual income or net worth; and
- During the 12-month period, the aggregate amount of securities sold to an investor through all crowdfunding offerings may not exceed $100,000.

Certain companies are not eligible to use the Regulation Crowdfunding exemption. Ineligible companies include non-U.S. companies, companies that already are Exchange Act reporting companies, certain investment companies, companies that are disqualified under Regulation Crowdfunding's disqualification rules, companies that have failed to comply with the annual reporting requirements under Regulation Crowdfunding during the two years immediately preceding the filing of the offering statement, and companies that have no specific business plan or have indicated their business plan is to engage in a merger or acquisition with an unidentified company or companies.

Securities purchased in a crowdfunding transaction generally cannot be resold for a period of one year. Holders of these securities do not count toward the threshold that requires an issuer to register its securities with the Commission under Section 12(g) of the Exchange Act if the

issuer is current in its annual reporting obligation, retains the services of a registered transfer agent and has less than $25 million in assets.

Disclosure by Issuers. The final rules require issuers conducting an offering pursuant to Regulation Crowdfunding to file certain information with the Commission and provide this information to investors and the relevant intermediary facilitating the crowdfunding offering. Among other things, in its offering documents, the issuer is required to disclose:

- Information about officers and directors as well as owners of 20 percent or more of the issuer;
- A description of the issuer's business and the use of proceeds from the offering;
- The price to the public of the securities or the method for determining the price, the target offering amount, the deadline to reach the target offering amount, and whether the issuer will accept investments in excess of the target offering amount;
- Certain related-party transactions;
- A discussion of the issuer's financial condition; and
- Financial statements of the issuer that are, depending on the amount offered and sold during a 12-month period, accompanied by information from the issuer's tax returns, reviewed by an independent public accountant, or audited by an independent auditor. An issuer relying on these rules for the first time would be permitted to provide reviewed rather than audited financial statements, unless financial statements of the issuer are available that have been audited by an independent auditor.

Issuers are required to amend the offering document during the offering period to reflect material changes and provide updates on the issuer's progress toward reaching the target offering amount.

In addition, issuers relying on the Regulation Crowdfunding exemption are required to file an annual report with the Commission and provide it to investors.

Crowdfunding Platforms. One of the key investor protections of Title III of the JOBS Act is the requirement that Regulation Crowdfunding transactions take place through an SEC-registered intermediary, either a broker-dealer or a funding portal. Under Regulation Crowdfunding, offerings must be conducted exclusively through a platform operated by a registered broker or a funding portal, which is a new type of SEC registrant. The rules require these intermediaries to:

- Provide investors with educational materials;
- Take measures to reduce the risk of fraud;
- Make available information about the issuer and the offering;
- Provide communication channels to permit discussions about offerings on the platform; and
- Facilitate the offer and sale of crowdfunded securities.

The rules prohibit funding portals from:

- Offering investment advice or making recommendations;
- Soliciting purchases, sales or offers to buy securities offered or displayed on its platform;
- Compensating promoters and others for solicitations or based on the sale of securities; and
- Holding, possessing, or handling investor funds or securities.

The rules provide a safe harbor under which funding portals can engage in certain activities consistent with these restrictions.

The staff will undertake to study and submit a report to the Commission no later than three years following the effective date of Regulation Crowdfunding on the impact of the regulation on

capital formation and investor protection. The report will include, but not be limited to, a review of: (1) issuer and intermediary compliance; (2) issuer offering limits and investor investment limits; (3) incidence of fraud, investor losses, and compliance with investor aggregates; (4) intermediary fee and compensation structures; (5) measures intermediaries have taken to reduce the risk of fraud, including reliance on issuer and investor representations; (6) the concept of a centralized database of investor contributions; (7) intermediary policies and procedures; (8) intermediary recordkeeping practices; and (9) secondary market trading practices.

A. Crowdfunding Exemption

Section 4(a)(6) provides an exemption from the registration requirements of Securities Act Section 5 for certain crowdfunding transactions. To qualify for this exemption, crowdfunding transactions by an issuer must meet specified requirements, including limits on the dollar amount of the securities that may be sold by an issuer and the dollar amount that may be invested by an individual in a 12-month period. The crowdfunding transaction also must be conducted through a registered intermediary that complies with specified requirements.[17] Title III also provides limitations on who may rely on the exemption and establishes specific liability provisions for material misstatements or omissions in connection with Section 4(a)(6) exempt transactions. As discussed below, the rules we are adopting are designed to aid issuers, investors and intermediaries in complying with these various limitations and requirements.

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[17] *See* Section II.C for a discussion of the intermediary requirements. *See also* Section II.D for a discussion of the additional funding portal requirements.

1. Limit on Capital Raised

a. Proposed Rules

The exemption from registration provided by Section 4(a)(6) is available to a U.S. issuer provided that "the aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the exemption provided under [Section 4(a)(6)] during the 12-month period preceding the date of such transaction, is not more than $1,000,000." Under Securities Act Section 4A(h), the Commission is required to adjust the dollar amounts in Section 4(a)(6) "not less frequently than once every five years, by notice published in the Federal Register, to reflect any change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics."

Consistent with the statute, we proposed in Rule 100(a) of Regulation Crowdfunding to limit the aggregate amount sold to all investors by the issuer in reliance on the new exemption to $1 million during a 12-month period. Capital raised through other exempt transactions would not be counted in determining the aggregate amount sold in reliance on Section 4(a)(6).

We also provided guidance clarifying our view that offerings made in reliance on Section 4(a)(6) will not be integrated[18] with other exempt offerings made by the issuer, provided that each offering complies with the requirements of the applicable exemption that is being relied upon for the particular offering.

Under Section 4(a)(6), the amount of securities sold in reliance on Section 4(a)(6) by entities controlled by or under common control with the issuer must be aggregated with the

[18] The integration doctrine seeks to prevent an issuer from improperly avoiding registration by artificially dividing a single offering into multiple offerings such that Securities Act exemptions would apply to multiple offerings that would not be available for the combined offering. *See, e.g.*, Final Rule: Nonpublic Offering Exemption, Release No. 33-4552 (Nov. 6, 1962).

amount to be sold by the issuer in the current offering to determine the aggregate amount sold in reliance on Section 4(a)(6) during the preceding 12-month period. Under the proposed rules, for purposes of determining whether an entity is "controlled by or under common control with" the issuer, an issuer would be required to consider whether it has "control" based on the definition in Securities Act Rule 405.[19] As proposed, the amount of securities sold in reliance on Section 4(a)(6) also would include securities sold by any predecessor of the issuer in reliance on Section 4(a)(6) during the preceding 12-month period.

b. Comments on the Proposed Rules

A few commenters supported a $1 million limit on capital raised by an issuer in reliance on Section 4(a)(6),[20] while many other commenters believed that the proposed $1 million limit was too low and, in some instances, recommended higher limits.[21] Several commenters urged that the $1 million limit be net of fees charged by the intermediary to host the offering on the intermediary's platform,[22] while other commenters generally opposed this idea.[23]

19 *See* 17 CFR 230.405 ("The term control (including the terms controlling, controlled by and under common control with) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise."). Exchange Act Rule 12b-2 contains the same definition. *See* 17 CFR 240.12b-2.

20 *See, e.g.*, Leverage PR Letter; StartEngine Letter 1; StartEngine Letter 2; Wilson Letter.

21 *See, e.g.*, Advanced Hydro Letter; Bushroe Letter; Cole D. Letter; Concerned Capital Letter; Hamman Letter; Harrison Letter; Hillside Letter; Jazz Letter; Kickstarter Coaching Letter; McCulley Letter; McGladrey Letter; Meling Letter; Miami Nation Enterprises Letter; Multistate Tax Service Letter; Peers Letter; Pioneer Realty Letter; Public Startup Letter 2; Qizilbash Letter; Rosenthal O. Letter; Sarles Letter; SBM Letter; Taylor R. Letter; Taylor T. Letter; Wales Capital Letter 1; Wales Capital Letter 3; WealthForge Letter; Wear Letter; Wilhelm Letter; Winters Letter; Yudek Letter.

22 *See, e.g.*, Benjamin Letter; FundHub Letter 1; Hackers/Founders Letter; Joinvestor Letter; Odhner Letter; Omara Letter; Public Startup Letter 2; RFPIA Letter; RoC Letter; RocketHub Letter; Seed&Spark Letter; Thomas Letter 1; Wales Capital Letter 1; Whitaker Chalk Letter; Wilson Letter.

23 *See, e.g.*, Arctic Island Letter 4; ASSOB Letter; Commonwealth of Massachusetts Letter; MCS Letter; PeoplePowerFund Letter.

Commenters were divided on the proposed guidance that other exempt offerings should not be integrated when determining the amount sold during the preceding 12-month period for purposes of the $1 million limit, with some supporting this approach,[24] and others opposing it.[25]

c. Final Rules

We are adopting as proposed rules that limit to $1 million the aggregate amount that may be sold to all investors by the issuer in a 12-month period in reliance on the new exemption.[26] We continue to believe this approach is consistent with the statute and will provide for a meaningful addition to the existing capital formation options for smaller companies while maintaining important investor protections. Moreover, Regulation Crowdfunding is a novel method of raising capital for smaller companies, and we are concerned about expanding the offering limit of the exemption beyond the level specified in Section 4(a)(6) at the outset of the adoption of final rules. Some commenters suggested that the $1 million limit be net of fees charged by the intermediary to host the offering on the intermediary's platform,[27] which would be an indirect way of increasing the $1 million limit. We are concerned that expanding the offering limit in this way would

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24 *See, e.g.*, AngelList Letter; Arctic Island Letter 4; Campbell R. Letter; CFA Institute Letter; CFIRA Letter 11; EarlyShares Letter; EMKF Letter; Farnkoff Letter; Feinstein Letter; Growthfountain Letter; Hackers/Founders Letter; Heritage Letter; NSBA Letter; Parsont Letter; Perfect Circle Solutions Letter; Public Startup Letter 2; RoC Letter; RocketHub Letter; Wales Capital Letter 1; Wefunder Letter; Whitaker Chalk Letter; Wilson Letter.

25 *See, e.g.*, AFL-CIO Letter (not integrating other exempt offerings will make crowdfunding available to larger companies and "crowd out" smaller companies that lack other options for raising capital); AFR Letter; Brown J. Letter; Consumer Federation Letter (not integrating other exempt offerings will allow issuers to evade regulatory requirements); Fund Democracy Letter (not integrating other exempt offerings will give issuers an incentive to engage in advertising in concurrent private offerings to indirectly publicly advertise their crowdfunding offering); IAC Recommendation; MCS Letter; NASAA Letter.

26 *See* Rule 100(a)(1) of Regulation Crowdfunding. There is a technical change to the rule text ("offer and sell securities" is changed to "offer or sell securities") to clarify that an issuer does not have to complete a sale in order to rely on the Section 4(a)(6) exemption for an offering.

27 *See, e.g.*, Benjamin Letter; FundHub Letter 1; Hackers/Founders Letter; Joinvestor Letter; Odhner Letter; Omara Letter; Public Startup Letter 2; RFPIA Letter; RoC Letter; RocketHub Letter; Seed&Spark Letter; Thomas Letter 1; Wales Capital Letter 1; Whitaker Chalk Letter; Wilson Letter.

provide less certainty and could raise interpretive questions, which would make the exemption more costly for issuers to comply with. If a funding portal's fees are not known in advance, for example, this may create uncertainty for issuers about how much capital they would be able to raise. Therefore, we are adopting as proposed the limit on the aggregate amount sold.

Title III provides that the $1 million limit applies to the "aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the exemption provided under [Section 4(a)(6)]." Securities Act Section 4A(g), however, provides that "[n]othing in the exemption shall be construed as preventing an issuer from raising capital through means other than [S]ection 4[(a)](6)." Considered together, these two provisions create statutory ambiguity because the first provision could be read to provide for the aggregation of amounts raised in all exempt transactions, even those that do not involve crowdfunding, while the second provision could be read to provide that nothing in the Section 4(a)(6) exemption should limit an issuer's capital raising through other methods. We believe that the overall intent of providing the exemption under Section 4(a)(6) was to provide an additional mechanism for capital raising for startup and small businesses and not to affect the amount an issuer could raise outside of that exemption. Thus, we believe that only the capital raised in reliance on the exemption provided by Section 4(a)(6) should be counted toward the limit. Capital raised through other means should not be counted in determining the aggregate amount sold in reliance on Section 4(a)(6). The opposite approach – requiring aggregation of amounts raised in any exempt transaction – would be inconsistent with the goal of alleviating the funding gap for startups and small businesses because, by electing crowdfunding, such issuers would be placing a cap on the amount of capital they could raise. An issuer that already sold $1 million in reliance on the exemption provided under Section 4(a)(6), for example, would be prevented from raising capital through other exempt methods and,

conversely, an issuer that sold $1 million through other exempt methods would be prevented from raising capital under Section 4(a)(6).

In determining the amount that may be sold in reliance on Section 4(a)(6), an issuer should aggregate amounts it sold (including amounts sold by entities controlled by, or under common control with, the issuer, as well as any amounts sold by any predecessor of the issuer) in reliance on Section 4(a)(6) during the 12-month period preceding the expected date of sale and the amount the issuer intends to raise in reliance on the exemption. An issuer should not include amounts sold in other exempt offerings during the preceding 12-month period.

Further, in light of Section 4A(g) and for the reasons discussed above, we continue to believe that an offering made in reliance on Section 4(a)(6) should not be integrated with another exempt offering made by the issuer, provided that each offering complies with the requirements of the applicable exemption that is being relied upon for the particular offering. For example, an issuer conducting a concurrent exempt offering for which general solicitation is not permitted will need to be satisfied that purchasers in that offering were not solicited by means of the offering made in reliance on Section 4(a)(6).[28] As another example, an issuer conducting a concurrent exempt offering for which general solicitation is permitted, for example, under Securities Act Rule 506(c), could not include in any such general solicitation an advertisement of the terms of an offering made in reliance on Section 4(a)(6), unless that advertisement otherwise complied with Section 4(a)(6) and the final rules. As such, a concurrent offering would be bound by the more restrictive solicitation requirements of Regulation Crowdfunding, unless the issuer can conclude

[28] For a concurrent offering under Rule 506(b), an issuer will have to conclude that purchasers in the Rule 506(b) offering were not solicited by means of the offering made in reliance on Section 4(a)(6). For example, the issuer may have had a preexisting substantive relationship with such purchasers. Otherwise, the solicitation conducted in connection with the crowdfunding offering may preclude reliance on Rule 506(b). *See also* Rel. No. 33-8828 (Aug. 3, 2007) [72 FR 45116].

that the purchasers in the Regulation Crowdfunding offering were not solicited by means of the offering made in reliance on Rule 506(c).

The amount of securities sold in reliance on Section 4(a)(6) by entities controlled by or under common control with the issuer must be aggregated with the amount to be sold by the issuer in the current offering to determine the aggregate amount sold in reliance on Section 4(a)(6) during the preceding 12-month period. The statute does not define the term "controlled by or under common control with" the issuer; however, the term "control" is defined in Securities Act Rule 405.[29] Under the final rules, for purposes of determining whether an entity is "controlled by or under common control with" the issuer, an issuer will be required to consider whether it possesses, directly or indirectly, the power to direct or cause the direction of the management and policies of the entity, whether through the ownership of voting securities, by contract or otherwise, consistent with the definition of "control" in Securities Act Rule 405.[30]

Under the final rules, the amount of securities sold in reliance on Section 4(a)(6) also includes securities sold by any predecessor of the issuer in reliance on Section 4(a)(6) during the preceding 12-month period.[31] We believe this approach is necessary to prevent an issuer from exceeding the $1 million limit by reorganizing into a new entity that would otherwise not be limited by previous sales made by its predecessor.

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[29] *See* note 19.

[30] *See* Instruction to paragraph (c) of Rule 100 of Regulation Crowdfunding.

[31] *See* Rule 100(c) of Regulation Crowdfunding (defining issuer, in certain circumstances, to include all entities controlled by or under common control with the issuer and any predecessor of the issuer).

2. Investment Limits

a. Proposed Rules

Under the exemption from registration set forth in Securities Act Section 4(a)(6)(B), the aggregate amount of securities sold to any investor by an issuer, including any amount sold in reliance on the exemption during the 12-month period preceding the date of such transaction, cannot exceed: "(i) the greater of $2,000 or 5 percent of the annual income or net worth of such investor, as applicable, if either the annual income or the net worth of the investor is less than $100,000; and (ii) 10 percent of the annual income or net worth of such investor, as applicable, not to exceed a maximum aggregate amount sold of $100,000, if either the annual income or net worth of the investor is equal to or more than $100,000."

In the Proposing Release, we noted that this statutory language may present ambiguity in some cases about which of the two investment limits governs, because paragraph (i) applies if "either" annual income or net worth is less than $100,000 and paragraph (ii) applies if "either" annual income or net worth is equal to or more than $100,000. Accordingly, in a situation in which annual income is less than $100,000 and net worth is equal to or more than $100,000 (or vice versa), the language of the statute may be read to cause both paragraphs to apply. Paragraph (i) also fixes the maximum annual investment by an investor at 5 percent of "the annual income or net worth of such investor, as applicable" and paragraph (ii) fixes the maximum annual investment by an investor at 10 percent of "the annual income or net worth of such investor, as applicable," but neither states when that percentage should be applied against the investor's annual income and when it should be applied against the investor's net worth.

Under proposed Rule 100(a) of Regulation Crowdfunding, the aggregate amount of securities sold to any investor by any issuer in reliance on Section 4(a)(6) during the 12-month

period preceding the date of such transaction, including the securities sold to such investor in such transaction, could not exceed the greater of: (i) $2,000 or 5 percent of the annual income or net worth of the investor, whichever is greater, if both annual income and net worth are less than $100,000; or (ii) 10 percent of the annual income or net worth of the investor, whichever is greater, not to exceed an amount sold of $100,000, if either annual income or net worth is equal to or more than $100,000.

We did not propose to alter these investment limits for any particular type of investor or create a different exemption based on different investment limits. Under the proposal, the annual income and net worth of a natural person would be calculated in accordance with the Commission's rules for the calculation of annual income and net worth of an accredited investor, and an investor's annual income or net worth could be calculated jointly with the annual income or net worth of the investor's spouse. An issuer would be able to rely on the efforts of an intermediary to determine that the aggregate amount of securities purchased by an investor will not cause the investor to exceed the investment limits, provided the issuer does not have knowledge to the contrary.

b. Comments on the Proposed Rules

Commenters were divided on the proposed investment limits. Many commenters supported some type of investment limit without necessarily expressing a specific opinion on the

proposed investment limits,[32] while many others generally opposed any type of investment limit.[33] A number of commenters recommended changes to the proposed limits.[34]

While some commenters supported the proposal to apply the higher investment limit (10 percent, as set forth in Section 4(a)(6)(B)(ii)) if only one of the annual income or net worth of the investor is equal to or more than $100,000,[35] some commenters also supported the lower investment limit ($2,000 or 5 percent, as set forth in Section 4(a)(6)(B)(i)) unless both the annual income and net worth of the investor are equal to or more than $100,000.[36]

A number of commenters supported the proposal that within each of the two levels of investment limits, the limits would be calculated based on the "greater of" an investor's annual income or net worth,[37] while a number of other commenters preferred a "lesser of" approach.[38] A few commenters suggested a combination of the approaches (*e.g.*, if either annual income or net worth is below $100,000, the lower investment limit level ($2,000 or 5 percent) would apply, but within that level, the limit would be based on the greater of annual income or net worth).[39]

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[32] *See, e.g.*, Accredify Letter; Ahmad Letter; Crowley Letter; Farnkoff Letter; Merkley Letter; Milken Institute Letter; Patel Letter; Saunders Letter; StartEngine Letter 1; Wales Capital Letter 1.

[33] *See, e.g.*, ASSOB Letter; Crowdstockz Letter; Hamman Letter; Holland Letter; McCulley Letter; Meling Letter; Qizilbash Letter; Ramsey Letter; SBM Letter; Taylor R Letter.

[34] *See, e.g.*, Crowdstockz Letter; Gill Letter; Johnston Letter; Morse Letter; Qizilbash Letter; Vossberg Letter; Winters Letter.

[35] *See, e.g.*, ABA Letter; CFA Institute Letter; CFIRA Letter 12; Craw Letter; Finkelstein Letter; RocketHub Letter; Wilson Letter.

[36] *See, e.g.*, AFL-CIO Letter; BetterInvesting Letter; Consumer Federation Letter; Fund Democracy Letter; IAC Recommendation; Jacobson Letter; NASAA Letter; Schwartz Letter.

[37] *See, e.g.*, ABA Letter; Anonymous Letter 6; CFIRA Letter 12; Craw Letter; EarlyShares Letter; Jacobson Letter; Omara Letter; RocketHub Letter; Wilson Letter.

[38] *See, e.g.*, AFR Letter; BetterInvesting Letter; Consumer Federation Letter; Fund Democracy Letter; Fryer Letter; Growthfountain Letter; IAC Recommendation (stating that the "greater of" approach would be appropriate for accredited investors); Merkley Letter; NASAA Letter; Schwartz Letter; Zhang Letter (recommending that net worth not be used to calculate the investment limit).

[39] *See, e.g.*, Consumer Federation Letter; Fund Democracy Letter; Jacobson Letter.

Many commenters supported the proposal that an issuer may rely on the efforts of an intermediary to determine that the aggregate amount of securities purchased by an investor will not cause the investor to exceed the investment limits, provided that the issuer does not have knowledge that the investor had exceeded, or would exceed, the investment limits as a result of purchasing securities in the issuer's offering.[40] A few commenters recommended that an issuer be required to obtain a written representation from the investor that the investor has not and will not exceed the limits by purchasing from the issuer.[41]

Commenters were divided about the joint calculation of annual income and net worth with the investor's spouse. Several commenters supported the proposal that an investor's annual income and net worth be calculated jointly with that of the investor's spouse,[42] while other commenters generally opposed that aspect of the proposal.[43] Several commenters recommended that if an investor's annual income and net worth are to be calculated jointly, the Commission should establish higher thresholds or an aggregate investment limit applicable to both spouses.[44]

A number of commenters favored different or no investment limits for accredited and institutional investors. Many commenters supported exempting accredited and institutional

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40 *See, e.g.*, Arctic Island Letter 4; CFA Institute Letter; Consumer Federation Letter; CrowdBouncer Letter; EarlyShares Letter; EMKF Letter; Finkelstein Letter; Fund Democracy Letter; Heritage Letter; Joinvestor Letter; Public Startup Letter 2; RoC Letter; RocketHub Letter; Vann Letter; Wefunder Letter; Whitaker Chalk Letter.

41 *See, e.g.*, FundHub Letter 1; Public Startup Letter 2; RocketHub Letter.

42 *See, e.g.*, Arctic Island Letter 4; Heritage Letter; Joinvestor Letter; NSBA Letter; Omara Letter; RocketHub Letter; Wilson Letter.

43 *See, e.g.*, Brown J. Letter; Consumer Federation Letter; Fund Democracy Letter; Jacobson Letter; Projectheureka Letter; Public Startup Letter 2.

44 *See, e.g.*, Brown, J. Letter; Consumer Federation Letter; Fund Democracy Letter; Jacobson Letter.

investors from the investment limits,[45] although a number of other commenters opposed such an exemption.[46] A few commenters recommended allowing higher investment limits for accredited and institutional investors.[47] One commenter stated that applying the investment limits to accredited and institutional investors would deter those investors from participating, but noted that allowing concurrent offerings under Securities Act Rule 506(c)[48] may mitigate this problem.[49]

c. Final Rules

Consistent with the statute, we are adopting investment limits for securities-based crowdfunding transactions, but with some modifications from the proposed rules. We have modified the final rules from the proposal to clarify that the investment limit reflects the aggregate amount an investor may invest in all offerings under Section 4(a)(6) in a 12-month period across all issuers. In addition, as noted above, some commenters supported a "greater of" approach to implementing the two statutory investment limits, while others supported a "lesser of" approach. After considering the comments received, we have decided to adopt a "lesser of" approach. Thus, under the final rules, an investor will be limited to investing: (1) the greater of: $2,000 or 5 percent of the lesser of the investor's annual income or net worth if either annual income or net worth is less than $100,000; or (2) 10 percent of the lesser of the investor's annual income or net

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[45] *See, e.g.*, ASSOB Letter; Crowdstockz Letter; Crowley Letter; EMKF Letter; FundHub Letter 1; Gibb Letter; Heritage Letter; Joinvestor Letter; Public Startup Letter 2; RoC Letter; RocketHub Letter; Vann Letter; Wales Capital Letter 1; WealthForge Letter; Wefunder Letter.

[46] *See, e.g.*, CFA Institute Letter; FundDemocracy Letter; Hackers/Founders Letter; Jacobson Letter; PeoplePowerFund Letter; Projectheureka Letter; Whitaker Chalk Letter; Wilson Letter.

[47] *See, e.g.*, Growthfountain Letter; RFPIA Letter; WealthForge Letter.

[48] 17 CFR §230.506.

[49] *See* Arctic Island Letter 4.

worth, not to exceed an amount sold of $100,000, if both annual income and net worth are $100,000 or more.[50]

Under this approach, an investor with annual income of $50,000 a year and $105,000 in net worth would be subject to an investment limit of $2,500, in contrast to the proposed rules in which that same investor would have been eligible for an investment limit of $10,500.[51] We recognize that this change from the proposed rules could place constraints on capital formation. Nevertheless, we believe that the investment limits in the final rules appropriately take into consideration the need to give issuers access to capital while minimizing an investor's exposure to risk in a crowdfunding transaction.

The chart below illustrates a few examples:

Investor Annual Income	Investor Net Worth	Calculation	Investment Limit[52]
$30,000	$105,000	Greater of $2,000 or 5% of $30,000 ($1,500)	$2,000
$150,000	$80,000	Greater of $2,000 or 5% of $80,000 ($4,000)	$4,000
$150,000	$100,000	10% of $100,000 ($10,000)	$10,000
$200,000	$900,000	10% of $200,000 ($20,000)	$20,000
$1,200,000	$2,000,000	10% of $1,200,000 ($120,000), subject to $100,000 cap	$100,000

A number of commenters expressed concerns about investors potentially incurring unaffordable losses under the proposed rule,[53] and we find these comments persuasive given the

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50 *See* paragraph (a)(2) of Rule 100 of Regulation Crowdfunding.

51 *See* Instruction 2 to paragraph (a)(2) of Rule 100 of Regulation Crowdfunding.

52 This "Investment Limit" column reflects the aggregate investment limit across all offerings under Section 4(a)(6) within a 12-month period.

53 *See, e.g.*, AFL-CIO Letter; BetterInvesting Letter; Consumer Federation Letter; Fund Democracy Letter; IAC Recommendation; Jacobson Letter; Merkley Letter; NASAA Letter; Schwartz Letter.

risks involved. The startups and small businesses that we expect will rely on the crowdfunding exemption are likely to experience a higher failure rate than more seasoned companies.[54] Applying the lower limit ($2,000 or 5%, rather than 10%) for investors whose annual income or net worth is below $100,000 and applying that formula to the lesser of annual income or net worth will potentially limit investment losses in crowdfunding offerings for investors who may be less able to bear the risk of loss. We are concerned about the number of households where there is a sizeable gap between net worth and annual income, and the ability of these households to withstand the risk of loss. According to Commission staff analysis of the data in the 2013 Survey of Consumer Finances, approximately 20% of U.S. households with net worth over $100,000 have annual income under $50,000.

Consistent with the proposed rules, the final rules allow an issuer to rely on efforts that an intermediary is required to undertake in order to determine that the aggregate amount of securities purchased by an investor does not cause the investor to exceed the investment limits, provided that the issuer does not have knowledge that the investor had exceeded, or would exceed, the investment limits as a result of purchasing securities in the issuer's offering.[55]

We are adopting, as proposed, final rules that allow an investor's annual income and net worth to be calculated as those values are calculated for purposes of determining accredited investor status.[56] Securities Act Rule 501 specifies the manner in which annual income and net worth are calculated for purposes of determining accredited investor status.[57] As in the proposal,

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54 For a more detailed discussion of survival rates for startups and small businesses see Section III.A, below.

55 *See* Instruction 3 to paragraph (a)(2) of Rule 100 of Regulation Crowdfunding.

56 *See* Instruction 1 to paragraph (a)(2) of Rule 100 of Regulation Crowdfunding.

57 17 CFR §230.501. Thus, for example, a natural person's primary residence shall not be included as an asset in the calculation of net worth. 17 CFR §230.501(a)(5)(i)(A).

the final rules allow spouses to calculate their net worth or annual income jointly. Although some commenters opposed permitting net worth or annual income to be calculated jointly, we believe this approach is appropriate in light of the stricter investment limits being adopted in the final rules. Several commenters recommended that, if the final rules permit net worth and annual income to be calculated jointly, we should establish an aggregate investment limit applicable to both spouses.[58] Consistent with this recommendation, the final rules add an instruction to explain that when such a joint calculation is used, the aggregate investment of the spouses may not exceed the limit that would apply to an individual investor at that income and net worth level.[59] We believe this approach is necessary to preserve the intended protections of the investment limits.

While a number of commenters supported the creation of a different investment limit for accredited or institutional investors, or exempting them altogether, we are not making such a change. As noted above, crowdfunding is an innovative approach to raising capital in which the entity or individual raising capital typically seeks small individual contributions from a large number of people. As such, we believe that crowdfunding transactions were intended under Section 4(a)(6) to be available equally to all types of investors.[60] The statute provides specific investment limits, and the only reference in the statute to changing those investment limits is the requirement that we update the investment limits not less frequently than every five years based

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[58] *See* Brown J. Letter; Consumer Federation Letter; Fund Democracy Letter; Jacobs Letter.

[59] For example, if each spouse's annual income is $30,000, the spouses jointly may invest up to an aggregate of 5% of their joint income of $60,000. If one spouse's annual income is $120,000 and the other's is $30,000, the spouses jointly may invest up to an aggregate of 10% of their joint income of $150,000, the same investment limit that would apply for an individual investor with income of $150,000. *See* Instruction 2 to paragraph (a)(2) of Rule 100 of Regulation Crowdfunding.

[60] *See* 158 CONG. REC. S1689 (daily ed. Mar. 15, 2012) (statement of Sen. Mark Warner ("There is now the ability to use the Internet as a way for small investors to get the same kind of deals that up to this point only select investors have gotten that have been customers of some of the best known investment banking firms, where we can now use the power of the Internet, through a term called crowdfunding.").

on the Consumer Price Index. Further, issuers can rely on other exemptions to offer and sell securities to accredited investors and institutional investors. As discussed above, concurrent offerings to these types of investors are possible if the conditions of each applicable exemption are met.[61] Therefore, we are not altering the investment limits for any particular type of investor or to create a different exemption based on different investment limits. Thus, as proposed, the investment limits will apply equally to all investors, including retail, institutional and accredited investors.

3. Transaction Conducted Through an Intermediary

a. Proposed Rules

Section 4(a)(6)(C) requires that a transaction in reliance on Section 4(a)(6) be conducted through a broker or funding portal that complies with the requirements of Securities Act Section 4A(a). To implement this provision, we proposed in Rule 100(a)(3) of Regulation Crowdfunding that for any transaction conducted in reliance on Section 4(a)(6), an issuer use only one intermediary (that complies with the requirements of Section 4A(a) and the related requirements in Regulation Crowdfunding) and that the transaction be conducted exclusively on the intermediary's platform. We also proposed to permit the intermediary to engage in back office[62] or other administrative functions other than on the intermediary's platform, and to define "platform" as "an Internet website or other similar electronic medium through which a registered broker or a registered funding portal acts as an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6)."

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[61] For a discussion of integration, see Section II.A.1.c.

[62] Back office personnel typically perform functions such as, but not limited to, recordkeeping, trade confirmations, internal accounting, and account maintenance.

b. Comments on the Proposed Rules

Commenters were divided about the proposed prohibition on an issuer using more than one intermediary for any transaction conducted pursuant to Section 4(a)(6). Supporters of the proposed prohibition expressed the view that the prohibition would benefit communication between issuers and investors.[63] One commenter stated that the prohibition also would assist in assessing whether investors are within their investment limits.[64] Commenters who opposed the proposed prohibition noted that increasing the number of platforms used per transaction would both increase the likelihood of investors becoming informed that a transaction is taking place, as well as elicit information from a more diverse crowd.[65]

Commenters were generally divided about the proposed requirement that transactions made in reliance on Section 4(a)(6) be conducted exclusively through the intermediary's platform. Commenters who supported[66] the proposed requirement cited concerns that allowing the transactions to be effected through means other than the intermediary's platform could increase the potential for fraudulent activity[67] and prevent the leveraging of information sharing and crowdsourced review that are intended through crowdfunding.[68] Commenters who opposed[69] the proposed requirement expressed their view that permitting other means would allow persons who lack Internet access to invest through crowdfunding,[70] and also would foster different types of in-

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63 *See, e.g.*, CFA Institute Letter; Rockethub Letter.

64 *See* CFA Institute Letter.

65 *See, e.g.*, Graves Letter.

66 *See, e.g.*, Joinvestor Letter; RoC Letter; RocketHub Letter; Wilson Letter.

67 *See, e.g.*, StartupValley Letter.

68 *See, e.g.*, RocketHub Letter.

69 *See, e.g.*, Benjamin Letter; Omara Letter; Public Startup Letter 2.

70 *See, e.g.*, Projecteureka Letter.

person communication that are not possible to achieve online.[71] One commenter expressed a preference for issuers to be able to host their own offerings subject to certain conditions.[72] One commenter also suggested that intermediaries should be able to engage in certain activities other than on their platforms, such as physically meeting with representatives of issuers and investors, and hosting launch parties.[73]

A few commenters supported, but suggested technical revisions to, our proposed definition of "platform."[74] One commenter suggested deleting the phrase "an Internet website or other similar electronic medium" and replacing the phrase with "a software program accessible via TCP/IP enabled applications" or to more commonly define "platform" as "a software program accessible via the Internet."[75]

c. Final Rules

After considering the comments, we are adopting as proposed Rule 100(a)(3). We also are adopting the definition of "platform" with one clarifying amendment and with a change in location to Rule 300(c).

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71 *See, e.g.*, Benjamin Letter ("Without doubt, the web fosters a crowd and a convenient forum to express ideas and learn about the Issuer. However, small community gatherings provide similar feedback loops and often times serve the community and some investors better by fostering nuanced forms of communication that can never be achieved. Further, some SEC concerns can be assuaged regarding the loss of creating a 'crowd' online because some investors that may rely on the website to educate themselves may not be inclined to contribute to the 'crowd intelligence' online, yet would be vocal in a community gathering.").

72 *See* Public Startup Letter 2. We note that Section 4(a)(6) of the Securities Act requires that, as a condition of the exemption, the transaction be "conducted through a broker or funding portal that complies with the requirements of section 4A(b)." 15 U.S.C. 77d(a)(6).

73 *See* Wilson Letter.

74 *See, e.g.*, Arctic Island Letter 1, Arctic Island Letter 3; Arctic Island Letter 4; and Startup Valley Letter (explaining that websites, application programmable interfaces (APIs) and other electronic media are generally only the means to access a platform, which itself is an Internet-accessible software program).

75 *See* Arctic Island Letter 1; Arctic Island Letter 4 (noting that a "platform" is actually a software program that is accessible via the Internet and that a "website or other electronic medium" is merely a way to access the platform, not the platform itself).

As stated in the Proposing Release, we believe that requiring an issuer to use only one intermediary to conduct an offering or concurrent offerings in reliance on Section 4(a)(6) would help foster the creation of a "crowd" and better accomplish the purpose of the statute. In order for a crowd to effectively share information, we believe it would be most beneficial to have one meeting place for the crowd to obtain and share information, thus avoiding dilution or dispersement of the "crowd." We also believe that limiting a crowdfunding transaction to a single intermediary's online platform helps to minimize the risk that issuers and intermediaries would circumvent the requirements of Regulation Crowdfunding. For example, allowing an issuer to conduct an offering using more than one intermediary would make it more difficult for intermediaries to determine whether an issuer is exceeding the $1 million aggregate offering limit.

We continue to believe that crowdfunding transactions made in reliance on Section 4(a)(6) and activities associated with these transactions should occur over the Internet or other similar electronic medium that is accessible to the public. Such an "online-only" requirement enables the public to access offering information and share information publicly in a way that will allow members of the crowd to share their views on whether to participate in the offering and fund the business or idea. While we acknowledge, as one commenter observed, that there are forms of communication that cannot be achieved online,[76] we nevertheless believe that the requirement that the transaction be conducted exclusively through the intermediary's platform will help to ensure transparency, provide for ready availability of information in one place to all investors, and promote greater uniformity in the distribution of information among investors. We also do not believe that funding portals should be permitted to physically meet with investors to solicit investments and offerings on its platform, or host launch parties, as one commenter recommended,

[76] *See* Benjamin Letter (in-person gatherings may foster more "nuanced forms of communication").

because these activities likely violate the statutory prohibition on funding portals soliciting and providing investment advice and recommendations. However, we continue to believe that intermediaries should be able to engage in back office and other administrative functions other than on their platforms.

In a change from the proposed rules, and consistent with the suggestions of commenters, the final rules define "platform" as "*a program or application accessible via the Internet or other similar electronic communication medium* through which a registered broker or a registered funding portal acts as an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6))" [emphasis added].[77] We believe that this definition is more technically accurate and also will accommodate innovation in the event of technological advancements. We are moving the definition of "platform" from Rule 100 to Rule 300(c) so that it will be located alongside the other Regulation Crowdfunding definitions related to intermediaries. Also, in a change from the proposed rule, we are moving to the definition of platform an instruction stating that an intermediary through which a crowdfunding transaction is conducted may engage in back office or other administrative functions other than on the intermediary's platform.[78]

4. Exclusion of Certain Issuers from Eligibility under Section 4(a)(6)

Securities Act Section 4A(f) excludes certain categories of issuers from eligibility to rely on Section 4(a)(6) to engage in crowdfunding transactions. These are: (1) issuers that are not organized under the laws of a state or territory of the United States or the District of Columbia; (2)

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77 Rule 300(c) of Regulation Crowdfunding.

78 In the final rule, this is an instruction to Rule 300(c)(4). The instruction was proposed under proposed Rule 100(a)(3), but we believe it is more appropriate under the definition of platform because the instruction explains that back office activities can happen off the platform.

issuers that are subject to Exchange Act reporting requirements;[79] (3) investment companies as defined in the Investment Company Act of 1940 (the "Investment Company Act")[80] or companies that are excluded from the definition of investment company under Section 3(b) or 3(c) of the Investment Company Act;[81] and (4) any other issuer that the Commission, by rule or regulation, determines appropriate.

a. Proposed Rules

Rule 100(b) of Regulation Crowdfunding, as proposed, would exclude the categories of issuers specifically identified in Section 4A(f). In addition, the proposed rules would exclude: (1) issuers that are disqualified from relying on Section 4(a)(6) pursuant to the disqualification provision in Rule 503(a) of Regulation Crowdfunding; (2) issuers that have sold securities in reliance on Section 4(a)(6) if they have not filed with the Commission and provided to investors, to the extent required, the ongoing annual reports required by Regulation Crowdfunding during the two years immediately preceding the filing of the required new offering statement; and (3) issuers that have no specific business plan or that have indicated that their business plan is to engage in a merger or acquisition with an unidentified company or companies.

b. Comments on the Proposed Rules

Foreign Issuers, Exchange Act Reporting Companies, and Investment Companies. Several commenters opposed the exclusion of foreign issuers, Exchange Act reporting companies, and investment companies.[82] Other commenters, however, supported the exclusion of investment

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79 These are issuers who are required to file reports with the Commission pursuant to Exchange Act Sections 13(a) (15 U.S.C. 78m(a)) or 15(d) (15 U.S.C. 78*o*(d)).

80 15 U.S.C 80a-1 *et seq.*

81 15 U.S.C. 80a-3(b) or (c).

82 *See, e.g.*, M.A.V. Letter (opposing the exclusion of public companies from eligibility to rely on Section 4(a)(6)); Ritter Letter (asking for clarification regarding companies that are excluded from the definition of

companies or companies that are excluded from the definition of investment company under Section 3(b) or 3(c) of the Investment Company Act.[83] Some commenters recommended that, despite the exclusion of investment companies, the Commission allow a single purpose fund, including LLCs and LPs, to conduct an offering in reliance on Section 4(a)(6) if such fund were organized to invest in, or lend money to, a single company.[84]

Delinquent in Ongoing Reporting. A number of commenters supported the exclusion of issuers that are delinquent in their reporting obligations,[85] although others opposed the exclusion of delinquent issuers.[86] Some commenters suggested options such as disclosure of the issuer's reporting delinquency in its offering documents or on its website or a cure provision.[87]

We also received comments about whether the exclusion should extend to issuers that are delinquent in other reporting requirements (e.g., updates on the progress of the issuer in meeting the target offering amount, issuers whose affiliates have failed to comply with the ongoing reporting requirements, and issuers with an officer, director, or controlling shareholder who

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investment company pursuant to 3(b) of the Investment Company Act); TAN Letter (opposing the exclusion of foreign issuers over concerns that investors would not have Title III protections when investing in foreign issuers and that investors' ability to invest in early opportunities would be reduced).

[83] *See, e.g.*, Commonwealth of Massachusetts Letter; PeoplePowerFund Letter.

[84] *See, e.g.*, EMKF Letter (stating that having hundreds of direct shareholders can give startups "messy cap tables" that deter follow-on financing and alternatively recommending the Commission permit an intermediary, including a funding portal, to act as a holder of record); Fryer Letter; Growthfountain Letter; Martin Letter (recommending that crowdfunding be operated through a trust fund mechanism that would own shares of the entity seeking capital); Propellr Letter 2; Ritter Letter; Wefunder Letter.

[85] *See, e.g.*, ASSOB Letter; Commonwealth of Massachusetts Letter; Consumer Federation Letter; Fund Democracy Letter; Grassi Letter; Joinvestor Letter; NASAA Letter; Wefunder Letter.

[86] *See, e.g.*, ABA Letter; Parsont Letter; Projectheureka Letter; Public Startup Letter 2; RocketHub Letter.

[87] *See, e.g.*, ABA Letter (suggesting a reasonable cure period and limiting the "look-back" period to one year); Grassi Letter (recommending that a delinquent issuer be required to file a form with the Commission and publish on its website and the relevant intermediary's platform a notice to potential investors that it has not met its reporting obligations); Parsont Letter (recommending the Commission treat the ongoing reporting requirements as a condition to the Section 4(a)(6) exemption and create a notice and cure provision in the proposed insignificant deviation safe harbor); RocketHub Letter (suggesting delinquent issuers be required to disclose their delinquent status in their offering documents); Vann Letter (recommending a grace period for curing the deficiency).

served in a similar capacity with another issuer that failed to file its ongoing reports). Commenters generally opposed extending the exclusion beyond issuers delinquent in their ongoing annual reports during the two years immediately preceding the filing of the required new offering statement.[88] Further, two commenters opposed the idea of excluding an issuer whose officer, director, or controlling shareholder served in a similar capacity with another issuer that failed to file its annual reports.[89]

Business Plans. Commenters were divided on excluding issuers that have no specific business plan from eligibility to rely on Section 4(a)(6).[90] Commenters, however, supported the exclusion of issuers that have business plans to engage in a merger or acquisition with an unidentified company.[91]

c. Final Rules

We are adopting the issuer eligibility requirements as proposed, with the addition of two clarifications. As noted above, Section 4A(f) expressly excludes foreign issuers, Exchange Act reporting companies and companies that are investment companies as defined in the Investment Company Act or companies that are excluded from the definition of investment company under Section 3(b) or 3(c) of the Investment Company Act from the exemption for crowdfunding

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88 *See, e.g.*, Grassi Letter (stating that further exclusions would impose a more onerous burden on issuers under Section 4(a)(6) than that placed on current registrants filing under Exchange Act Sections 13(a) or 15(d) or emerging growth companies); Projectheureka Letter.

89 *See* Grassi Letter (stating that these persons may not have the authority or responsibility to file an annual report); Whitaker Chalk Letter.

90 For commenters who expressed support, *see, e.g.*, Anonymous Letter 2; CFA Institute Letter; CFIRA Letter 7; Commonwealth of Massachusetts Letter; Consumer Federation Letter; Hackers/Founders Letter; NASAA Letter; ODS Letter; Traklight Letter; Whitaker Chalk Letter. For commenters who expressed opposition, *see, e.g.*, ABA Letter (expressing concern that a particular business idea disclosed by a crowdfunding issuer might be deemed after-the-fact to be too non-specific to have permitted reliance on Section 4(a)(6), thus exposing that issuer to a potential Section 5 violation); FundHub Letter 1; Projectheureka Letter; Public Startup Letter 2; RoC Letter; RocketHub Letter; SBM Letter; Wilson Letter.

91 *See, e.g.*, ABA Letter; CFA Institute Letter; Commonwealth of Massachusetts Letter; Consumer Federation Letter; Grassi Letter; ODS Letter; RFPIA Letter.

transactions provided by Section 4(a)(6). Although some commenters expressed concerns about these statutory exclusions, including that such exclusions could limit the investment choices of crowdfunding investors, we are not creating additional exemptions for these categories of issuers. In reaching this determination, we have considered that the primary purpose of Section 4(a)(6), as we understand it, is to facilitate capital formation by early stage companies that might not otherwise have access to capital.[92] As a general matter, we do not believe that Exchange Act reporting companies, investment companies and foreign issuers accessing the U.S. capital markets constitute the types of issuers that Section 4(a)(6) and Regulation Crowdfunding are intended to benefit. Moreover, we believe that certain of these issuers, such as foreign issuers or investment companies, may present unique risks that would make them unsuitable for the scaled regulatory regime associated with securities-based crowdfunding transactions. Accordingly, the final rules exclude these categories of issuers from Regulation Crowdfunding.[93]

We are not creating, as suggested by some commenters,[94] an exception to this exclusion for a single purpose fund organized to invest in, or lend money to, a single company. The statute specifically excludes investment funds from eligibility to rely on Section 4(a)(6) and investment fund issuers present considerations different from those for non-fund issuers.

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92 *See, e.g.*, 158 Cong. Rec. S1765 (daily ed. Mar. 29, 2012) (statement of Sen. Jack Reed) ("[Crowdfunding] is the place where we envision the smallest entrepreneurs could obtain much needed seed capital for their good ideas."); 158 Cong. Rec. H1581 (daily ed. Mar. 27, 2012) (statement of Rep. Patrick McHenry ("Crowdfunding is the best of microfinancing and crowdsourcing. You use a wide network of individuals and you can raise capital for your new business, your start-up, or your small business.").

93 See Rule 100(b) of Regulation Crowdfunding.

94 *See, e.g.*, EMKF Letter; Fryer Letter; Growthfountain Letter; Martin Letter; Propellr Letter 2; Wefunder Letter.

In addition to these statutorily excluded categories of issuers, the final rules also exclude, as proposed, several additional categories of issuers. Below we discuss each of these additional categories:

Disqualification Provisions. As discussed further in Section II.E.6 below, the final rules also exclude issuers that are disqualified from relying on Section 4(a)(6).[95]

Delinquent in Ongoing Reporting. Consistent with the proposed rules and the views of a number of commenters,[96] the final rules exclude an issuer that has sold securities in reliance on Section 4(a)(6) if the issuer has not filed with the Commission and provided to investors, to the extent required, the ongoing annual reports required by Regulation Crowdfunding[97] during the two years immediately preceding the filing of the required new offering statement.[98] As discussed further in Section II.B.2 below, we believe that the annual ongoing reporting requirement will benefit investors by enabling them to consider updated information about the issuer, thereby allowing them to make more informed investment decisions. If issuers fail to comply with this requirement, we do not believe that they should have the benefit of relying on the exemption under Section 4(a)(6) again until they file, to the extent required, the two most recent annual reports.[99] In addition, as discussed further in Section II.B.1 below, in a modification to the

95 *See* Rule 100(b)(4) of Regulation Crowdfunding. *See also* Rule 503 of Regulation Crowdfunding and Section II.E.6 for a discussion of the disqualification provisions.

96 *See, e.g.*, ASSOB Letter; Commonwealth of Massachusetts Letter; Consumer Federation Letter; Fund Democracy Letter; Grassi Letter; Joinvestor Letter; NASAA Letter; Wefunder Letter.

97 *See* Rules 202 and 203(b) of Regulation Crowdfunding and Section II.B.2 for a discussion of the ongoing reporting requirements.

98 *See* Rule 100(b)(5) of Regulation Crowdfunding.

99 We note that even if an issuer has regained eligibility to rely on Regulation Crowdfunding, the Commission could still bring an enforcement action under the federal securities laws based on the issuer's failure to make the required filings. In addition, as discussed in Section II.E.4., new Rule 12g-6 provides an exemption from Section 12(g) conditioned, among other things, on the issuer's compliance with the annual reporting requirements of Rule 202 of Regulation Crowdfunding.

proposed rules, the final rules require an issuer to disclose in its offering statement and annual report if it, or any of its predecessors, previously failed to comply with the ongoing reporting requirements of Regulation Crowdfunding.

We note that some commenters read the provision requiring issuers to have filed their two most recent annual reports to mean that the disqualification would be triggered only after the issuer was delinquent for two consecutive years or that an issuer would be disqualified for two years.[100] Instead, the final rule requires that any ongoing annual report that was due during the two years immediately preceding the currently contemplated offering must be filed before an issuer may rely on the Section 4(a)(6) exemption. For example, if more than 120 days have passed since the issuer's fiscal year end and the issuer has not filed the required annual report for that most recently ended fiscal year, the issuer will not be able to conduct a new offering of securities in reliance on the Section 4(a)(6) exemption until the delinquent annual report has been filed. Similarly, if an issuer did file an annual report for the most recently ended fiscal year but did not file an annual report for the fiscal year prior to that, the issuer will not be able to rely on the Section 4(a)(6) exemption until the missing report has been filed. In both cases, as soon as the issuer has filed with the Commission and provided to investors both of the annual reports required during the two years immediately preceding the filing of the required offering statement, the issuer will be able to rely on the Section 4(a)(6) exemption. The final rule text includes an instruction to clarify this requirement.[101]

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[100] *See, e.g.*, Consumer Federation Letter; Fund Democracy Letter; NASAA Letter.

[101] *See* instruction to paragraph (b)(5) of Rule 100 of Regulation Crowdfunding

Consistent with the proposal and the recommendations of commenters,[102] we are not extending the exclusion to issuers that are delinquent in the progress update or termination of reporting requirements, nor are we excluding issuers whose officer, director, or controlling shareholder served in a similar capacity with another issuer that failed to file its annual reports. Extending the exclusion to those issuers would impose more stringent requirements than those faced by current reporting companies and issuers under Regulation A.

Business Plans. The final rules also exclude an issuer that has no specific business plan or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies.[103] We believe that the exemption under Section 4(a)(6) is intended to provide an issuer with an early stage project, idea or business an opportunity to share it publicly with a wider range of investors. Those investors may then share information with each other about the opportunity and use that information to decide whether or not to invest. Thus, we believe that an issuer engaging in crowdfunding under the exemption should give the public sufficient information about a particular proposed project or business to allow investors to make an informed investment decision.[104]

As discussed in the proposal, we are cognizant of the challenges noted by some commenters[105] in distinguishing between early-stage proposals that have information sufficient to support the crowdfunding mechanism and those that cannot by their terms do so. After

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102 *See, e.g.*, Grassi Letter; Projectheureka Letter; Whitaker Chalk Letter.

103 *See* Rule 101(b)(6) of Regulation Crowdfunding.

104 *See, e.g.*, Section 4A(b)(1)(C) (requiring a description of the business of the issuer and the anticipated business plan of the issuer).

105 *See, e.g.*, ABA Letter; FundHub Letter 1; Projectheureka Letter; Public Startup Letter 2; RoC Letter; RocketHub Letter; SBM Letter; Wilson Letter.

considering the comments received,[106] we continue to believe that the rules should exclude issuers that have no specific business plan or whose business plan is to engage in a merger or acquisition with an unidentified company or companies. We understand that issuers engaging in crowdfunding transactions may have businesses at various stages of development in differing industries, and therefore, we believe that a specific "business plan" for such issuers could encompass a wide range of project descriptions, articulated ideas, and business models.

Overall, we believe that the exclusions in the final rules appropriately consider the need to limit the potential risks to investors that could result from extending issuer eligibility to certain types of entities without unduly limiting the benefits of the exemption as a tool for capital formation.

B. Issuer Requirements

1. Disclosure Requirements

Securities Act Section 4A(b)(1) sets forth specific disclosures that an issuer offering or selling securities in reliance on Section 4(a)(6) must "file with the Commission and provide to investors and the relevant broker or funding portal, and make available to potential investors". These disclosures include:

- the name, legal status, physical address and website address of the issuer;[107]
- the names of the directors and officers (and any persons occupying a similar status or performing a similar function), and each person holding more than 20 percent of the shares of the issuer;[108]

[106] *See, e.g.*, ABA Letter; Anonymous Letter 2; CFA Institute Letter; CFIRA Letter 7; Commonwealth of Massachusetts Letter; Consumer Federation Letter; FundHub Letter 1; Grassi Letter; Hackers/Founders Letter; NASAA Letter; ODS Letter; Projectheureka Letter; Public Startup Letter 2; RFPIA Letter; RoC Letter; RocketHub Letter; SBM Letter; Traklight Letter; Whitaker Chalk Letter; Wilson Letter.

[107] Section 4A(b)(1)(A).

- a description of the business of the issuer and the anticipated business plan of the issuer;[109]
- a description of the financial condition of the issuer;[110]
- a description of the stated purpose and intended use of the proceeds of the offering sought by the issuer with respect to the target offering amount;[111]
- the target offering amount, the deadline to reach the target offering amount and regular updates about the progress of the issuer in meeting the target offering amount;[112]
- the price to the public of the securities or the method for determining the price;[113] and
- a description of the ownership and capital structure of the issuer.[114]

In addition, Section 4A(b)(1)(I) specifies that the Commission may require additional disclosures for the protection of investors and in the public interest.

As discussed further in Section II.B.3 below, we are requiring issuers to file these disclosures with the Commission on Form C.[115] Unless otherwise indicated in the form,

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108 Section 4A(b)(1)(B).

109 Section 4A(b)(1)(C).

110 Section 4A(b)(1)(D).

111 Section 4A(b)(1)(E).

112 Section 4A(b)(1)(F).

113 Section 4A(b)(1)(G).

114 Section 4A(b)(1)(H). Specifically, Section 4A(b)(1)(H) requires a description of: "(i) terms of the securities of the issuer being offered and each other class of security of the issuer…; (ii) a description of how the exercise of the rights held by the principal shareholders of the issuer could negatively impact the purchasers of the securities being offered; (iii) the name and ownership level of each existing shareholder who owns more than 20 percent of any class of the securities of the issuer; (iv) how the securities being offered are being valued…; and (v) the risks to purchasers of the securities relating to minority ownership in the issuer, the risks associated with corporate actions, including additional issuances of shares, a sale of the issuer or of assets of the issuer, or transactions with related parties."

Form C must be filed in the standard format of eXtensible Markup Language (XML). The XML-based fillable portion of Form C will enable issuers to provide information in a convenient medium without requiring the issuer to purchase or maintain additional software or technology. This will provide the Commission and the public with readily available data about offerings made in reliance on Section 4(a)(6). Other required disclosure that is not required to be provided in the XML-based text boxes will be filed as attachments to Form C. We are not mandating a specific presentation format for the attachments to Form C; however, the final Form C does include an optional Q&A format that crowdfunding issuers may use to provide disclosures that are not required to be filed in XML format.[116] We believe that this optional format should help reduce the burden on crowdfunding issuers of preparing disclosures.

By filing Form C with the Commission and providing it to the relevant intermediary, issuers will satisfy the requirement of Securities Act Section 4A(b) that issuers relying on Section 4(a)(6) must "file with the Commission and provide to investors and the relevant broker of funding portal, and make available to potential investors" certain information. In a clarifying change from the proposal, we have moved the definition of "investor" from proposed Rule 300(c)(4) to Rule 100(d) to clarify that for purposes of all of Regulation Crowdfunding, "investor" includes any investor or any potential investor, as the context requires.[117] In connection with this clarifying move we

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115 Issuers will use Form C to provide the required disclosures about the crowdfunding transaction and the information required to be filed annually. *See* Section II.B.3.

116 *See* Item 1 of General Instruction III to Form C of Regulation Crowdfunding.

117 *See* Rule 100(d) of Regulation Crowdfunding.

have deleted the phrase "and make available to potential investors" each time it appeared in the proposed Rules 201 and 203 to avoid redundancy.[118]

Additionally, as we clarify in the final rules, to the extent that some of the required disclosures overlap, issuers are not required to duplicate disclosures.

a. Offering Statement Disclosure Requirements

(1) Information about the Issuer and the Offering

(a) General Information about the Issuer, Officers and Directors, and Certain Shareholders

(i) Proposed Rules

To implement Sections 4A(b)(1)(A) and (B), we proposed in Rule 201 of Regulation Crowdfunding to require an issuer to disclose information about its legal status, directors, officers and certain shareholders and how interested parties may contact the issuer. Specifically, we proposed to require that an issuer disclose:

- its name and legal status, including its form of organization, jurisdiction in which it is organized and date of organization;
- its physical address and its website address; and
- the names of the directors and officers, including any persons occupying a similar status or performing a similar function, all positions and offices with the issuer held by such persons, the period of time in which such persons served in the positions or offices and their business experience during the past three years, including:
    - each person's principal occupation and employment, including whether any officer is employed by another employer; and

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118 *See* Rules 201 and 203(a) of Regulation Crowdfunding.

- the name and principal business of any corporation or other organization in which such occupation and employment took place.

We proposed to define "officer" consistent with the definition in Securities Act Rule 405 and in Exchange Act Rule 3b-2. We further proposed to require disclosure of the business experience of directors and officers of the issuer during the past three years.

Section 4A(b)(1)(B) requires disclosure of "the names of . . . each person holding more than 20 percent of the shares of the issuer." In contrast, Section 4A(b)(1)(H)(iii) requires disclosure of the "name and ownership level of each existing shareholder who owns more than 20 percent *of any class* of the securities of the issuer" (emphasis added). We proposed in Rule 201(c) to require disclosure of the names of persons, as of the most recent practicable date, who are the beneficial owners of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power ("20 Percent Beneficial Owners"). Neither Section 4A(b)(1)(B) nor Section 4A(b)(1)(H)(iii) states as of what date the beneficial ownership should be calculated. We proposed in Rule 201(c) to require issuers to calculate beneficial ownership as of the most recent practicable date.

(ii) Comments on the Proposed Rules

Of the commenters that addressed the proposed issuer, officer and director disclosure rules, some generally supported them,[119] while others opposed specific disclosure requirements. For example, one commenter opposed requiring issuers to disclose a website address.[120] Other commenters opposed requiring issuers to disclose the business experience of their officers and

119 *See, e.g.*, Angel Letter 1; CCI Letter; Denlinger Letter 1; Mollick Letter; Wefunder Letter; Wilson Letter.

120 *See* Vann Letter (recommending that the disclosure requirement be optional or only required for businesses that have a website).

directors,[121] while one commenter suggested narrowing the definition of the term "officer."[122] Some commenters expressed opposition to any revision to the proposed rules that would require disclosure of any court orders, judgments or civil litigation involving any directors and officers.[123]

Some commenters supported the proposed three-year time period to be covered by the officer and director disclosure rules,[124] while others recommended that officer and director disclosure cover the previous five years.[125] Some commenters recommended we require additional disclosures about an issuer's officers, directors and persons occupying a similar status or performing a similar function.[126]

A few commenters commented on the proposed 20 Percent Beneficial Owner rules. One commenter supported the requirement to disclose the names of persons who are the 20 Percent Beneficial Owners,[127] while one commenter opposed the requirement.[128] One commenter recommended that, to provide greater certainty for investors and more guidance for issuers, the beneficial ownership be calculated as of a specific date, rather than the most recent practicable date, and that the disclosure be updated when there are significant changes in beneficial

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121 *See, e.g.*, Public Startup Letter 2; RocketHub Letter; Schwartz Letter; Zhang Letter.

122 *See* RocketHub Letter (stating that only relevant officers for most companies using Regulation Crowdfunding would be the principal executive officer and the principal financial officer, which may be the same person.)

123 *See, e.g.*, FundHub Letter 1; RocketHub Letter; Wefunder Letter.

124 *See, e.g.*, Denlinger Letter 1; Joinvestor Letter; Wefunder Letter.

125 *See, e.g.*, Commonwealth of Massachusetts Letter; NASAA Letter.

126 *See, e.g.*, Angel Letter 1 (qualifications of candidates for the board of directors); Denlinger Letter 1(educational background of the officers and directors); Mollick Letter (online identities of the officers and directors); ODS Letter (educational background of the officers and directors);Wilson Letter (technical and business skills of the officers and directors); Zeman Letter (any officer and director positions held by the officers and directors or their family members, as well as any 10 percent beneficial holdings they may have with other SEC registrants; and disputes the officers and directors had with other employers).

127 *See* RocketHub Letter.

128 *See* Public Startup Letter 2.

ownership.[129] Finally, one commenter recommended that the Commission keep the requirement as simple as possible.[130]

(iii) Final Rules

We are adopting the issuer, officer and director, and 20 Percent Beneficial Owners disclosure requirements largely as proposed.[131] An issuer will be required to disclose information about its president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer and any person routinely performing similar functions. As noted by at least one commenter,[132] an issuer may not have officers serving in each of these roles. Accordingly, the final rules require the disclosure only to the extent an issuer has individuals serving in these capacities or performing similar functions.[133] The required information includes all positions and offices held with the issuer, the period of time in which such persons served in the position or office and their prior business experience.[134] Contrary to the views of some commenters,[135] we believe that additional disclosures about an issuer's officers, directors and persons occupying a similar status or performing a similar function would be unduly burdensome and generally not necessary for investors to be in a position to make an informed investment decision. Given the diverse nature of the startups and small businesses that we anticipate will

129 *See* NASAA Letter.

130 *See* RocketHub Letter.

131 *See* Rule 201(a)-(c) of Regulation Crowdfunding.

132 *See* RocketHub Letter.

133 *See* Instruction to paragraph (b) of Rule 201 of Regulation Crowdfunding.

134 *See* Rule 201(b) of Regulation Crowdfunding.

135 *See, e.g.*, Denlinger 1 Letter (educational background of officers); ODS Letter (educational background of officers, directors and similar persons); Zeman Letter (proposing that officers and directors of an issuer be required to disclose their (or family members) officer and director positions with other SEC registrants, and disclose material holdings of more than 10% with other SEC registrants).

seek to raise capital in reliance on Section 4(a)(6), additional disclosures such as those recommended by some commenters may not be relevant in all instances.

The required disclosure about the business experience of the directors and officers (and any persons occupying a similar status or performing a similar function) must cover the past three years,[136] which, as some commenters noted,[137] is shorter than the five-year period that applies to issuers conducting registered offerings[138] or exempt offerings pursuant to Regulation A.[139] We believe that startups and small businesses that may seek to raise capital in reliance on Section 4(a)(6) generally will be smaller than the issuers conducting registered offerings or exempt offerings pursuant to Regulation A, and generally are likely to have a more limited operating history.[140] Therefore, in comparison to registered offerings and Regulation A, we believe the three-year period is more relevant given the stage of development of these issuers and should help to reduce compliance costs for issuers conducting offerings pursuant to Section 4(a)(6) while still providing investors with sufficient information about the business experience of directors and officers of the issuer to make an informed investment decision.

Notwithstanding the suggestion of one commenter, and consistent with the statute, the final rules require disclosure of an issuer's website.[141] Given the Internet-based nature of Crowdfunding, we anticipate that every issuer will have a website or be able to create one at a minimal cost.

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136 *See* Rule 201(b) of Regulation Crowdfunding.

137 *See, e.g.*, Commonwealth of Massachusetts Letter; NASAA Letter.

138 *See* Item 401(e) of Regulation S-K [17 CFR 229.401(e)].

139 *See* Item 8(c) of Form 1-A [17 CFR 239.90].

140 There is no limit on the amount of proceeds that may be raised in a registered offering, and Regulation A permits offerings of up to $50 million of securities annually.

141 *See* Rule 201(a) of Regulation Crowdfunding.

We also are adopting the 20 Percent Beneficial Owner disclosure requirement as proposed with one modification.[142] Instead of requiring issuers to disclose the name of each 20 Percent Beneficial Owner as of the most recent practicable date, we are requiring such disclosure as of the most recent practicable date, but no earlier than 120 days prior to the date the offering statement or report is filed. We believe that this change should address commenter concerns[143] about the discretion afforded by the proposed "most recent practicable date." While we are not adding to Rule 201(c) a specific requirement that the disclosure be updated when there are significant changes in beneficial ownership, as requested by one commenter,[144] to the extent a material change in beneficial ownership takes place during the offering, an issuer would be required to file an amended offering statement on Form C/A: Amendment.

As stated in the Proposing Release, we believe that the universe of 20 Percent Beneficial Owners should be the same for the disclosure requirements and the disqualification provisions[145] because this would ease the burden on issuers by requiring them to identify only one set of persons who would be the subject of these rules. We continue to believe that assessing beneficial ownership based on total outstanding voting securities is consistent with Section 4A(b)(1)(B). Section 4A(b)(1)(B) is not limited to voting equity securities, but we believe the limitation is necessary to clarify how beneficial ownership should be calculated since issuers could potentially have multiple classes of securities with different voting powers.

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142 *See* Rule 201(c) of Regulation Crowdfunding.

143 *See* NASAA Letter.

144 *Id.*

145 *See* Rule 503 of Regulation Crowdfunding and Section II.E.6 for a discussion of the disqualification provisions.

(b) Description of the Business

(i) Proposed Rules

Consistent with Section 4A(b)(1)(C), we proposed in Rule 201(d) of Regulation Crowdfunding to require an issuer to disclose information about its business and business plan. The proposed rules did not specify the disclosures that an issuer would need to include in the description of the business and the business plan.

(ii) Comments on the Proposed Rules

While several commenters expressed concerns about requiring an issuer to disclose a description of its business and business plan,[146] most commenters supported this proposed requirement.[147] Some commenters recommended that the disclosure include specific items, such as disclosure of any material contracts of the issuer, any material litigation or any outstanding court order or judgment affecting the issuer or its property;[148] the issuer's business value proposition, revenue model, team, regulatory issues and executive compensation;[149] how the issuer will build value for the shareholders;[150] and plans for implementation, concrete next steps, outside recommendations about the validity of the business, backgrounds of the individuals

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146 *See, e.g.*, ABA Letter; ASSOB Letter; Public Startup Letter 2; Traklight Letter.

147 *See, e.g.*, Anonymous Letter 2; Arctic Island Letter 5; Benjamin Letter; CFIRA Letter 7; Consumer Federation Letter; EMKF Letter; Hackers/Founders Letter; Mollick Letter; NFIB Letter; RocketHub Letter; Saunders Letter; Wefunder Letter.

148 *See, e.g.*, Arctic Island Letter 4 (referencing only pending litigation); Arctic Island Letter 5 (referencing only threatened or pending litigation); FundHub Letter 1; Wilson Letter.

149 *See, e.g.*, Arctic Island Letter 5.

150 *See, e.g.*, Hackers/Founders Letter.

involved and prototypes or concept drawings.[151] One commenter recommended that the disclosure requirement be scaled to match the size of the offering.[152]

Some commenters recommended that the Commission provide a non-exclusive list of the types of information an issuer should consider disclosing, templates, examples or other guidance to assist the issuer in complying with this disclosure requirement.[153] One commenter recommended that the Commission not specify the information to be included in the description of the business or the business plan.[154] Commenters also opposed revising the proposed business description requirement to require the description to include the information requirements of Items 101(a)(2) and 101(h)[155] of Regulation S-K.[156]

(iii) Final Rules

Consistent with the proposal, Rule 201(d) requires an issuer to disclose information about its business and business plan. We are not modifying the proposed rule, as some commenters recommended,[157] to specify the disclosures that an issuer must include in the description of the business and the business plan or to provide a non-exclusive list of the types of information an issuer should consider disclosing. We anticipate that issuers engaging in crowdfunding transactions may have businesses at various stages of development in different industries, and

151 *See, e.g.*, Mollick Letter.

152 *See* Consumer Federation Letter.

153 *See, e.g.*, ABA Letter; Benjamin Letter; CFIRA Letter 7; Commonwealth of Massachusetts Letter; FundHub Letter 1 (recommending a safe harbor list of requirements); Traklight Letter; Wilson Letter (recommending a checklist or prescribed list of questions).

154 *See* RocketHub Letter.

155 17 CFR 229.101.

156 *See, e.g.*, Hamilton Letter; Public Startup Letter 2; RocketHub Letter.

157 *See, e.g.*, ABA Letter; Arctic Island Letter 4; Arctic Island Letter 5; Benjamin Letter; CFIRA Letter 7; Commonwealth of Massachusetts Letter; FundHub Letter 1; Hackers/Founders Letter; Mollick Letter; Traklight Letter; Wilson Letter.

therefore, we believe that the rules should provide flexibility for these issuers regarding what information they disclose about their businesses. This flexible approach is consistent with the suggestion of one commenter that the business plan requirements be scaled to match the size of the offering.[158] We also are concerned that a non-exclusive list of the types of information an issuer should consider providing would be viewed as a *de facto* disclosure requirement that all issuers would feel compelled to meet and would, therefore, undermine the intended flexibility of the final rules.

(c) Use of Proceeds

(i) Proposed Rules

Consistent with Section 4A(b)(1)(E), we proposed in Rule 201(i) of Regulation Crowdfunding to require an issuer to provide a description of the purpose of the offering and intended use of the offering proceeds. We expected that such disclosure would provide a sufficiently detailed description of the intended use of proceeds to permit investors to evaluate the investment. Under the proposed rules, if an issuer did not have definitive plans for the proceeds, but instead had identified a range of possible uses, then the issuer would be required to identify and describe each probable use and factors affecting the selection of each particular use. In addition, if an issuer indicated that it would accept proceeds in excess of the target offering amount,[159] the issuer would be required to provide a separate, reasonably detailed description of the purpose and intended use of any excess proceeds with similar specificity.

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158 *See* Consumer Federation Letter.

159 *See* Section II.B(1)(d) below for a description of the final rule's disclosure requirements with respect to target amounts.

(ii) Comments on the Proposed Rules

Most commenters supported the requirement that issuers disclose the intended use of the offering proceeds.[160] One commenter recommended that we prescribe the use of proceeds disclosure or provide a list of examples that issuers should consider when providing such disclosures.[161] Others recommended a variety of circumstances under which an issuer should be required to update the use of proceeds disclosure.[162]

(iii) Final Rules

We are adopting the use of proceeds disclosure requirement substantially as proposed in Rule 201(i). An issuer will be required to provide a reasonably detailed description of the purpose of the offering, such that investors are provided with enough information to understand how the offering proceeds will be used.[163] While one commenter[164] recommended that we prescribe this disclosure or provide a list of examples, we believe a more prescriptive rule would not best accommodate a diverse range of issuers. Instead, below we provide several examples of the disclosures issuers should consider making with respect to various uses of proceeds.

The disclosure requirement is designed to provide investors with sufficient information to evaluate the investment. For example, an issuer may intend to use the proceeds of an offering to acquire assets or businesses, compensate the intermediary or its own employees or repurchase

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160 *See, e.g.*, ABA Letter; ASSOB Letter; Consumer Federation Letter; Joinvestor Letter; Saunders Letter; Traklight Letter; Whitaker Chalk Letter; Wilson Letter. *But see*, Public Startup Letter 2.

161 *See* Commonwealth of Massachusetts Letter.

162 *See, e.g.*, ASSOB Letter (five percent change); CFIRA Letter 7 (material deviations in the offering statement and any deviations in the annual report); Commonwealth of Massachusetts Letter (material change); Joinvestor Letter (substantial change); RocketHub Letter (significant change); Traklight Letter (material deviations); Whitaker Chalk Letter (material change); Wilson Letter (any deviation). *See* also Section II.B.3 for discussion of when an amendment to the offering statement may be required.

163 *See* Instruction to paragraph (i) of Rule 201 of Regulation Crowdfunding.

164 *See* Commonwealth of Massachusetts Letter.

outstanding securities of the issuer. In providing its description, an issuer would need to consider the appropriate level of detail to provide investors about the assets or businesses that the issuer anticipates acquiring, based on its particular facts and circumstances, so that the investors could make informed decisions. If the proceeds will be used to compensate existing employees or to hire new employees, the issuer should consider disclosing whether the proceeds will be used for salaries or bonuses and how many employees it plans to hire, as applicable. If the issuer will repurchase outstanding issuer securities, it should consider disclosing its plans, terms and purpose for repurchasing the securities. An issuer also should consider disclosing how long the proceeds will satisfy the operational needs of the business. If an issuer does not have definitive plans for the proceeds, but instead has identified a range of possible uses, then the issuer should identify and describe each probable use and the factors the issuer may consider in allocating proceeds among the potential uses.[165] If an issuer indicates that it will accept proceeds in excess of the target offering amount, the issuer must provide a reasonably detailed description of the purpose, method for allocating oversubscriptions, and intended use of any excess proceeds with similar specificity.[166]

(d) Target Offering Amount and Deadline

(i) Proposed Rules

Consistent with Section 4A(b)(1)(F), we proposed in Rule 201(g) of Regulation Crowdfunding to require issuers to disclose the target offering amount and the deadline to reach the target offering amount. In addition, we proposed in Rule 201(h) to require an issuer to disclose whether it would accept investments in excess of the target offering amount, and, if it

[165] *See* Instruction to paragraph (i) of Rule 201 of Regulation Crowdfunding.

[166] *See* Instruction to paragraph (i) of Rule 201 of Regulation Crowdfunding.

would, we proposed to require the issuer to disclose, at the commencement of the offering, the maximum amount it would accept. The issuer also, under proposed Rule 201(h), would be required to disclose, at the commencement of the offering, how shares in oversubscribed offerings would be allocated. We further proposed in Rule 201(j) to require issuers to describe the process to cancel an investment commitment or to complete the transaction once the target amount is met, including a statement that:

- investors may cancel an investment commitment until 48 hours prior to the deadline identified in the issuer's offering materials;[167]
- the intermediary will notify investors when the target offering amount has been met;
- if an issuer reaches the target offering amount prior to the deadline identified in its offering materials, it may close the offering early if it provides at least five business days' notice prior to that new deadline (absent a material change that would require an extension of the offering and reconfirmation of the investment commitment);[168] and
- if an investor does not cancel an investment commitment before the 48-hour period prior to the offering deadline, the funds will be released to the issuer upon closing of the offering and the investor will receive securities in exchange for his or her investment.

In addition, proposed Rule 201(k) would require issuers to disclose that if an investor does not reconfirm his or her investment commitment after a material change is made to the offering,

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167 Section II.C.6 further discusses the cancellation provisions.

168 *Id.*

the investor's investment commitment will be cancelled and committed funds will be returned. Proposed Rule 201(g) also would require issuers to disclose that if the sum of the investment commitments does not equal or exceed the target offering amount at the time of the offering deadline, no securities will be sold in the offering, investment commitments will be cancelled and committed funds will be returned.[169]

(ii) Final Rules

Commenters were supportive of the proposed rules, and we are adopting the target offering amount and deadline disclosure rules as proposed.[170] As an example of how the final rules will apply, if an issuer sets a target offering amount of $80,000 but is willing to accept up to $650,000, the issuer will be required to disclose both the $80,000 target offering amount and the $650,000 maximum offering amount that it will accept.[171] In an instance where an issuer reaches the target offering amount prior to the deadline identified in its offering materials, it may close the offering early if it provides at least five business days' notice about the new offering deadline as set forth in Rules 201(j) and 302(d) of Regulation Crowdfunding. Accelerating the deadline would not require an extension of the offering and reconfirmation of the investment commitment; however,

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169 *See* Section 4A(a)(7) (requiring intermediaries to "ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount....") and discussion in Section II.C.6.

170 *See* Rules 201(g), 201(h), 201(j) and 201(k) of Regulation Crowdfunding.

171 The issuer in this case also will need to disclose the intended use of the additional proceeds. *See* Instruction to paragraph (i) of Rule 201 of Regulation Crowdfunding. *See also* Section II.B.1.a.i(c) above. In addition, the issuer in this case will be required to provide financial statements reviewed by an independent public accountant (rather than certain tax return information for the most recently completed fiscal year and financial statements certified by the principal executive officer). *See* Section II.B.1.a.ii for a discussion of the financial statement requirements.

issuers would need to consider whether any material change occurred that would require an extension and reconfirmation from investors.[172]

We do not believe it is necessary for us to prescribe how oversubscribed offerings must be allocated if the issuer is required to disclose, at the commencement of the offering, how shares in oversubscribed offerings will be allocated. Commenters were supportive of this approach,[173] and we believe this disclosure should provide investors with important information while maintaining flexibility for issuers to structure the offering as they believe appropriate.

We believe that investors in a crowdfunding transaction will benefit from clear disclosure about their right to cancel, the circumstances under which an issuer may close an offering early and the need to reconfirm the investment commitment under certain circumstances, as they will be more aware of their rights to rescind an investment commitment. Therefore, we are adopting disclosure requirements covering these points, as proposed.

(e) Offering Price

Consistent with Section 4A(b)(1)(G), we proposed in Rule 201(l) of Regulation Crowdfunding to require an issuer to disclose the offering price of the securities or, in the alternative, the method for determining the price, so long as before the sale each investor is provided in writing the final price and all required disclosures.

Commenters were supportive of the proposed disclosure[174] and we are adopting the offering price disclosure rules as proposed.[175] We believe that disclosure of the price or the

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172 Section II.B.1.c discusses the amendment and reconfirmation requirements.

173 *See, e.g.*, CFA Institute Letter; RoC Letter; RocketHub Letter; Wilson Letter.

174 *See, e.g.*, CFA Institute Letter; Wilson Letter. As discussed below, however, a few commenters recommended that the Commission require a fixed price at the commencement of an offering. *See, e.g.*, Joinvestor Letter; RocketHub Letter. We address those comments in Section II.B.6.

175 *See* Rule 201(l) of Regulation Crowdfunding.

methods used for determining the price, coupled with investors' rights to cancel their investment upon determination of the final price, provide sufficient opportunity for investors to evaluate the price.

(f) Ownership and Capital Structure

(i) Proposed Rules

Consistent with Section 4A(b)(1)(H), we proposed in Rule 201(m) of Regulation Crowdfunding to require an issuer to provide a description of its ownership and capital structure. This disclosure would include:

- the terms of the securities being offered and each other class of security of the issuer, including the number of securities being offered and those outstanding, whether or not such securities have voting rights, any limitations on such voting rights, how the terms of the securities being offered may be modified and a summary of the differences between such securities and each other class of security of the issuer, and how the rights of the securities being offered may be materially limited, diluted or qualified by the rights of any other class of security of the issuer;
- a description of how the exercise of the rights held by the principal shareholders of the issuer could affect the purchasers of the securities;
- the name and ownership level of persons who are 20 Percent Beneficial Owners;
- how the securities being offered are being valued, and examples of methods for how such securities may be valued by the issuer in the future, including during subsequent corporate actions;
- the risks to purchasers of the securities relating to minority ownership in the issuer and the risks associated with corporate actions including additional issuances of

securities, issuer repurchases of securities, a sale of the issuer or of assets of the issuer or transactions with related parties; and

- a description of the restrictions on the transfer of the securities.

As proposed, the rules would require disclosure of the number of securities being offered and those outstanding, whether or not such securities have voting rights, any limitations on such voting rights and a description of the restrictions on the transfer of the securities.

(ii) Comments on the Proposed Rules

A number of commenters supported the proposed ownership and capital structure disclosure rules,[176] while two commenters opposed them as burdensome.[177] One of these commenters suggested that issuers should only be required to disclose the price of a share and the percentage ownership represented by a share, and noted that the principals of an issuer conducting a crowdfunding offering may not consider the issuer's capital structure or whether its shareholders will have voting rights.[178]

(iii) Final Rules

We are adopting the ownership and capital structure disclosure rules as proposed, with the addition of language specifying that beneficial ownership must be calculated no earlier than 120 days prior to the date of the filing of the offering statement or report,[179] consistent with the treatment of beneficial ownership elsewhere in the rule.[180] Investors in crowdfunding transactions

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176 *See, e.g.*, CFA Institute Letter; Commonwealth of Massachusetts Letter; Hackers/Founders Letter; Joinvestor Letter; NASAA Letter; RocketHub (supporting only to the extent that such disclosures do not require additional form submission or accountant or legal work); Saunders Letter; Wilson Letter.

177 *See* Campbell R. Letter; Schatz Letter.

178 Schatz Letter.

179 *See* Rule 201(m) of Regulation Crowdfunding.

180 *See* Rule 201(c) of Regulation Crowdfunding.

will benefit from clear disclosure about the terms of the securities being offered and each other class of security of the issuer. The final rules require disclosure of the number of securities being offered and those outstanding, whether or not such securities have voting rights, any limitations on such voting rights[181] and a description of the restrictions on the transfer of securities.[182] Although Section 4A(b)(1)(H) does not specifically call for all aspects of this disclosure, we believe that such disclosure is necessary to provide investors with a more complete picture of the issuer's capital structure than would be obtained solely pursuant to the statutory requirements. This should help investors better evaluate the terms of the offer before making an investment decision.

(g) Additional Disclosure Requirements

(i) Proposed Rules

We also proposed to require the following additional disclosures:[183]

- disclosure of the name, SEC file number and Central Registration Depository number ("CRD number") (as applicable)[184] of the intermediary through which the offering is being conducted;
- disclosure of the amount of compensation paid to the intermediary for conducting the offering, including the amount of any referral or other fees associated with the offering;
- certain legends in the offering statement;
- disclosure of the current number of employees of the issuer;

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181 *Id.*

182 *See* Rule 501 of Regulation Crowdfunding and Section II.E.2 for a discussion of restrictions on resales.

183 Section 4A(b)(1)(I) provides us with discretion to require crowdfunding issuers to provide additional information for the protection of investors and in the public interest.

184 The Financial Industry Regulatory Authority, Inc. ("FINRA") issues CRD numbers to registered broker-dealers.

- a discussion of the material factors that make an investment in the issuer speculative or risky;
- a description of the material terms of any indebtedness of the issuer, including the amount, interest rate, maturity date and any other material terms;
- disclosure of any exempt offerings conducted within the past three years; and
- disclosure of related-party transactions since the beginning of the issuer's last fiscal year in excess of five percent of the aggregate amount of capital raised by the issuer in reliance on Section 4(a)(6) during the preceding 12-month period, inclusive of the amount the issuer seeks to raise in the current offering.

(ii) Comments on the Proposed Rules

Identity of the Intermediary. Several commenters supported the proposed requirement that issuers identify the intermediary through which the offering is being conducted.[185] Two commenters opposed such a requirement as unnecessary.[186]

Compensation Paid to the Intermediary. Some commenters supported the proposed requirement that issuers disclose the amount of compensation paid to the intermediary for conducting the offering, including the amount of any referral or other fees associated with the offering.[187] One commenter noted that to the extent components of the intermediary's fee are percentage based, the exact amount of the compensation may not be calculable at the onset of an

185 *See, e.g.*, Commonwealth of Massachusetts Letter; Joinvestor Letter; Schwartz Letter; Wilson Letter (recommending that issuers also disclose whether the intermediary specializes in offerings based on criteria such as industry size or type).

186 *See* Public Startup Letter 2; RocketHub.

187 *See, e.g.*, ASSOB Letter; Commonwealth of Massachusetts Letter; RocketHub Letter; Startup Valley Letter; Wilson Letter. *But see, e.g.*, Grassi Letter (opposing the requirement unless offering proceeds will be used to compensate the intermediary); Public Startup Letter 2; Schwartz Letter.

offering.[188] A few commenters recommended that issuers also should disclose all payments and fees, if any, they make to the intermediary.[189]

Legends. Comments were mixed as to the proposed requirement that issuers include specified legends in the offering statement about the risks of investing in a crowdfunding transaction and the required ongoing reports. Some commenters supported such a requirement,[190] while others opposed the requirement.[191]

Current Number of Employees. While several commenters supported the proposed requirement that issuers disclose their current number of employees,[192] two commenters opposed such a requirement.[193] One commenter opposed this requirement, noting that the number of employees is not useful for investors in evaluating early-stage startups, and is likely to increase during the course of a crowdfunding offering conducted concurrently with an offering pursuant to Rule 506(c).[194] This commenter also noted that many early-stage startups spend the majority of their initial funds on consultants.[195] Another commenter noted that it may be unreasonably costly, relative to the benefit gained, to accurately count the number of employees in instances where

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188 *See* RocketHub Letter.

189 *See, e.g.*, ASSOB Letter (recommending disclosure of all payments); RocketHub Letter (recommending disclosure of fees paid for compliance and overhead to enhance transparency for investors).

190 *See, e.g.*, ABA Letter; CFA Institute Letter; Commonwealth of Massachusetts Letter; Jacobson Letter; Schwartz Letter; Wilson Letter.

191 *See, e.g.*, Grassi Letter (recommending that general risks be disclosed on the intermediaries' platforms rather than in each issuer's offering statement); Hackers/Founders Letter (noting that crowdfunding issuers will tend to be smaller and lack the resources of large companies, and intermediaries should be required to provide examples of risks associated with crowdfunding offerings); Public Startup Letter 2; Startup Valley Letter (stating that a legend by the issuer about the risks of investing in a crowdfunding transaction is not needed because it is the responsibility of the intermediary to educate the public about this information).

192 *See, e.g.*, NASAA Letter; Wilson Letter; Zhang Letter.

193 *See* Schwartz Letter; Wefunder Letter.

194 *See* Wefunder Letter.

195 *Id.*

businesses engage many contract workers, or have workers on arrangements such as "flex-time" or "half-time."[196]

Risk Factors. Commenters were divided as to the proposed requirement that issuers discuss the material factors that make an investment in the issuer speculative or risky. A number of commenters supported this proposed requirement,[197] while a number of others opposed it.[198] Some commenters recommended that we provide examples of, or develop standard disclosures for, issuer risk factor discussions.[199]

Indebtedness. Commenters supported the proposed requirement that issuers describe the material terms of any indebtedness of the issuer.[200] Two commenters recommended that we clarify that this disclosure requirement could be satisfied if the issuer includes such disclosure in its financial statements.[201] Another recommended that we require issuers to disclose the identities of their creditors.[202]

Prior Exempt Offerings. Commenters supported the proposed requirement that issuers disclose their prior exempt offerings.[203] One commenter recommended that we require additional

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196 *See* Schwartz Letter.

197 *See, e.g.*, ASSOB Letter; CFA Institute Letter; Commonwealth of Massachusetts Letter; Consumer Federation Letter; EMKF Letter; Jacobson Letter; McGladrey Letter; STA Letter; StartupValley Letter; Wilson Letter.

198 *See, e.g.*, ABA Letter; Campbell R. Letter; Cole A. Letter; Grassi Letter; Hackers/Founders Letter; RocketHub Letter (recommending that a generic 500-word statement suffice); Schwartz Letter; Scruggs Letter.

199 *See, e.g.*, Commonwealth of Massachusetts Letter; EMKF Letter; Heritage Letter (recommending also that the Commission define "material"); Jacobson Letter; SBA Office of Advocacy Letter. *But see,* StartupValley Letter (opposing such a recommendation).

200 *See, e.g.*, Consumer Federation Letter; ODS Letter; Schwartz Letter; Wilson Letter.

201 *See* Grassi Letter; EY Letter.

202 *See* ODS Letter.

203 *See, e.g.*, CFA Institute Letter (recommending a brief statement about prior capital raising transactions); Commonwealth of Massachusetts Letter; Grassi Letter; Joinvestor Letter; ODS Letter; Parsont Letter; RoC

disclosure to help non-accredited investors understand how well aligned their interests are with earlier accredited investors,[204] while other commenters suggested scaling back this disclosure in order to contain costs.[205]

Related-Party Transactions. Commenters generally supported our proposal to require disclosure of certain related-party transactions between the issuer and any director or officer of the issuer, any person who is a 20 Percent Beneficial Owner, any promoter of the issuer (if the issuer was incorporated or organized within the past three years) or immediate family members of the foregoing persons.[206] Rather than using the definition of "immediate family member" contained in Item 404 of Regulation S-K,[207] one commenter recommended that we use a common definition for "immediate family member" in the related-party transactions context and "member of the family of the purchaser or the equivalent" in the resale restrictions context.[208]

One commenter supported the proposal to limit the disclosure of related-party transactions to transactions since the beginning of the issuer's last fiscal year.[209] Other commenters recommended that the related-party transaction disclosure cover the period for which financial

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Letter (supporting the disclosure covering the past three years); RocketHub Letter (recommending disclosure of successful prior offerings only); Whitaker Chalk Letter (recommending that the disclosure exclude the target amount of any offerings made in reliance on Section 4(a)(6) and whether such target was reached); Wilson Letter. *But see, e.g.*, Heritage Letter; Public Startup Letter 2; Schwartz Letter; Wefunder Letter.

204 *See* Parsont Letter.

205 *See, e.g.*, Grassi Letter (recommending disclosure of only the date, amount raised, type of securities sold and a link to a website where more information on such prior offerings can be found); Wefunder Letter (recommending disclosure of only the aggregate capital raised in all prior exempt transactions, as well as the date, terms, valuation of and types of securities issued in the most recent exempt offering).

206 *See, e.g.*, AICPA Letter (recommending disclosure of transactions between the issuer and 10 percent beneficial owners); Commonwealth of Massachusetts Letter; Grassi Letter (also recommending disclosure of transactions between the issuer and employees or affiliated entities with common ownership or control); NASAA Letter; RocketHub Letter; Wilson Letter. *But see,* Public Startup Letter 2; Schwartz Letter.

207 17 CFR 229.404.

208 *See* Brown J. Letter. *See also,* Section II.E.2 for a discussion of the restrictions on resales.

209 *See* RocketHub Letter.

statements are required.[210] In addition, one commenter supported the proposal to limit disclosure of related-party transactions based on the size of the offering,[211] while a few commenters suggested alternatives to such proposal.[212]

Other Disclosures. Several commenters specifically recommended that we not require any additional disclosures.[213] One commenter pointed out that there was no "catch-all" clause requiring any other material information not specifically enumerated in Rule 201 of Regulation Crowdfunding.[214]

Other commenters recommended that we require issuers to disclose general information;[215] executive compensation;[216] zoning issues and issues with the Environmental Protection Agency or Food and Drug Administration;[217] a copy of their articles of incorporation;[218] the extent to which they are affected by market risk, material contracts, business backlogs and the names of, and

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210 *See* AICPA Letter; Grassi Letter.

211 *See* AICPA Letter.

212 *See, e.g.*, Grassi Letter (recommending disclosure of all related-party transactions not deemed *de minimis*); NASAA Letter (recommending a lower percentage threshold); RocketHub Letter (recommending a fixed threshold).

213 *See, e.g.*, ABA Letter; Public Startup Letter 2; RocketHub Letter; Schwartz Letter.

214 *See* CrowdCheck Letter 1.

215 *See, e.g.*, ODS Letter; STA Letter; Tiny Cat Letter. Such general information may include the issuer's contact information; agent for service; information about the manner in which ownership interests will be evidenced; who will be providing record keeping services; where records of ownership will be maintained; and/or statements that the issuer may not provide account statements and that investors will have the responsibility of monitoring their investments, communicating with the record keeper and updating their information with the record keeper.

216 *See, e.g.*, Arctic Island Letter 4; Denlinger Letter 1 (recommending disclosure of deferred compensation, stock options or warrants, contingent payments for services, shareholder and other related-party loans and contingent liabilities); Grassi Letter (recommending separate amounts for base salary, bonus and an "other" category for the three highest paid individuals and the number and type of equity instruments granted); NASAA Letter; RFPIA Letter (recommending inclusion of owners' compensation).

217 *See, e.g.*, Arctic Island Letter 4.

218 *See, e.g.*, Hackers/Founders Letter.

number of shares being sold by, existing shareholders;[219] and the credit history of the business and the business owners.[220]

As discussed in Section II.B.2 below in connection with ongoing annual reports, a number of commenters recommended ways to make it easier for investors to locate an issuer's annual reports.[221]

(iii) Final Rules

We are adopting the additional disclosure requirements as proposed in Rule 201 with several modifications. As discussed below, we have added a requirement to disclose any material information necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.[222] We also have modified the rule to require disclosure of the compensation to be paid to the intermediary so that it could be disclosed either as a dollar amount or percentage of the offering amount or as a good faith estimate if the exact amount is not available at the time of the filing.[223] We also have added a requirement to disclose the location on the issuer's website where investors will be able to find the issuer's annual report and the date by which such report will be available on the issuer's website.[224] In addition, we have added a requirement to disclose whether the issuer or any of its predecessors previously has failed to comply with the ongoing reporting requirements of Regulation Crowdfunding.[225]

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219 *See, e.g.*, CFA Institute Letter.

220 *See, e.g.*, SBM Letter.

221 *See, e.g.*, Arctic Island Letter 5; CFA Institute Letter (recommending advance notice as to when and where annual reports will be available); RocketHub Letter.

222 *See* Rule 201(y) of Regulation Crowdfunding.

223 See Rule 201(o) of Regulation Crowdfunding.

224 *See* Rule 201(w) of Regulation Crowdfunding.

225 *See* Rule 201(x) of Regulation Crowdfunding.

We agree with the suggestion by some commenters that issuers should not be required to disclose in multiple places the information required to be provided to investors.[226] As a result, to avoid duplicative disclosure, an issuer will not be required to repeat what is already provided elsewhere in the issuer's disclosure, including the financial statements.[227] Issuers may cross-reference within the offering statement or report, including to the location of the information in the financial statements.[228]

Identity of the Intermediary. Despite the suggestion of one commenter that this disclosure is unnecessary,[229] we believe requiring an issuer to identify the name, SEC file number and CRD number (as applicable) of the intermediary through which the offering is being conducted should assist investors and regulators in obtaining information about the offering and use of the exemption.[230] It also could help investors obtain background information on the intermediary, for instance, through filings made by the intermediary with the Commission, as well as through the Financial Industry Regulatory Authority's ("FINRA") BrokerCheck system for broker-dealers[231] or a similar system, if created, for funding portals.

Compensation Paid to the Intermediary. Requiring an issuer to disclose the amount of compensation paid to the intermediary for conducting the offering, including the amount of any referral or other fees associated with the offering, will permit investors and regulators to determine how much of the proceeds of the offering is used to compensate the intermediary.

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226 *See, e.g.*, EY Letter (noting that certain required disclosure would be included in an issuer's financial statements); Grassi Letter (same).

227 *See* Instruction to Item 201 of Regulation Crowdfunding.

228 *Id.*

229 *See* RocketHub Letter.

230 *See* Rule 201(n) of Regulation Crowdfunding.

231 *See* FINRA, FINRA BrokerCheck, *available at* http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/P015175.

Based on a comment received,[232] we understand that in some instances the exact amount of compensation and fees to be paid to the intermediary will not be known at the time the Form C is filed, and we have modified the rule from the proposal to address this issue. Consistent with this understanding, and to avoid suggesting that only amounts certain and paid to date must be disclosed, the final rules require disclosure of all compensation paid or to be paid to the intermediary for conducting the offering, which may be disclosed as a dollar amount or as a percentage of the offering amount. If the exact amount of the compensation paid or to be paid is not available at the time of the filing, issuers are permitted to provide a good faith estimate.[233]

In addition, we are modifying the rule text from the proposal to require issuers to disclose any other direct or indirect interest in the issuer held by the intermediary, or any arrangement for the intermediary to acquire such an interest.[234] The proposed rules would have prohibited an intermediary from holding any financial interest in the issuers conducting offerings on its platforms. However, as discussed in Section II.C.2.b below, the final rules permit intermediaries to hold such interests. We believe that, similar to the amount of compensation paid to the intermediary, an intermediary's interests in an issuer and the issuer's transaction could be material to an investment decision in the issuer. Therefore, we believe that issuers should disclose such interests to investors.

Legends. We are adopting this requirement as proposed.[235] The requirement for an issuer to include in the offering statement specified legends about the risks of investing in a crowdfunding transaction is intended to help investors understand the general risks of investing in

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232 *See* RocketHub Letter.

233 *See* Rule 201(o)(1) of Regulation Crowdfunding.

234 *See* Rule 201(o)(2) of Regulation Crowdfunding.

235 *See* Item 2 of General Instruction III to Form C.

a crowdfunding transaction. We continue to believe, despite the suggestions of some commenters,[236] that requiring legends in each issuer's offering statement, regardless of any general warnings available on an intermediary's platform, will provide additional investor protection with minimal costs. For example, the requirement that an issuer include in the offering statement certain legends about the required ongoing reports, including how those reports will be made available to investors and how an issuer may terminate its ongoing reporting obligations, will help investors understand an issuer's ongoing reporting obligations and how they will be able to access those reports.

Current Number of Employees. Consistent with the proposal and the recommendation of several commenters,[237] the final rules require disclosure of the current number of employees.[238] We believe this disclosure is important to investors in evaluating a crowdfunding transaction because it will give investors a sense of the size of the issuers using the exemption. We expect that the early-stage issuers who are likely to use securities-based crowdfunding will not have many employees, so we do not believe this requirement will be unreasonably burdensome.

Risk Factors. We are adopting this disclosure requirement as proposed.[239] While some commenters expressed concerns about potential expenses or confusion associated with risk disclosure,[240] we agree with those commenters who indicated that disclosure of the material factors that make an investment in the issuer speculative or risky is important to help investors

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236 *See, e.g.*, Grassi Letter; Hackers/Founders Letter; Public Startup Letter 2; Startup Valley Letter.

237 *See, e.g.*, NASAA Letter; Wilson Letter; Zhang Letter.

238 *See* Rule 201(e) of Regulation Crowdfunding.

239 *See* Rule 201(f) of Regulation Crowdfunding.

240 *See, e.g.*, Campbell R. Letter; Cole A. Letter; Grassi Letter; Hackers/Founders Letter; RocketHub Letter; Schwartz Letter; Scruggs Letter.

understand the risks of investing in a specific issuer's offering.[241] To help investors to better understand these risks, we believe that risk factor disclosure should be tailored to the issuer's business and the offering and should not repeat the factors addressed in the required legends.[242] For similar reasons, we are not providing examples of, or developing standard disclosure for, issuer risk factor discussions, as we believe issuers will be in the best positions to articulate the risks associated with their business and offerings in light of their particular facts and circumstances.

Indebtedness. Consistent with the proposal, we are adopting the requirement to provide a description of the material terms of any indebtedness of the issuer.[243] We believe disclosure of the material terms of any indebtedness of the issuer, including, among other items, the amount, interest rate and maturity date of the indebtedness, is important to investors because servicing debt could place additional pressures on an issuer in the early stages of development. We expect that for many issuers this information will be included in the financial statements, which will satisfy this reporting requirement.[244]

While one commenter recommended that we require issuers to disclose the identities of their creditors,[245] we do not believe, as a general matter, that such disclosure would provide

241 *See, e.g.*, ASSOB Letter; CFA Institute Letter; Commonwealth of Massachusetts Letter; Consumer Federation Letter; EMKF Letter; Jacobson Letter; McGladrey Letter; STA Letter; StartupValley Letter; Wilson Letter.

242 *See* Item 2 of General Instruction III to Form C.

243 *See* Rule 201(p) of Regulation Crowdfunding.

244 *See* Instruction to Rule 201 of Regulation Crowdfunding; Items 1 and 3 of General Instruction III to Form C.

245 *See* ODS Letter.

meaningful information to investors. Accordingly, under the final rules, such disclosure is required only to the extent the creditor's identity is a material aspect of the indebtedness.[246]

Prior Exempt Offerings. Consistent with the proposal and with commenters' recommendations, we are requiring issuers to provide disclosure about the exempt offerings that they conducted within the past three years.[247] For each exempt offering within the past three years, issuers must describe the date of the offering, the offering exemption relied upon, the type of securities offered and the amount of securities sold and the use of proceeds.[248] We believe that information about prior offerings will better inform investors about the capital structure of the issuer and will provide information about how prior offerings were valued.

Related-Party Transactions. We are adopting this disclosure requirement substantially as proposed.[249] Related-party transactions create potential conflicts of interest that may result in actions that benefit the related parties at the expense of the issuer or the investors. After considering the comments received, we continue to believe the related-party transactions disclosure will assist investors in obtaining a more complete picture of the financial relationships between certain related parties and the issuer and provide additional insight as to potential uses of the issuer's resources, including the proceeds of the offering. The final rule differs from the proposal in that an issuer is required to disclose transactions with any person who is, as of the most recent practicable date but no earlier than 120 days prior to the date the offering statement or report is filed, the beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities. Limiting the relevant period to 120 days prior to the date of the offering statement or

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[246] *See* Rule 201(y) of Regulation Crowdfunding.

[247] *See* Rule 201(q) of Regulation Crowdfunding.

[248] *See* Instruction to paragraph (q) of Rule 201 of Regulation Crowdfunding.

[249] *See* Rule 201(r) of Regulation Crowdfunding.

report is consistent with the treatment of beneficial ownership elsewhere in Regulation Crowdfunding.[250] We also believe this limitation and the consistency it provides will help limit compliance costs for issuers.

The final rule also includes an instruction to clarify that, for purposes of Rule 201(r), a transaction includes, but is not limited to, any financial transaction, arrangement or relationship (including any indebtedness or guarantee of indebtedness) or any series of similar transactions, arrangements or relationships.[251] This instruction is consistent with Item 404 of Regulation S-K.[252]

Given the early stage of development of the small businesses and startups that we expect will seek to raise capital pursuant to Section 4(a)(6), as well as the investment limits prescribed by the rules, we believe that limiting the disclosure of related-party transactions to transactions occurring since the beginning of the issuer's last fiscal year, as proposed, will help to limit compliance costs for issuers while still providing investors with sufficient information to evaluate the relationship between related parties and the issuer.[253] In addition, we are requiring issuers to disclose only related-party transactions that, in the aggregate, are in excess of five percent of the aggregate amount of capital raised by the issuer in reliance on Section 4(a)(6) during the preceding 12-month period, inclusive of the amount the issuer seeks to raise in the current offering under Section 4(a)(6). We also have added an instruction to clarify that any series of similar transactions, arrangements or relationships should be aggregated for purposes of determining

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250 *See, e.g.*, Rules 201(c) and 201(m) of Regulation Crowdfunding.

251 *See* Instruction 2 to Rule 201(r) of Regulation Crowdfunding.

252 *See* Instruction 2 to Item 404(a) of Regulation S-K [17 CFR 229.404(a)].

253 We note, however, that financial statements covering the two most recently completed fiscal years will include disclosure of related-party transactions, as required by U.S. GAAP, for each of the years presented.

whether related-party transactions should be disclosed.[254] For example, an issuer seeking to raise $1 million will be required to disclose related-party transactions that, in the aggregate, are in excess of $50,000, which is the same dollar threshold required in Form 1-A[255] for offerings of any size made pursuant to Tier 1 of Regulation A,[256] and an issuer that raises $250,000 will be required to disclose such transactions in excess of $12,500. We believe that, in light of the sizes and varieties of issuers that may make offerings in reliance on Section 4(a)(6), this approach could mitigate the potential for the requirement to be disproportionate to the size of certain offerings and issuers. While one commenter suggested we use a percentage threshold less than five percent, we believe this threshold appropriately takes into consideration the need to provide investors with relevant information about the issuer's activities involving related parties during this crucial early stage of development.

As suggested by one commenter,[257] in a change from the proposal, we are adopting a definition for "member of the family" in the related-party transactions context that is consistent with the definition of "member of the family of the purchaser or the equivalent" in the resale restrictions context.[258] The final rule defines "member of the family" as a "child, stepchild, grandchild, parent, stepparent, grandparent, spouse or spousal equivalent, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, [including] adoptive relationships" of any of the persons identified in Rules 201(r)(1), (r)(2) or (r)(3).[259] This

[254] *See* Instruction 1 to Rule 201(r) of Regulation Crowdfunding.

[255] 17 CFR 239.900

[256] 17 CFR 230.251 through 230.263

[257] *See* Brown J. Letter.

[258] *See* Rule 501(a) of Regulation Crowdfunding;

[259] *See* Rule 201(r)(4) of Regulation Crowdfunding.

definition tracks the definition of "immediate family" in Exchange Act Rule 16a-1(e),[260] but with the addition of "spousal equivalent," which the final rule defines to mean "a cohabitant occupying a relationship generally equivalent to that of a spouse."[261] We believe a common definition of "member of the family" that is consistent with our disclosure rules in other contexts[262] will provide certainty for issuers in identifying the persons covered by the rule.

Other Disclosures. We are adopting this provision as proposed but with the addition of three issuer disclosure requirements in response to comments received.

The first is a requirement that an issuer disclose the location on its website where investors will be able to find the issuer's annual report and the date by which such report will be available on its website.[263] We believe this requirement addresses the concern expressed by commenters that investors may not know where to find an issuer's annual report. We do not believe physical delivery of the annual report is necessary due to the electronic nature of the crowdfunding marketplace, nor do we believe that e-mail delivery of the annual report is practical because the issuer may not have access to e-mail addresses of its investors. Instead, we are requiring issuers to disclose this information in the offering statement, which will assist investors in locating the information while limiting the compliance costs for issuers.

The second additional disclosure requirement, as suggested by a commenter,[264] is a requirement that the disclosure include any material information necessary in order to make the

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260 17 CFR 240.16a-1(e).

261 *See* Rule 201(r)(4) of Regulation Crowdfunding.

262 *See, e.g.*, Exchange Act Rule 16a-1(e).

263 *See* Rule 201(w) of Regulation Crowdfunding. *See also,* Section II.B.2 for a discussion of the requirement on issuers to post their annual reports on their websites.

264 *See* CrowdCheck Letter 1.

statements made, in light of the circumstances under which they were made, not misleading.[265] This provision should help ensure that investors have all of the material information they need on which to base their investment decisions.

The third additional requirement, similar to suggestions from some commenters,[266] requires the issuer to disclose whether it or any of its predecessors previously failed to comply with the ongoing reporting requirements of Regulation Crowdfunding.[267] While we continue to believe, and the final rules provide, that only those issuers that have failed to file their two most recent annual reports should be prohibited from relying on the exemption available under Section 4A(6), we also believe that any history of non-compliance with ongoing reporting obligations would provide important information to investors about the issuer.

Although we appreciate that commenters made various suggestions for additional issuer disclosure requirements, such as those relating to executive compensation, market risk and material contracts, we are not mandating further disclosures. In adopting issuer requirements for Regulation Crowdfunding, we have been mindful of the limited resources and start-up operations of issuers likely to use security-based crowdfunding and have sought to consider the need to provide investors with relevant information to make an informed investment decision while limiting the compliance costs for issuers. We believe the issuer disclosure requirements we are adopting along with other protections, such as investment limits, achieve this goal.

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[265] *See* Rule 201(y) of Regulation Crowdfunding.

[266] *See* Grassi Letter; RocketHub Letter.

[267] *See* Rule 201(x) of Regulation Crowdfunding.

(2) Financial Disclosure

Section 4A(b)(1)(D) requires "a description of the financial condition of the issuer." It also establishes a framework of tiered financial disclosure requirements based on aggregate target offering amounts of the offering and all other offerings made in reliance on Section 4(a)(6) within the preceding 12-month period.

(a) Financial Condition Discussion

(i) Proposed Rules

Consistent with Section 4A(b)(1)(D), we proposed in Rule 201(s) of Regulation Crowdfunding to require an issuer to provide a narrative discussion of its financial condition.

(ii) Comments on the Proposed Rules

Commenters generally supported the proposed requirement that issuers provide a narrative discussion of their financial condition.[268] One commenter expressed concern that the requirement could be challenging for issuers at an early stage of development and result in duplicative disclosure.[269] The same commenter suggested that issuers be encouraged, rather than mandated, to discuss material historical operating results.[270]

(iii) Final Rules

We are adopting this requirement as proposed, with a few technical modifications.[271] Rule 201(s) clarifies that the description must include, to the extent material, a discussion of liquidity, capital resources and historical results of operations. Rule 201(s) also includes an

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[268] *See, e.g.*, ABA Letter; CFA Institute Letter; CFIRA Letter 5; Commonwealth of Massachusetts Letter; Grassi Letter; Jacobson Letter; Joinvestor Letter; Saunders Letter. *But see, e.g.*, EY Letter; Public Startup Letter 2; RocketHub Letter.

[269] *See* EY Letter.

[270] *Id.*

[271] *See* Rule 201(s) of Regulation Crowdfunding.

instruction noting that issuers will be required to include a discussion of each period for which financial statements are provided and a discussion of any material changes or trends known to management in the financial condition and results of operations of the issuer subsequent to the period for which financial statements are provided.[272] In connection with this instruction, an issuer will need to consider whether more recent financial information is necessary to make the disclosure in the offering document not misleading. The instruction in final Rule 201(s) was included in proposed Rule 201(t) as an instruction to the financial statement requirements, but we have moved this instruction to Rule 201(s) because it elicits narrative disclosure that we believe is more appropriately presented as part of the discussion of the issuer's financial condition. In addition, another instruction clarifies that references to the issuer in Rule 201(s) refer to the issuer and its predecessors, if any.[273]

We expect that the discussion required by the final rule and instructions will inform investors about the financial condition and results of operations of the issuer by providing management's perspective on the issuer's operations and financial results, including information about the issuer's liquidity and capital resources and any known trends or uncertainties that could materially affect the company's results. Because issuers seeking to engage in crowdfunding transactions will likely be smaller, less complex and at an earlier stage of development than issuers conducting registered offerings or Exchange Act reporting companies, we expect that the discussion generally will not, contrary to the concern of at least one commenter,[274] need to be as lengthy or detailed as the management's discussion and analysis of financial condition and results

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[272] *See* Instruction 1 to Rule 201(s) of Regulation Crowdfunding.

[273] *See* Instruction 4 to Rule 201(s) of Regulation Crowdfunding.

[274] *See* EY Letter.

of operations of those issuers. Accordingly, we are not prescribing a specific content or format for this information, but instead set forth general principles for making this disclosure.[275] The discussion should address, to the extent material, the issuer's historical results of operations in addition to its liquidity and capital resources. If an issuer does not have a prior operating history, the discussion should focus on financial milestones and operational, liquidity and other challenges. If an issuer has a prior operating history, the discussion should focus on whether historical earnings and cash flows are representative of what investors should expect in the future. An issuer's discussion of its financial condition should take into account the proceeds of the offering and any other known or pending sources of capital. Issuers also should discuss how the proceeds from the offering will affect their liquidity, whether these funds and any other additional funds are necessary to the viability of the business and how quickly the issuer anticipates using its available cash. In addition, issuers should describe the other available sources of capital to the business, such as lines of credit or required contributions by principal shareholders. To the extent these items of disclosure overlap with the issuer's discussion of its business or business plan, issuers are not required to make duplicate disclosures.[276] While we are not mandating a specific presentation, we expect issuers to present the required disclosures, including any other information that is material to an investor, in a clear and understandable manner.

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[275] *See* Instructions 1 and 2 to Rule 201(s) of Regulation Crowdfunding.

[276] *See* Instruction to Rule 201 of Regulation Crowdfunding.

(b) Financial Disclosures

(i) Proposed Rules

Proposed Rule 201(t) of Regulation Crowdfunding would have established financial statement disclosure requirements that are based on aggregate target offering amounts within the preceding 12-month period:

- issuers offering $100,000 or less would be required to file with the Commission and provide to investors and the relevant intermediary income tax returns filed by the issuer for the most recently completed year (if any) and financial statements that are certified by the principal executive officer to be true and complete in all material respects;
- issuers offering more than $100,000, but not more than $500,000, would be required to file with the Commission and provide to investors and the relevant intermediary financial statements reviewed by a public accountant that is independent of the issuer; and
- issuers offering more than $500,000 would be required to file with the Commission and provide to investors and the relevant intermediary financial statements audited by a public accountant that is independent of the issuer.

Under proposed Rule 201(t), issuers would be permitted to voluntarily provide financial statements that meet the requirements for a higher aggregate target offering amount.

The proposed rules also would have set forth the following requirements for the financial statements:

- <u>Basis of Accounting</u>. All issuers would be required to file with the Commission and provide to investors and the relevant intermediary a complete set of their financial statements (balance sheets, income statements, statements of cash flows and statements of

changes in owners' equity), prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP").

- Public Accountant Requirements. To qualify as independent of the issuer, a public accountant would be required to comply with the Commission's independence rules, which are set forth in Rule 2-01 of Regulation S-X.[277]
- Periods Covered in the Financial Statements. The financial statements would be required to cover the shorter of the two most recently completed fiscal years or the period since inception of the business.
- Age of Financial Statements. During the first 120 days of the issuer's fiscal year, an issuer would be able to conduct an offering in reliance on Section 4(a)(6) and the related rules using financial statements for the fiscal year prior to the most recently completed fiscal year if the financial statements for the most recently completed fiscal year are not otherwise available or required to be filed.
- Review and Audit Standards. Reviewed financial statements would be required to be reviewed in accordance with the Statements on Standards for Accounting and Review Services ("SSARS") issued by the American Institute of Certified Public Accountants ("AICPA"). Audited financial statements would be required to be audited in accordance with the auditing standards issued by either the AICPA or the Public Company Accounting Oversight Board ("PCAOB").
- Review and Audit Reports. Issuers would be required to file with the Commission and provide to investors and the relevant intermediary a copy of the public accountant's review

[277] 17 CFR 210.2-01.

or audit report. An issuer that received an adverse opinion or disclaimer of opinion in its audit report would not be in compliance with the audited financial statement requirements.

- Exemptions from the Financial Statement Requirements. The proposed rules would not exempt any issuers from the financial statement requirements.

(ii) Comments on the Proposed Rules

Commenters were divided on the proposed financial statement requirements,[278] although commenters generally supported allowing issuers to voluntarily provide financial statements that meet the requirements for a higher aggregate target offering amount.[279]

Offerings of $100,000 or less. In general, commenters supported requiring issuers to provide financial statements certified by the principal executive officer to be true and complete in all material respects.[280] Further, several recommended that all issuers relying on the Section 4(a)(6) exemption be required to provide such certification.[281]

Commenters were divided on the requirement that issuers offering $100,000 or less file and provide to investors their federal income tax returns. Supporters of the tax return requirement noted that income tax returns would be a source of credible information for investors that should be readily available without requiring issuers to bear significant additional preparation

278 For an example of those who generally supported the proposed financial disclosure requirements, *see, e.g.*, ABA Letter (recommending some modifications); CFA Institute Letter; Commonwealth of Massachusetts Letter; Consumer Federation Letter (the financial information is critical to an informed evaluation of the investment opportunity); Denlinger Letter 1; Funderbuddies Letter; NASAA Letter.

For an example of those who generally opposed, *see, e.g.*, AEO Letter; Joinvestor Letter (recommending that only issuer-generated documents produced in good faith be required); Marsala Letter; RocketHub (stating that "requirements are excessive in cost and misguided in intent"); Traklight Letter (recommending that instead of pre-raise and ongoing financial statement reviews or audits, issuers only be required to have a limited review engagement on the use of proceeds after the raise); Zhang Letter.

279 *See, e.g.*, AICPA Letter; Denlinger Letter 1; Grassi Letter; Heritage Letter; RocketHub Letter; Wilson Letter. *But see* Public Startup Letter 2.

280 *See, e.g.*, AICPA Letter; Zeman Letter.

281 *See, e.g.*, AICPA Letter; Denlinger Letter 1; Grassi Letter; Jacobson Letter. *But see* Public Startup Letter 2.

expenses.[282] On the other hand, opponents of the tax return requirement raised concerns about privacy,[283] identity theft and tax fraud.[284] One commenter expressed concern that small issuers may not be adequately prepared to consider the patchwork of state and federal privacy laws that might apply to the disclosure of tax returns.[285]

Several commenters suggested approaches to allow access by investors to the information available from a tax return,[286] including permitting issuers to digitally submit the data from their tax return in a standardized format.[287] Supporters of digital submission suggested that approach would provide a standardized format and protect issuers from accidental disclosure of confidential information. Commenters generally supported the proposal to require issuers to redact personally identifiable information from their tax returns,[288] although some requested clarifications.[289]

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282 *See, e.g.*, Angel Letter 1 ("tax returns are even more credible than audited financial statements, as companies are highly unlikely to exaggerate profitability to the IRS."); Fund Democracy Letter; NPCM Letter; Zeman Letter ("the small risk for these investors does not meet the consideration of audited financial statements.").

283 *See, e.g.*, AICPA Letter (disclosing an issuer's tax return "...has the potential to cause serious problems. Tax returns are intended to be confidential and should remain so."); Public Startup Letter 2; RocketHub Letter; SBM Letter; Wilson Letter (personal income tax information should be on a voluntary basis only); Zhang Letter.

284 *See* AICPA Letter.

285 *See* AICPA Letter.

286 *See, e.g.*, Arctic Island Letter 5 (recommending that only the two primary pages and not the schedules be made public); CrowdBouncer Letter (recommending the Commission allow issuers to disclose electronic transcripts of filed tax returns to investors through the intermediary platforms); NPCM (expressing concern that unless tax returns are filed as a PDF stamped by the IRS, there is no way to know if the posted document is a true reflection of the tax return); RocketHub Letter.

287 *See, e.g.*, RocketHub Letter (suggesting digital submission "will protect the issuers from accidental disclosure of confidential information, and will allow investors to view the information in a structured and consistent manner. For example, if each issuer were to upload their version of a financial statement, the responsibility of learning to understand each format would fall to the investor. Standardized formats for financial projections, financial statements, and business plans will allow investors to quickly compare issuances and more readily evaluate investment opportunities."); Zhang Letter.

288 *See, e.g.*, ABA Letter; AICPA Letter; Fund Democracy Letter; Whitaker Chalk Letter.

289 *See, e.g.*, ABA Letter (recommending the Commission provide a non-exhaustive list of the specific types of information that may be redacted); AICPA Letter (recommending that if the tax return requirement is adopted, the Commission define "personally identifiable information" and clarify that the redaction includes third-party information).

Two commenters recommended that the timing of financial statement disclosures correspond to any extended tax filing deadlines,[290] while two other commenters opposed such application.[291] Further, a few commenters supported the proposal to permit an issuer that has not yet filed its tax return for the most recently completed fiscal year to use the tax return filed for the prior year and update the information after filing the tax return for the most recently completed fiscal year.[292] One commenter recommended that at least one tax return be available,[293] and another recommended that the Commission provide guidance for issuers who have not filed a U.S. tax return.[294] One commenter supported requiring issuers to describe any material changes that are expected in the tax returns for the most recently completed fiscal year,[295] while another recommended that such disclosure be permitted, but not required.[296]

A number of commenters recommended raising the maximum offering amount for issuers that provide this level of financial information.[297]

Offerings of more than $100,000 but not more than $500,000. Some commenters supported the requirement in the proposed rules that offerings of more than $100,000 but not more

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290 *See* EY Letter; Grassi Letter.

291 *See, e.g.*, ASSOB Letter (recommending that issuers should provide their tax accounts within three months of the end of the reporting period); Fund Democracy Letter.

292 *See, e.g.*, Grassi Letter; RocketHub Letter.

293 *See* Fund Democracy Letter.

294 *See* AICPA Letter.

295 *See* Grassi Letter.

296 *See* RocketHub Letter (also recommending that the Commission define what qualifies as a material change).

297 *See, e.g.*, Hackers/Founders Letter ($500,000); Kickstarter Coaching Letter ($250,000); RocketHub Letter ($500,000); Zeman Letter (recommending that offerings under $500,000 require two years of tax returns and unaudited balance sheets).

than $500,000 include financial statements reviewed by an independent public accountant,[298] while other commenters opposed such requirement.[299] A number of commenters recommended a different range of offering amounts or methods for determining when an issuer is required to file and provide reviewed financial statements.[300]

Offerings of more than $500,000. We received extensive comments on our proposal that issuers offering more than $500,000 be required to file with the Commission and provide to investors and the relevant intermediary financial statements audited by an independent public accountant. A significant number of those commenters opposed the proposed requirement,[301] although some commenters expressed support.[302] Some commenters recommended the elimination of the audit requirement,[303] and others recommended that we consider additional criteria for determining when an issuer would be required to provide audited financial

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298 *See, e.g.*, Denlinger Letter 1; Leverage PR Letter (stating that the industry will evolve to provide lower cost reviews); StartEngine Letter 1 (stating that the industry will evolve to provide lower cost reviews, such as in the $1,500-$10,000 range for smaller, newer companies).

299 *See, e.g.*, Angel Letter 1 (recommending requiring audited financial statements if they are available and tax returns if they are not); Arctic Island Letter 5 (recommending only for issuers that have greater than $15 million in annual revenue); Johnston Letter; McGladrey Letter (recommending only after the issuer meets certain revenue and operational thresholds); NACVA Letter; Public Startup Letter 2; Zeman Letter.

300 *See, e.g.*, ABA Letter; CIFRA Letter 5 (noting the financial disclosure standards of the SBA's Section 8(a) program require reviewed financial statements for companies with gross annual receipts for $2 million to $10 million); Grassi Letter ($300,000 to $700,000); Kickstarter Coaching Letter ($250,000 to $1 million).

301 *See, e.g.*, AEO Letter; Angel Letter 1; AWBC Letter; CFIRA Letter 5; CfPA Letter; CrowdFundConnect Letter; EarlyShares Letter; EMKF Letter; EY Letter; Finkelstein Letter; FundHub Letter 1; Generation Enterprise Letter; Fryer Letter; Grassi Letter; Graves Letter; Guzik Letter 1; Hakanson Letter; Holland Letter; Johnston Letter; Kickstarter Coaching Letter; McGladrey Letter; Milken Institute Letter; NACVA Letter; NFIB Letter; NPCM Letter; NSBA Letter; PBA Letter; Reed Letter; RocketHub Letter; Saunders Letter; SBA Office of Advocacy Letter; SBEC Letter; SBM Letter; Seyfarth Letter; WealthForge Letter; Wefunder Letter; Woods Letter; Zeman Letter.

302 *See, e.g.*, AICPA Letter; Consumer Federation Letter; CSTTC Letter; Denlinger Letter 2; FundDemocracy Letter; Leverage PR; NASAA Letter; StartEngine Letter 1.

303 *See, e.g.*, CrowdFundConnect Letter; FundHub Letter 1; Johnston Letter; SBEC Letter; StartupValley Letter (for issuers less than two years old); Woods Letter.

statements.[304] A number of commenters opposed the proposed $500,000 threshold as being too low,[305] and a number recommended alternative thresholds.[306] A number of commenters stated that funding the upfront cost of an audit would be particularly difficult for issuers raising capital for the first time.[307]

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304 *See, e.g.*, Angel Letter 1 (only if such financial statements are available); Arctic Island Letter 5 (only apply to issuers that have greater than $15 million in revenue); EY Letter (only if issuer has raised $5 million in equity securities in crowdfunding transactions unless audited financial statements are otherwise available); McGladrey Letter (eliminate the audit requirements until the issuer meets certain revenue and operational thresholds); Reed Letter (if an audit is required, the requirement only apply to issuers that reach a certain size in investment or investors); RocketHub Letter ($5 million offering amount and the issuer has been in operation for more than two years). *But see* AICPA Letter (additional criteria would add complexity without any additional benefit).

305 *See, e.g.*, ABA Letter; CCA Letter; CFIRA Letter 5; CfPA Letter; CrowdFundConnect Letter; EarlyShares Letter; EMKF Letter; EY Letter; FundHub Letter 1; Generation Enterprise Letter; Grassi Letter; Graves Letter; Guzik Letter 1; Kickstarter Coaching Letter; Milken Institute Letter; NFIB Letter; PBA Letter; RocketHub Letter; SBA Office of Advocacy Letter; SBM Letter; Seyfarth Letter; WealthForge Letter; Wefunder Letter; Woods Letter. *But see* AICPA Letter; Denlinger Letter 1; Fund Democracy Letter; Zeman Letter.

306 *See, e.g.*, ABA Letter ($750,000); EarlyShares Letter ($1 million); EMKF Letter ($800,000); EY Letter ($5 million, unless audited financial statements are otherwise available); Grassi Letter ($700,000); Graves Letter ($900,000); Guzik Letter 1 ($700,000); Kickstarter Coaching Letter ($1 million); PBA Letter ($1 million); RocketHub Letter ($5 million and the issuer has been in operation for more than two years); Seyfarth Letter ($1 million); WealthForge Letter ($1 million).

307 *See, e.g.*, AEO Letter (expressing concern that start-up businesses with no revenue to date, and raising capital for the first time, would find it difficult or impossible to fund the cost of an audit); AWBC Letter; CFIRA Letter 5 (stating that the proposed level of financial disclosure for capital raises over $500,000 would be an impediment for small business when many will have limited financial resources to absorb the expense prior to raising capital using crowdfunding); CfPA Letter (suggesting the Commission determine an alternate audit threshold because "the costs of an audit must necessarily be incurred prior to an offering, and in the numerous expected cases of unsuccessful offerings, would lead to substantial net losses to the businesses that Crowdfunding is supposed to help"); EMKF Letter (stating that many of the issuers looking to raise capital through crowdfunding will be startups with little or no revenue to afford audited financial statements); Generation Enterprise Letter; Grassi Letter; Graves Letter; Holland Letter; McGladrey Letter; NSBA Letter; Reed Letter (noting that few start-ups could afford auditing fees); RocketHub Letter (stating that the filing and audit requirements establish an upfront cost that is too high for small businesses to accept); SBM Letter (noting that many startups do not have the resources to obtain audited financials); Seyfarth Letter (stating that the audit requirement will deny access to issuers who do not have the necessary upfront capital); WealthForge Letter; Wefunder Letter.

We received a number of comments expressing concern about the anticipated costs associated with audited financial statements.[308] Other commenters noted that costs would be lower than those estimated in the Proposing Release or in other comment letters.[309]

Basis of Accounting. Commenters generally were divided on whether issuers relying on Section 4(a)(6) should be required to prepare financial statements in accordance with U.S. GAAP.[310] Commenters in support of requiring U.S. GAAP noted the benefit to investors of

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308 *See, e.g.*, AEO Letter; CfPA Letter; CFIRA Letter 5; CrowdCheck Letter 4; ErrandRunner Letter; Finkelstein Letter; FundHub Letter 1 (stating that the difference in cost for reviewed versus audited financial statements could easily run into tens of thousands of dollars); Graves Letter (stating that a partner from a leading accounting firm predicted the cost to small businesses of providing audited financial statements could be upwards of $18,000 to $25,000); Grassi Letter (stating that audits take more time than companies seeking capital may have); NFIB Letter; RocketHub Letter; SBA Office of Advocacy Letter; SBEC Letter; SBM Letter; Seyfarth Letter; StartupValley Letter (stating that audits for small startups with no financials can cost $10,000 and that GAAP audits typically cost 25-50% more than other comprehensive basis of accounting audits); Stephenson Letter; Traklight Letter (stating that audit costs have been cited as low as $5,000 and as high as $20,000 for a startup; also stating that review costs are estimated at about 60% of the cost of an audit); WealthForge Letter.

309 *See, e.g.*, CCA Letter (analyzing regulatory costs borne by Title II issuers); CrowdFranchise Letter 1; CrowdFunding Network (stating that projected costs are already decreasing through market forces); D'Amore Letter; ddb*mckennon* Letter (noting that the majority of issuers will be newly formed with limited historical operations and that an audit for such companies may range from $4,000-$9,000 in year one); Denlinger Letter 1 (citing a study that found that about half of the cost of an audit is made up for in interest rate savings on bank loans); Denlinger Letter 2 (the market will evolve for small issuers such that audit costs may be in the range of $2,000-$4,000); FundHub Letter 2 (noting the emergence of CPA firms willing to do a complete audit for a startup business for $2,500 or less); Holm Letter (stating that new providers are offering compliance services at much lower costs than anticipated); JumperCard Letter; Kemp Letter; Leverage PR Letter; Sfinarolakis Letter; StartEngine Letter 1 (noting that reviews and audits will be in the range of $1,500-$10,000 for smaller, newer companies); StartEngine Letter 2 (noting the emergence of third-party service providers); tempCFO Letter; Upchurch Letter (stating that the market will adjust for costs).

310 For supporters, *see, e.g.*, AICPA Letter (for offerings over $100,000); CFA Institute Letter; EY Letter (for offerings over $100,000 for only the most recent year); Hackers/Founders Letter; Heritage Letter (recommending for issuers with assets over $100,000, that if financial statements are not prepared in accordance with U.S. GAAP, the issuer be required to note any variance from U.S. GAAP and state the reason for such variance); NASAA Letter; RocketHub Letter; Whitaker Chalk Letter (for offerings over $500,000 until such time as the Commission accepts IFRS for U.S. domestic issuers).

For opponents, *see, e.g.*, ABA Letter (noting that the benefits associated with GAAP-compliant financial statements do not outweigh the burdens that mandatory application of GAAP would impose); CrowdCheck Letter 4; EarlyShares Letter; Graves Letter (recommending that U.S. GAAP only be required for issuers with $5 million in revenue); Milken Institute Letter (recommending that U.S. GAAP only be required for issuers with $5 million in revenue, the threshold at which the IRS requires a switch to accrual accounting); Public Startup Letter 2; SBEC Letter (noting the AICPA's release of new guidelines in June 2013 for small and mid-size businesses); Tiny Cat Letter; U.S. Chamber of Commerce Letter; Wilson Letter (recommending

having a single standard to facilitate comparison of different issuers,[311] and also that U.S. GAAP would be more likely to provide investors with a fair representation of an issuer's financial position and results of operations than financial statements using a comprehensive basis of accounting other than U.S. GAAP.[312]

A number of commenters recommended that, as a less expensive alternative to requiring U.S. GAAP, the Commission allow financial statements prepared in accordance with a comprehensive basis of accounting other than U.S. GAAP.[313] Other commenters recommended that if financial statements prepared in accordance with U.S. GAAP are required, they only be required in certain circumstances.[314]

A few commenters recommended that issuers relying on Section 4(a)(6) be permitted to take advantage of the extended transition period applicable to private companies for complying

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that the Commission consider the stage of the business in determining whether to require compliance with U.S. GAAP); Zhang Letter.

311 *See, e.g.*, NASAA Letter.

312 *See, e.g.*, EY Letter.

313 *See, e.g.*, ABA Letter (for offerings of $100,000 or less, but stating that the Commission could require providing U.S. GAAP financial statements if available); AICPA Letter; CFIRA Letter 5; CFIRA Letter 7; CrowdCheck Letter 4; EarlyShares Letter; EY Letter (for offerings of $100,000 or less, unless U.S. GAAP financial statements are available); Grassi Letter; Graves Letter (for issuers with less than $5 million in revenue); Mahurin Letter (stating that simple Excel spreadsheets accompanied by bank records should meet the financial statement requirements); Milken Institute Letter (for early-stage issuers); NFIB Letter; SBEC Letter; StartupValley Letter; Tiny Cat Letter (for offerings of less than $500,000); Whitaker Chalk Letter (for offerings of less than $500,000 if the issuer has an asset or income level below a certain level).

314 *See, e.g.*, ABA Letter (suggesting that: (i) in offerings of $100,000 or less, the certifying principal executive officer could be required to represent that the issuer is unable to prepare financial statements in accordance with U.S. GAAP without unreasonable effort or expense; (ii) in offerings of more than $100,000, but not more than $500,000, the exception could also require the principal executive officer representation and be limited to issuers that have not prepared U.S. GAAP-compliant financial statements for any other purpose and who have no operating history, no revenues and/or a minimal amount of assets (*e.g.*, $500,000); and (iii) in offerings of more than $500,000, the exception could require the principal executive officer representation, including a representation that the other comprehensive basis of accounting methodology selected is acceptable under AICPA standards, and be limited to issuers with no operating history or revenue and minimal assets).

with new or revised accounting standards.[315] A few commenters expressed concern that Section 4(a)(6) issuers may be viewed as "public business entities" by FASB.[316] One commenter recommended that the Commission provide an exemption from this definition for such issuers.[317]

Periods Covered in the Financial Statements. While two commenters generally supported requiring two years of financial statements,[318] a number of commenters generally opposed the proposal, recommending one year of financial statements instead.[319] Many commenters opposed requiring interim financial statements,[320] while several supported such a requirement.[321] Several commenters recommended that if interim financial statements are required, they not be subject to audit or review,[322] while another commenter recommended that they not be filed with the Commission, but only be provided to investors.[323]

Age of Financial Statements. Several commenters opposed our proposal that financial statements be dated within 120 days of the start of the offering,[324] while one commenter supported

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315 *See, e.g.*, EY Letter; U.S. Chamber of Commerce Letter.

316 *See, e.g.*, ABA Letter; EY Letter (noting also the definition of "public entity" under the Accounting Standards Codification).

317 *See* EY Letter.

318 *See* ASSOB Letter; Zeman Letter.

319 *See, e.g.*, Denlinger Letter 1; EY Letter; Grassi Letter; Joinvestor Letter; Public Startup Letter 2; RFPIA Letter (as it relates to audited financial statements); RocketHub Letter; Verrill Dana Letter.

320 *See, e.g.*, CFIRA Letter 7; EMKF Letter; EY Letter; FundHub Letter 1; Grassi Letter; Public Startup Letter 2; RocketHub Letter; Traklight Letter; Wefunder Letter; Whitaker Chalk Letter.

321 *See, e.g.*, AICPA Letter; Consumer Federation Letter (recommending supplementing the proposed financial statement requirements with unaudited CEO-certified financial statements through the end of the month ending no more than two months before the offering begins); Denlinger Letter 1 (recommending quarterly basic financial reporting, including a balance sheet, income statement and statement of cash flows); Fund Democracy Letter.

322 *See, e.g.*, CFIRA Letter 7; Consumer Federation Letter; Denlinger Letter 1; Fund Democracy Letter; Traklight Letter.

323 *See* RocketHub Letter.

324 *See, e.g.*, Grassi Letter; Public Startup Letter 2; RocketHub Letter.

it.[325] Some commenters opposed our proposal to permit an issuer, during the first 120 days of the issuer's fiscal year, to conduct an offering in reliance on Section 4(a)(6) using financial statements for the fiscal year prior to the most recently completed fiscal year,[326] while two others supported such accommodation.[327] One commenter recommended that, to provide "truly current financials" for large offerings, the Commission could require unaudited financial statements through the end of the month that ends no more than two months before the month in which the offering begins (*e.g.*, an offering any day in March would require financials up to January 31); for smaller offerings, the commenter indicated a modified standard for providing current information might be appropriate.[328]

Public Accountant Requirements. We received several comments on standards for audit firms.[329] Commenters supported not requiring audits to be conducted by a PCAOB-registered firm.[330] Some commenters supported our proposal to require the public accountant reviewing or

325 *See* Denlinger Letter 1.

326 *See, e.g.*, Consumer Federation Letter (stating that the proposal allows for the provision of stale and limited financial information because it "would allow issuers to submit financial statements that are more than a year out of date and that cover only a very limited portion of the issuer's existence."); EY Letter (recommending this time period be extended to 180 days if an issuer presents interim financial statements certified by the principal executive officer that cover the first six months of the issuer's most recently completed fiscal year); Fund Democracy Letter (noting that financial statements could be 16-months stale); Merkley Letter (recommending that the Commission not permit financial statements "to be so thoroughly out of date"); Public Startup Letter 2.

327 *See, e.g.*, Grassi Letter (noting that the material change disclosure requirements should be sufficient to keep investors updated); RocketHub Letter.

328 *See* Fund Democracy Letter.

329 *See, e.g.*, Grassi Letter (recommending no audit be accepted that has been performed by a firm that is not subject to, or that has received a fail report under, the AICPA peer review standards); ASSOB Letter (recommending the rules not place restrictions on the type of accountant an issuer is required to use to review or audit its financial statements); Multistate Tax Letter (an issuer should not be required to obtain accounting services).

330 *See, e.g.*, AICPA Letter; ASSOB Letter (recommending the rules not place restrictions on the type of accountant an issuer is required to use to review or audit its financial statements); Denlinger Letter 1; Funderbuddies Letter; EY Letter; Grassi Letter; Heritage Letter; Multistate Tax Letter (an issuer should not be required to obtain accounting services); Public Startup Letter 2; RocketHub Letter; Traklight Letter. *See*

auditing an issuer's financial statements to comply with the independence requirements set forth in Rule 2-01 of Regulation S-X,[331] while other commenters recommended allowing the public accountant to comply by meeting the independence requirements of the AICPA.[332] Some commenters noted that many startups and early-stage small businesses require assistance in the preparation of financial statements, and that complying with the independence standards of Regulation S-X would require such issuers to engage two external accountants – one to assist in preparing the financial statements and another to audit or review them.[333] One commenter asked the Commission not to create new independence standards.[334]

Review and Audit Standards. With respect to review standards, commenters supported requiring reviewed financial statements to be reviewed in accordance with the SSARS issued by the AICPA.[335] Commenters also opposed creating a new set of review standards.[336]

With respect to audit standards, several commenters supported our proposal to require that financial statements be audited in accordance with the auditing standards issued by either the AICPA or the PCAOB,[337] while several others opposed it.[338] Two commenters recommended that

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also RFPIA Letter (recommending the public accountants conducting an audit be required to be members of the AICPA or the PCAOB for one year.).

331 *See, e.g.*, ABA Letter; Commonwealth of Massachusetts Letter; RocketHub Letter.

332 *See, e.g.*, AICPA Letter; Denlinger Letter 1; EY Letter; Grassi Letter; McGladrey Letter.

333 *See, e.g.*, AICPA Letter; EY Letter; Grassi Letter.

334 *See* AICPA Letter (recommending that the Commission not create new independence, review, or auditing standards or that the definition of "a complete set of financial statements" be different than under U.S. GAAP because doing so would result in confusion, further complexity and increased costs).

335 *See, e.g.*, ABA Letter; AICPA Letter; Denlinger Letter 1; EY Letter; Fund Democracy Letter; Grassi Letter. *But see* Public Startup Letter 2.

336 *See, e.g.*, AICPA Letter; Denlinger Letter 1; Grassi Letter; Traklight Letter.

337 *See, e.g.* AICPA Letter; Denlinger Letter 1; EY Letter; Grassi Letter.

338 *See, e.g.*, Consumer Federation Letter; Fund Democracy Letter; Public Startup Letter 2; RocketHub Letter; Rucker Letter (stating that GAAS fit poorly with the kinds of businesses Title III is intended to accommodate).

audits be required to be conducted in accordance with the auditing standards issued by the PCAOB.[339] Commenters generally opposed creating a new set of audit standards,[340] although one commenter recommended that if the Commission were to create a new set of audit standards, it "should be designed as an ultra-low-cost procedure."[341]

Review and Audit Reports. With respect to review reports, two commenters supported our proposal that a review report that includes modifications would satisfy the reviewed financial statement requirement,[342] while one commenter opposed it.[343] With respect to audit reports, commenters supported our proposal that a qualified audit opinion would satisfy the audited financial statement requirements,[344] although one commenter opposed it.[345] One commenter requested clarification as to the requirements that may be applicable to the issuer and the public accountant when an issuer intends to include a previously issued audit or review report in an offering statement.[346]

Exemptions from Financial Statement Requirements. While the proposed rules did not exempt any issuers from the financial statement requirements, a number of commenters

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339 *See* Consumer Federation Letter; Fund Democracy Letter.

340 *See, e.g.*, AICPA Letter; Grassi Letter (recommending that the Commission require issuers to use the same standards used in the offering or higher standards, with the PCAOB standards deemed to be the higher standard, when complying with the ongoing reporting requirements); Heritage Letter; Traklight Letter.

341 RocketHub Letter.

342 *See* AICPA Letter; Heritage Letter (for going concern opinions).

343 *See* Grassi Letter.

344 *See, e.g.*, AICPA Letter; Arctic Island Letter 5 (noting that most small business audit opinions are likely to include a going concern clause); Denlinger Letter 1 (noting, however, that a going concern opinion is not a qualified opinion); EY Letter; Heritage Letter (noting that a majority of crowdfunding issuers should receive going concern opinions but should not be disqualified); RocketHub Letter; Traklight Letter (recommending that going concern opinions and noncompliance with U.S. GAAP should be allowed); Whitaker Chalk Letter.

345 *See* Grassi Letter.

346 *See* EY Letter.

recommended exempting issuers with no operating history or issuers that have been in existence for fewer than 12 months from the requirement to provide financial statements,[347] although a few commenters opposed such a concept.[348] A number of commenters recommended that if an exemption for such issuers is allowed, the exempted issuers should provide certain basic disclosures,[349] and two commenters specifically recommended that if an exemption for such issuers is allowed, the exempted issuers should still provide a balance sheet.[350]

(iii) Final Rules

We are adopting financial disclosure requirements for Title III issuers in Rule 201(t) with a number of changes from the proposal. As described in more detail below, the final requirements are based on the amount offered and sold in reliance on Section 4(a)(6) within the preceding 12-month period, as follows:

- For issuers offering $100,000 or less: disclosure of the amount of total income, taxable income and total tax as reflected in the issuer's federal income tax returns certified by the principal executive officer to reflect accurately the information in the issuer's federal income tax returns (in lieu of filing a copy of the tax returns), and financial statements certified by the principal executive officer to be true and complete in all material

347 *See, e.g.*, Arctic Island Letter 5 (supporting only an exemption from the audit requirement); CFIRA Letter 5; CFIRA Letter 7; CrowdFundConnect Letter; Crowdpassage Letter 2; EY Letter; Grassi Letter; Hackers/Founders Letter; Joinvestor Letter; McGladrey Letter; PBA Letter; PeoplePowerFund Letter; RocketHub Letter (recommending that the audit requirements should only apply to issuers that have been in operation for more than two years and are raising more than $5 million); StartupValley Letter (supporting an exemption from the audit requirements); Wefunder Letter; Whitaker Chalk Letter.

348 *See, e.g.*, AICPA Letter; Denlinger Letter 1; Wilson Letter.

349 *See, e.g.*, ASSOB Letter; CFIRA Letter 5; Denlinger Letter 1; Grassi Letter; McGladrey Letter; PBA Letter; PeoplePowerFund Letter; RocketHub Letter; Wefunder Letter; Whitaker Chalk Letter; Zhang Letter.

350 *See* EY Letter; PBA Letter.

respects.[351] If, however, financial statements of the issuer are available that have either been reviewed or audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead and need not include the information reported on the federal income tax returns or the certification of the principal executive officer.

- Issuers offering more than $100,000 but not more than $500,000: financial statements reviewed by a public accountant that is independent of the issuer.[352] If, however, financial statements of the issuer are available that have been audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead and need not include the reviewed financial statements.
- Issuers offering more than $500,000:
    - For issuers offering more than $500,000 but not more than $1 million of securities in reliance on Regulation Crowdfunding for the first time: financial statements reviewed by a public accountant that is independent of the issuer. If, however, financial statements of the issuer are available that have been audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead and need not include the reviewed financial statements.
    - For issuers that have previously sold securities in reliance on Regulation Crowdfunding: financial statements audited by a public accountant that is independent of the issuer.[353]

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351 *See* Rule 201(t)(1) of Regulation Crowdfunding.

352 *See* Rule 201(t)(2) of Regulation Crowdfunding.

353 *See* Rule 201(t)(3) of Regulation Crowdfunding. *See also* discussion below under "Offerings of more than $500,000."

Content of Financial Statements. We are adopting substantially as proposed the requirement that all issuers file with the Commission and provide to investors and the relevant intermediary a complete set of their financial statements, which includes balance sheets, statements of comprehensive income, statements of cash flows, statements of changes in stockholders' equity and notes to the financial statements.[354] In order to avoid potential confusion as to the presentation of financial statements, and consistent with Tier 1 offerings under Regulation A,[355] the final rule adds an instruction that financial statements that are not audited must be labeled as unaudited.[356] Consistent with the proposal, the final rules do not exempt any issuers from the financial statement requirements. Although some commenters expressed concerns about the costs of the financial statement requirements for issuers with no operating history or issuers that have been in existence for fewer than 12 months,[357] we believe that financial statements are important information for investors and that the changes from the proposed rules described below will help reduce the costs associated with preparing financial statements for many of those issuers.

The final rule also includes an instruction to clarify that references to the issuer in Rule 201(t) refer to the issuer and its predecessors, if any.

Offerings of $100,000 or less. Consistent with Securities Act Section 4A(b)(1)(D)(i), we are adopting as proposed the requirement in Rule 201(t)(1) that an issuer offering $100,000 or less

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[354] *See* Instruction 3 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

[355] *See* Paragraph (b) of Part F/S of Form 1-A.

[356] *See* Instruction 3 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

[357] *See, e.g.*, Arctic Island Letter 5; CFIRA Letter 5; CFIRA Letter 7; CrowdFundConnect Letter; Crowdpassage Letter 2; EY Letter; Grassi Letter; Hackers/Founders Letter; Joinvestor Letter; McGladrey Letter; PBA Letter; PeoplePowerFund Letter; RocketHub Letter; StartupValley Letter; Wefunder Letter; Whitaker Chalk Letter. *But see* AICPA Letter; Denlinger Letter 1; Wilson Letter.

provide financial statements of the issuer that are certified by the principal executive officer of the issuer to be true and complete in all material respects.[358] While we believe it will be beneficial for investors to have an independent accountant review financial statements in offerings over $100,000, we believe that for offerings of $100,000 or less this certification is sufficient and will contribute to the integrity of the issuer's financial reporting process. It will affirm for investors that, although the financial statements have not been reviewed or audited by an independent public accountant, there has been senior executive attention paid to the financial statements. We are not requiring this certification for reviewed or audited financial statements, as some commenters suggested, because we believe the certification is intended as an added measure of assurance that is not needed in offerings of this size when an independent accountant reviews or audits the financial statements. We also are adopting the form of the certification that must be provided by the issuer's principal executive officer as proposed with one change relating to the information from the issuer's tax return.[359]

Instead of mandating that issuers offering $100,000 or less provide copies of their federal income tax returns as proposed, the final rules require an issuer to disclose the amount of total income, taxable income and total tax, or the equivalent line items from the applicable form, exactly as reflected in its filed federal income tax returns, and to have the principal executive officer certify that those amounts reflect accurately the information in the issuer's federal income tax returns.[360] As noted by commenters,[361] requiring that issuers provide tax returns may present a

[358] *See* Rule 201(t)(1) of Regulation Crowdfunding.

[359] *See* Instruction 7 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

[360] *See* Rule 201(t)(1) of Regulation Crowdfunding.

[361] *See, e.g.*, AICPA Letter; Public Startup Letter 2; RocketHub Letter; SBM Letter; Wilson Letter; Zhang Letter.

significant risk of disclosure of private information. While the proposed rule would require personally identifiable information to be redacted, we are persuaded by commenters that such a requirement might not provide an adequate safeguard against inadvertent disclosure of this type of information in some instances. The consequences for an issuer and an intermediary of such disclosure, including the potential violation of applicable privacy laws, could be severe. Specifying the information from the tax return that is required without requiring submission of the tax return itself will provide standardized disclosure for investors and help protect against the accidental disclosure of personally identifiable or confidential information. Requiring that these amounts be certified by the principal executive officer will provide investors additional assurance of the accuracy of those amounts in lieu of providing the underlying tax returns.[362] At the same time, because the principal executive officer will be certifying only that the amounts are as reported on the applicable income tax return, we do not expect this requirement to impose any significant new burdens on principal executive officers, who will already be certifying as to the truth and completeness of the financial statements themselves. We believe the alternative approach we are adopting provides a similar benefit to investors as the proposal while addressing the privacy concerns raised by commenters.

As we stated in the Proposing Release, it remains unclear to us to what extent all of the information presented in a tax return would be useful for an investor evaluating whether to purchase securities from the issuer. We believe, however, that certain information such as total income, taxable income and total tax could be informative and would likely be available to the issuer in tax documentation. The final rules, therefore, provide that an issuer must disclose its

[362] We note that any intentional misstatements or omissions of facts may constitute federal criminal violations by the certifying principal executive officer. *See* 18 U.S.C. 1001.

total income, taxable income and total tax, or the equivalent line items from its federal income tax documentation and have the principal executive officer certify that those amounts reflect accurately the information in the issuer's federal income tax returns.[363]

Under the final rules, an issuer that offers securities in reliance on Section 4(a)(6) before filing its tax return for the most recently completed fiscal year will be allowed to use information from the tax return filed for the prior year. An issuer that uses information from the prior year's tax return will be required to provide tax return information for the most recently completed fiscal year when filed with the U.S. Internal Revenue Service (if the tax return is filed during the offering period). An issuer that has requested an extension from the U.S. Internal Revenue Service would not be required to provide the information until the date when the return is filed, which is consistent with the concept of not requiring tax information until that information has been filed with the U.S. Internal Revenue Service. If an issuer has not yet filed a tax return and is not required to file a tax return before the end of the offering period, then the tax return information does not need to be provided.[364]

We are adding to Rule 201(t)(1) a requirement that if financial statements of the issuer are available that have either been reviewed or audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead, and need not include the information reported on the federal income tax returns or the certification of the principal executive officer.[365] This approach was suggested by two commenters,[366] and we believe it will benefit investors by providing access to audited or reviewed financial statements that were already

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363 *See* Rule 201(t)(1) of Regulation Crowdfunding.

364 *See* Instruction 6 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

365 *See* Rule 201(t)(1) of Regulation Crowdfunding.

366 *See* Angel Letter 1; EY letter.

prepared for other purposes. Unlike audit reports in a registered offering,[367] we are not requiring that review or audit reports be accompanied by a formal consent or acknowledgment letter. Rather, the final rules clarify that review and audit reports must be signed and that the issuers must notify the public accountants of their intended use in an offering in reliance on Section 4(a)(6).[368]

Offerings of more than $100,000 but not more than $500,000. Consistent with Section 4A(b)(1)(D)(iii) and the proposed rules, issuers must file and provide reviewed financial statements when offering more than $100,000 but not more than $500,000.[369] Similar to the addition to Rule 201(t)(1) discussed above, we have added to Rule 201(t)(2) a requirement that if financial statements of the issuer are available that have been audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead.[370] The approach of providing audited financial statements that are otherwise available is consistent with what the Commission adopted for issuers undertaking Tier 1 offerings under Regulation A.[371] We believe the benefits to investors of having access to these audited financial statements justify any additional burden imposed on issuers to provide these statements, which were already prepared for other purposes.

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367 *See* Securities Act Rule 436; Item 601 of Regulation S-K.

368 *See* Instructions 8 and 9 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

369 *See* Rule 201(t)(2) of Regulation Crowdfunding.

370 *Id.*

371 *See* Paragraph (b) of Part F/S of Form 1-A. While Regulation Crowdfunding incorporates a number of requirements that are consistent with Regulation A, it is important to note that Regulation Crowdfunding and Regulation A are different exemptions with distinct requirements. For example, unlike offerings under Regulation Crowdfunding, Tier 1 offerings under Regulation A are subject to state registration requirements and are required to be "qualified" by Commission staff.

Offerings of more than $500,000. As proposed, Rule 201(t)(3) provides that issuers offering more than $500,000 are required to provide audited financial statements. In a change from the proposal, the final rule includes an accommodation for issuers offering more than $500,000 but not more than $1 million that have not previously sold securities in reliance on Section 4(a)(6).[372] Under Rule 201(t)(3), those first-time issuers are permitted to provide reviewed rather than audited financial statements, unless audited financial statements are otherwise available.

We are adding this accommodation for first-time issuers in response to commenters' concerns about the expense of obtaining audited financial statements. While some commenters expressed support for the proposed audit requirement,[373] many others noted that the proposed audit requirement would be too costly and burdensome for issuers in comparison to the size of the offering proceeds.[374] A number of commenters expressed particular concern that issuers would need to incur the expense of an audit before having proceeds or even an assurance of proceeds from the offering.[375] After considering the comments, we are persuaded that for issuers undertaking a first-time crowdfunding offering of more than $500,000 but not more than $1

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[372] For purposes of determining whether an issuer has previously sold securities in reliance on Section 4(a)(6), "issuer" includes all entities controlled by or under common control with the issuer and any predecessors of the issuer. *See* Rule 100(c) of Regulation Crowdfunding.

[373] *See, e.g.*, AICPA Letter; Consumer Federation Letter; CSTTC Letter; Denlinger Letter 2; FundDemocracy Letter; Leverage PR; NASAA Letter; StartEngine Letter 1.

[374] *See, e.g.*, AEO Letter; Angel Letter 1; AWBC Letter; CFIRA Letter 5; CfPA Letter; CrowdFundConnect Letter; EarlyShares Letter; EMKF Letter; EY Letter; Finkelstein Letter; FundHub Letter 1; Generation Enterprise Letter; Grassi Letter; Graves Letter; Guzik Letter 1; Hakanson Letter; Holland Letter; Johnston Letter; Kickstarter Coaching Letter; McGladrey Letter; Milken Institute Letter; NACVA Letter; NFIB Letter; NPCM Letter; NSBA Letter; PBA Letter; Reed Letter; RocketHub Letter; Saunders Letter; SBA Office of Advocacy Letter; SBEC Letter; SBM Letter; Seyfarth Letter; Verrill Dana Letter; WealthForge Letter; Wefunder Letter; Woods Letter; Zeman Letter.

[375] *See, e.g.*, AEO Letter; AWBC Letter; CFIRA Letter 5; CfPA Letter; EMKF Letter; Generation Enterprise Letter; Grassi Letter; Graves Letter; Holland Letter; McGladrey Letter; NSBA Letter; Reed Letter; RocketHub Letter; SBM Letter; Seyfarth Letter; WealthForge Letter; Wefunder Letter.

million, the benefits of requiring audited financial statements are not likely to justify the costs. Accordingly, consistent with applicable standards,[376] for these first-time issuers, we are adopting instead a requirement that those selling securities in reliance on Section 4(a)(6) in these circumstances provide reviewed financial statements. Commenters stated that reviewed financial statements would cost less than audited financial statements,[377] and one commenter noted that the cost of an accounting review is approximately 60% of the cost of an audit.[378]

Basis of Accounting. We are adopting as proposed the requirement that all issuers provide financial statements prepared in accordance with U.S. GAAP.[379] As discussed in the Proposing Release, financial statements prepared in accordance with U.S. GAAP are generally self-scaling to the size and complexity of the issuer, which we believe can reduce the costs of preparing financial statements for many early stage issuers. We would not expect that the required financial statements would be long or complicated for issuers that are recently formed and have limited operating histories. Although we acknowledge, as some commenters observed, that other bases of accounting may be less expensive than U.S. GAAP, we believe the benefit of a single standard that will facilitate comparison among issuers relying on Section 4(a)(6) justifies any incremental expenses associated with U.S. GAAP. In addition, we are concerned that it may be difficult for investors to determine whether the issuer complied with another comprehensive basis of accounting. For these reasons, we continue to believe that financial statements prepared in

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[376] *See* Securities Act Section 28 [15 U.S.C. 77z-3].

[377] *See, e.g.*, Crowdcheck Letter 4; CfPA Letter (noting that many offerings made in reliance on Rule 506 that involve companies further along in their business development include reviewed but not audited financial statements); Graves Letter (discussing the "thorough" nature of a CPA review and the cost differential between reviewed and audited financial statements); NFIB Letter; Traklight Letter.

[378] *See* Traklight Letter.

[379] *See* Instruction 3 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

accordance with U.S. GAAP will be the most useful for investors in securities-based crowdfunding transactions, particularly when presented along with the required description of the issuer's financial condition.[380]

Additionally, as suggested by one commenter,[381] in order to be consistent with the treatment of emerging growth companies[382] and offerings relying on Regulation A,[383] Rule 201(t) permits issuers, where applicable, to delay the implementation of new accounting standards to the extent such standards provide for delayed implementation by non-public business entities.[384] In this regard, if the issuer chooses to take advantage of this extended transition period, the issuer:

- Must disclose such choice at the time the issuer files the offering statement; and
- May not take advantage of the extended transition period for some standards and not others, but must apply the same choice to all standards.

However, consistent with the treatment of emerging growth companies and offerings relying on Regulation A,[385] issuers electing not to use this accommodation must forgo this accommodation for all financial accounting standards and may not elect to rely on this accommodation in any future filings.[386]

On December 23, 2013, after we proposed rules for Regulation Crowdfunding, the Financial Accounting Standards Board (FASB) and Private Company Council (PCC) issued a

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380 *See* Rule 201(s) of Regulation Crowdfunding.

381 S*ee* EY Letter.

382 *See* Securities Act of 1933 Section 7(a)(2)(B) [15 USC 77g(a)(2)(B)].

383 *See* paragraph (a)(3) of Part F/S of Form 1-A.

384 *See* Instruction 5 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

385 *See* paragraph (a)(3) of Part F/S of Form 1-A. *See* also JOBS Act, Section 107(b)(1) and (3).

386 *See* Instruction 5 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

guide for evaluating financial accounting and reporting for non-public business entities.[387] The PCC was created in 2012 by the FASB and the Financial Accounting Foundation to improve the standard-setting process, and provide for accounting and reporting alternatives, for non-public business entities under U.S. GAAP.[388] As the standards for non-public business entities are new, there are currently very few distinctions between U.S. GAAP for public and non-public business entities. Over time, however, more distinctions between non-public business entity and public company accounting standards could develop.

Issuers that offer securities pursuant to Regulation Crowdfunding will be considered "public business entities" as defined by the FASB[389] and, therefore, ineligible to rely on any alternative accounting or reporting standards for non-public business entities.[390] Even though issuers of securities in a Regulation Crowdfunding offering fit within the definition of "public business entity," the Commission retains the authority to determine whether or not such issuers would be permitted to rely on the developing non-public business entity standards.[391]

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387 The Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies (the "PCC Guide"), *available at*: http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176163703583.

388 For a brief history behind the creation of the PCC, *see*: http://www.fasb.org/cs/ContentServer?c=Page&pagename=FASB%2FPage%2FSectionPage&cid=1351027243391.

389 Criterion (a) of FASB's Accounting Standards Update 2013-12, *Definition of a Public Business Entity*, states that an entity that "is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing)" is a Public Business Entity.

390 *See* numbered paragraph 12 of the PCC Guide, p. 3.

391 *Id.*

Commenters generally expressed concern about the costs associated with requiring issuers relying on Section 4(a)(6) to follow public company U.S. GAAP accounting standards.[392]

The final rules do not allow Regulation Crowdfunding issuers to use the alternatives available to non-public business entities under U.S. GAAP in the preparation of their financial statements. One of the significant factors considered by the FASB in developing its definition of "public business entity" was the number of primary users of the financial statements and their access to management.[393] As the FASB noted, "users of private company financial statements have continuous access to management and the ability to obtain financial information throughout the year."[394] As the number of investors increases and their ability individually to influence management decreases, it is important that all investors receive or have timely access to comprehensive financial information. As a result, although commenters generally expressed concern about the costs associated with requiring issuers relying on Section 4(a)(6) to follow public company U.S. GAAP accounting standards,[395] because crowdfunding investors will likely not have the access to management that the FASB envisions, the Commission believes that investor protection will be enhanced by requiring Regulation Crowdfunding issuers to provide financial statements prepared in the same manner as other entities meeting the FASB's definition of "public business entity."

Periods Covered in the Financial Statements. We are adopting substantially as proposed the requirement that financial statements cover the shorter of the two most recently completed

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392 *See, e.g.*, ABA Letter; CFIRA Letter 5; Grassi; EY Letter; U.S. Chamber of Commerce Letter.

393 *See* PCC Guide, p. 6.

394 *Id.*

395 *See, e.g.*, ABA Letter; CFIRA Letter 5; Grassi; EY Letter; U.S. Chamber of Commerce Letter.

fiscal years or the period since the issuer's inception.[396] While a number of commenters recommended only one year of financial statements,[397] we believe that requiring a second year will provide investors with a basis for comparison against the most recently completed period, without substantially increasing the costs for the issuer.

In addition, consistent with the proposal and with the views of many commenters,[398] the final rules do not require interim financial statements. While we recognize the needs of investors for current financial information, we are also cognizant of the anticipated costs of obtaining interim financial statements. We believe that the required discussion of any material changes or trends known to management in the financial condition and results of operations of the issuer since the period for which financial statements are provided will help provide investors with the necessary information.[399]

Age of Financial Statements. We are adopting substantially as proposed rules providing that during the first 120 days of the issuer's fiscal year, an issuer may conduct an offering in reliance on Section 4(a)(6) using financial statements for the fiscal year prior to the most recently completed fiscal year if the financial statements for the most recently completed fiscal year are not otherwise available.[400] For example, if an issuer that has a calendar fiscal year end conducts an offering in April 2016, it would be permitted to include financial statements for the fiscal year

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396 *See* Instruction 3 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

397 *See, e.g.*, Denlinger Letter 1; EY Letter; Fryer Letter; Grassi Letter; Joinvestor Letter; Public Startup Letter 2; RFPIA Letter; RocketHub Letter. *But see, e.g.*, ASSOB Letter; Zeman Letter.

398 *See, e.g.*, CFIRA Letter 7; EMKF Letter; EY Letter; FundHub Letter 1; Grassi Letter; Public Startup Letter 2; RocketHub Letter; Traklight Letter; Wefunder Letter; Whitaker Chalk Letter.

399 *See* Instruction 1 to paragraph (s) of Rule 201 of Regulation Crowdfunding.

400 *See* Instruction 4 to paragraph (t) of Rule 201 of Regulation Crowdfunding. The final rule incorporates instructions consistent with other SEC rules explaining that if the 120th day falls on a Saturday, Sunday, or holiday, the next business day shall be considered the 120th day.

ended December 31, 2014 if the financial statements for the fiscal year ended December 31, 2015 are not yet available. Once more than 120 days have passed since the end of the issuer's most recently completed fiscal year, the issuer would be required to include financial statements for its most recently completed fiscal year.[401] Regardless of the age of the financial statements, an issuer would be required to include in the narrative discussion of its financial condition a discussion of any material changes or trends known to management in the financial condition and results of operations of the issuer during any time period subsequent to the period for which financial statements are provided to inform investors of more recent developments.[402]

While some commenters expressed concern that this accommodation would not provide investors with sufficiently current financial information,[403] we believe that this risk will be mitigated by the requirement that the issuer include a narrative discussion of any material changes or trends known to management in the financial condition and results of operations during any time period subsequent to the period for which financial statements are provided.[404] Further, we believe this accommodation is needed because otherwise issuers would not be able to conduct offerings for a period of time between the end of their fiscal year and the date when the financial statements for that period are available.

We are not adopting the alternative proposed by one commenter to require unaudited financial statements through the end of the month that ends no more than two months before the month in which the offering began.[405] Such a requirement would require an issuer to prepare a set

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401 *Id.*

402 *See* Rule 201(s) of Regulation Crowdfunding and Instruction 1 to paragraph (s) of Rule 201.

403 *See, e.g.*, Consumer Federation Letter; Fund Democracy Letter; Merkley Letter.

404 *See* Rule 201(s) of Regulation Crowdfunding and instruction 1 to paragraph (s) of Rule 201.

405 *See* Fund Democracy Letter.

of financial statements at a time when it would not otherwise be doing so and would be a more onerous requirement than applies to registered or Regulation A offerings.[406]

Public Accountant Requirements. In a change from proposed Rule 201(t), in response to commenters' suggestions, the final rules provide that to qualify as independent of the issuer, a public accountant would be required to either: (1) comply with the Commission's independence rules, which are set forth in Rule 2-01 of Regulation S-X,[407] or (2) comply with the independence standards of the AICPA.[408] Allowing the AICPA independence standards as an alternative to the Commission's independence standards is consistent with the recommendations of a number of commenters[409] and the treatment of Tier 1 issuers under Regulation A.[410] We believe that providing issuers with this flexibility is appropriate in light of the potential costs to issuers that would otherwise be required to engage an accountant who was independent under Rule 2-01 of Regulation S-X.

Consistent with the recommendation of one commenter,[411] in addition to meeting the independence standards of Rule 2-01 of Regulation S-X or the AICPA, we are requiring that a public accountant that audits or reviews the financial statements provided by an issuer must meet the standards for public accountants of Rule 2-01(a) of Regulation S-X. The Commission will not

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406 *See* Rule 3-12(a) of Regulation S-X [17 CFR 210.3-12(a)] (requires that the latest balance sheet be as of a date no more than 134 days for non-accelerated filers (or 129 days for accelerated and large accelerated filers) before the effective date of a registration statement (or date a proxy statement is mailed)); Paragraph (b) of Part F/S of Form 1-A (Tier 1 and Tier 2 issuers are required to include financial statements in Form 1-A that are dated not more than nine months before the date of non-public submission, filing, or qualification, with the most recent annual or interim balance sheet not older than nine months).

407 17 CFR 210.2-01.

408 *See* Instruction 9 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

409 *See, e.g.*, AICPA Letter; Denlinger Letter 1; EY Letter; Grassi Letter; McGladrey Letter.

410 *See* Paragraph (b)(2) of Part F/S of Form 1-A. *See also*, *supra*, note 371.

411 *See* AICPA Letter.

recognize as a public accountant any person who: (1) is not duly registered and in good standing as a certified public accountant under the laws of the place of his residence or principal office; or (2) is not in good standing and entitled to practice as a public accountant under the laws of the place of his residence or principal office.[412] We believe these standards will promote the use of qualified accountants that are in compliance with the requirements for their profession for the review or audit of the financial statements with respect to all offerings, including offerings in reliance on Section 4(a)(6).

Consistent with the proposal and recommendations in response to our request for comments, we are not requiring audits to be conducted by a PCAOB-registered firm. We believe the final rules will result in a greater number of public accountants being eligible to audit the issuers' financial statements, which may reduce issuers' costs.

Review and Audit Standards. In line with the general support received from commenters,[413] we are adopting as proposed the requirement that reviewed financial statements be reviewed in accordance with the SSARS issued by the AICPA.[414] We also are adopting as proposed the requirement that audited financial statements, to the extent they are otherwise available, be audited in accordance with either the auditing standards of the AICPA (referred to as U.S. Generally Accepted Auditing Standards or GAAS) or the standards of the PCAOB.[415] We expect that this provision will provide issuers with more flexibility to file audited financial statements that may have been prepared for other purposes.

We believe that audits conducted in accordance with U.S. GAAS will provide sufficient

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412 *See* 17 CFR 210.2-01(a).

413 *See, e.g.*, ABA Letter; AICPA Letter; Denlinger Letter 1; EY Letter; Fund Democracy Letter; Grassi Letter.

414 *See* Instruction 8 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

415 *See* Instruction 9 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

protection for investors in these offerings, especially in light of the requirement that auditors must be independent under Rule 2-01 of Regulation S-X or AICPA independence standards. Moreover, we believe that the flexibility adopted in the final rules is appropriately tailored for the different types of issuers that are likely to conduct offerings under Regulation Crowdfunding.

Because issuers under Regulation Crowdfunding are not "issuers" as defined by Section 2(a)(7) of the Sarbanes-Oxley Act of 2002 nor broker-dealers registered with the Commission under Section 15(b) of the Securities Exchange Act of 1934, AICPA rules would require the audit to be compliant with U.S. GAAS even if the auditor has conducted the audit in accordance with PCAOB standards. Staff of the Commission consulted with the AICPA on this issue and has been advised that an audit performed by its members of an issuer conducting an offering under Regulation Crowdfunding would be required to comply with U.S. GAAS in accordance with the AICPA's Code of Professional Conduct.[416] As a result, an auditor for such an issuer who is conducting its audit in accordance with PCAOB standards also will be required to comply with U.S. GAAS, and the auditor will be required to comply with the reporting requirements of both the AICPA standards and the PCAOB standards. Commission staff also consulted with the AICPA on whether an auditor can currently comply with both sets of standards when issuing its auditor's report. In August 2015, the Auditing Standards Board of the AICPA proposed an amendment[417] to its auditing standards for situations when the auditor plans to refer to the standards of the PCAOB in addition to U.S. GAAS in the auditor's report. To comply with

416 The AICPA Code of Professional Conduct is available at: http://pub.aicpa.org/codeofconduct/ethicsresources/et-cod.pdf.

417 Proposed Statement on Auditing Standards, *Amendment to Statement on Auditing Standards No. 122,* Statement on Auditing Standards: Clarification and Recodification, *section 700,* Forming an Opinion and Reporting on Financial Statements. The proposed amendment would be effective for audits of financial statements for periods ending on or after December 15, 2015.

the reporting requirements of both sets of standards in those situations, the proposed amendment would require the auditor to use the report layout and wording specified by the auditing standards of the PCAOB, amended to indicate that the audit was also conducted in accordance with U.S. GAAS.

Review and Audit Reports. We are adopting, with changes from the proposal, the requirement that issuers file with the Commission and provide to investors and the relevant intermediary a signed review or audit report on the issuer's financial statements by an independent public accountant.[418] The issuer must notify the public accountant of the issuer's intended use of the report in the offering.[419]

We are adopting as proposed the provision that an audit report that includes an adverse opinion or disclaimer of opinion will not be in compliance with the audited financial statement requirements.[420] In a change from the proposal, as suggested by one commenter,[421] the final rules do not permit a qualified audit report.[422] As noted above, under the final rules an issuer is not required to provide audited financial statements for first-time crowdfunding offerings of more than $500,000 but not more than $1 million unless otherwise available. We believe that this change reduces the cost and burden for issuers generally of providing audited financial statements, and that an accommodation to permit qualified audit reports is not necessary.

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418 *See* Instructions 8 and 9 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

419 *Id.*

420 *See* Instruction 9 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

421 *See* Grassi Letter.

422 *See* Instruction 9 to paragraph (t) of Rule 201 of Regulation Crowdfunding. Accordingly, a qualified audit opinion would not be considered an audit opinion that is "available" for purposes of Rule 201(t) and 202(a).

The final rules also provide that a review report that includes modifications will not satisfy the requirement for reviewed financial statements.[423] Although two commenters expressed that a review report with modifications should be sufficient to satisfy the reviewed financial statement requirement,[424] one commenter opposed permitting modifications to review reports, noting that it considers certain departures from U.S. GAAP to be "unacceptable" and that it would not be feasible to develop a model of all allowable and disallowable modifications.[425] After considering the comments, we are persuaded that permitting modifications could result in financial statements that depart materially from U.S. GAAP, and, therefore, are not permitting modifications to review reports under the final rules. In response to concerns expressed by some commenters, however, we note that a review report or audit opinion that includes explanatory language pertaining to the entity's ability to continue as a going concern is not, under current auditing standards, a modified report or a qualified opinion.[426]

Exemptions from Financial Statement Requirements. Consistent with the proposal, the final rules do not exempt any issuers from the financial statement requirements. While we appreciate the concerns identified by commenters about the costs of the financial statement requirements for issuers with no operating history or issuers that have been in existence for fewer than 12 months,[427] we believe that financial statements are important information for all issuers

[423] *See* Instruction 8 to paragraph (t) of Rule 201 of Regulation Crowdfunding. Accordingly, a modified review report would not be considered an audit opinion that is "available" for purposes of Rule 201(t) and 202(a).

[424] *See* AICPA Letter; Heritage Letter.

[425] *See* Grassi Letter.

[426] *See, e.g.,* Public Company Accounting Oversight Board AU sec. 508, *Reports on Audited Financial Statements.*

[427] *See, e.g.,* Arctic Island Letter 5; CFIRA Letter 5; CFIRA Letter 7; CrowdFundConnect Letter; Crowdpassage Letter 2; EY Letter; Grassi Letter; Hackers/Founders Letter; Joinvestor Letter; McGladrey Letter; PBA Letter; PeoplePowerFund Letter; RocketHub Letter; StartupValley Letter; Wefunder Letter; Whitaker Chalk Letter.

and that other changes from the proposed rules such as raising the threshold at which audited financial statements are required will help reduce those costs.

b. Progress Updates

(1) Proposed Rules

Consistent with Securities Act Section 4A(b)(1)(F), proposed Rule 201(v) and Rule 203(a)(3) of Regulation Crowdfunding would require an issuer to file with the Commission and provide investors and the relevant intermediary regular updates on the issuer's progress in meeting the target offering amount no later than five business days after each of the dates that the issuer reaches particular intervals – *i.e.*, 50 percent and 100 percent – of the target offering amount. If the issuer will accept proceeds in excess of the target offering amount, the issuer also would be required to file with the Commission and provide investors and the relevant intermediary a final progress update, no later than five business days after the offering deadline, disclosing the total amount of securities sold in the offering. If, however, multiple progress updates are triggered within the same five business-day period (*e.g.*, the issuer reaches 50 percent of the target offering amount on November 5, 100 percent of the target offering amount on November 7, and the maximum amount of proceeds it will accept in excess of the target offering amount on November 9), the issuer could consolidate such progress updates into one Form C-U, so long as the Form C-U discloses the most recent threshold that was met and the Form C-U is filed with the Commission and provided to investors and the relevant intermediary by the day on which the first progress update would be due. The proposed rules also would require the intermediary to make these updates available to investors through the intermediary's platform.

(2) Comments on the Proposed Rules

Commenters were generally opposed to the progress update requirements, noting that progress updates filed with the Commission would be duplicative of what is available from the intermediary's website and generate unnecessary costs.[428] Based on that same rationale, a number of commenters supported the concept of exempting issuers from the requirement to file progress updates with the Commission so long as the intermediary publicly displays the progress of the issuer in meeting the target offering amount.[429]

(3) Final Rules

The final rules maintain the proposed progress update requirements, with a significant modification. Based on concerns expressed by commenters, the final rules permit issuers to satisfy the progress update requirement by relying on the relevant intermediary to make publicly available on the intermediary's platform frequent updates about the issuer's progress toward meeting the target offering amount.[430] However, if the intermediary does not provide such an update, the issuer would be required to file the interim progress updates. In addition, as described in more detail below, an issuer relying on the intermediary's reports of progress must still file a Form C-U at the end of the offering to disclose the total amount of securities sold in the offering.[431]

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428 *See, e.g.*, ASSOB Letter; EarlyShares Letter; Public Startup Letter 2; RFPIA Letter; RocketHub Letter. *But see* CFIRA Letter 7.

429 *See, e.g.*, Arctic Island Letter 5 (stating that intermediaries can display both text (*e.g.* "$125,000 of $500,000 raised thus far") and graphics (*e.g.* a status bar graph) of the offering progress); ASSOB Letter; PeoplePowerFund Letter; RFPIA Letter; RocketHub Letter (noting that portals already list progress for perks-based crowdfunding); Wefunder Letter. *But see* CFIRA Letter 7 (stating that the issuer should file progress updates with the Commission on a regular basis to allow for consistency across all issuers and intermediaries.).

430 *See* Rules 201(v) and 203(a)(3) of Regulation Crowdfunding.

431 *See* Rule 203(a)(3)(iii) of Regulation Crowdfunding.

As stated in the proposal, we continue to believe that the information available in progress updates will be important to investors by allowing them to gauge whether interest in the offer has increased gradually or whether it was concentrated at the beginning or at the end of the offering period. We believe that these same benefits can be achieved through information available on the intermediary's platform about the progress toward the target offering amount. Whether an issuer provides the required progress update report or relies on the intermediary's reporting, we believe investors will benefit by being able to stay informed during the offering of an issuer's progress.

Under the final rules, all issuers must file a Form C-U to report the total amount of securities sold in the offering. For issuers that are offering only up to a certain target offering amount, this requirement will be triggered five business days from the date they reach the target offering amount.[432] For issuers accepting proceeds in excess of the target offering amount, this requirement will be triggered five days after the offering deadline.[433] We believe that requiring a report of the total amount of securities sold in the offering is necessary to inform investors about the ultimate size of the offering, especially in cases where an issuer may have sold more than the target offering amount. Further, this requirement will result in a central repository of this information at the Commission – information that otherwise might no longer be available on the intermediary's platform after the offering terminated. Finally, we note that requiring a final report will make data available to the Commission and the general public that could be used to evaluate the effects of the Section 4(a)(6) exemption on capital formation.

432 *See* Rule 203(a)(3)(i) of Regulation Crowdfunding.

433 *See* Rule 203(a)(3)(ii) of Regulation Crowdfunding.

c. Amendments to the Offering Statement

(1) Proposed Rules

Proposed Rule 203(a)(2) of Regulation Crowdfunding would require that an issuer amend its disclosure for any material change in the offer terms or disclosure previously provided to investors. The amended disclosure would be filed with the Commission on Form C-A: Amendment and provided to investors and the relevant intermediary. Material changes would require reconfirmation by investors of their investment commitments within five business days. In addition, an issuer would be permitted, but not required, to file amendments for changes that are not material.

(2) Comments Received on Proposed Rules

Commenters were mixed on the proposed rules relating to amendments to the offering statement, with those opposed citing the burden on issuers.[434] Some commenters recommended that the Commission specify a filing deadline for amendments reflecting a material change,[435] and some recommended we require that investors be notified of the amendment.[436] Two commenters supported our view that the establishment of the final price should be considered a material change that would always require an amendment to Form C,[437] while one commenter opposed

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[434] For commenters generally in support, *see, e.g.*, CFA Institute Letter; CrowdCheck Letter 1 (recommending that only a final amendment prior to the offering deadline be required, provided there is a five day reconfirmation period between filing and the sale of securities); EMKF Letter; Wefunder Letter.

For commenters generally opposed, *see, e.g.*, ASSOB Letter (suggesting a supplement could suffice in certain instances); Public Startup Letter 2; RocketHub Letter (suggesting that not all amendments be filed with the Commission so long as the information was made available through the intermediary).

[435] *See, e.g.*, Commonwealth of Massachusetts Letter; Grassi Letter; Hackers/Founders Letter; RocketHub Letter.

[436] *See, e.g.*, Arctic Island Letter 5; CFA Institute Letter; Grassi Letter; Joinvestor Letter; RoC Letter; RocketHub Letter. *But see* Public Startup Letter 2.

[437] *See* Grassi Letter (recommending that reconfirmation not be required if the initial price is established in the offering documents and does not vary more than within a reasonable range established in such documents); Joinvestor Letter.

such an approach.[438] One commenter recommended that the Commission define "material change" in this context.[439]

(3) Final Rules

We are adopting requirements for the amendment to the offering statement as proposed. The final rules require that an issuer amend its disclosure for any material change in the offer terms or disclosure previously provided to investors.[440] While we recognize commenters' concerns about the costs that requiring one or more additional filings may impose on issuers, we note that an amendment will be required only in instances in which there was a material change. In such circumstances, we believe the additional efforts required of an issuer to file an amendment will be justified in order to provide investors with the information they need to make an informed investment decision.

The amended disclosure must be filed with the Commission on Form C and provided to investors and the relevant intermediary. Under the final rules, the issuer is required to check the box for "Form C/A: Amendment" on the cover of the Form C and explain, in summary manner, the nature of the changes, additions or updates in the space provided.[441]

With respect to what constitutes a "material change," as we stated in the Proposing Release, information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding whether or not to purchase the securities.[442] For example,

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438 *See* Public Startup Letter 2.

439 *See* ODS Letter.

440 *See* Rule 203(a)(2) of Regulation Crowdfunding. *See also* Section II.C.6 for discussion of the requirement that investors reconfirm their investment commitments following a material change.

441 *See* Form C.

442 See Basic Inc. v. Levinson, 485 U.S. 224 (1988) (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438 (1976)).

we believe that a material change in the financial condition or the intended use of proceeds requires an amendment to an issuer's disclosure. Also, in those instances in which an issuer has previously disclosed only the method for determining the price, and not the final price, of the securities offered, we believe that determination of the final price is a material change to the terms of the offer and must be disclosed. These are not, however, the only possible material changes that require amended disclosure. We are not providing additional guidance on what constitutes a "material change," as requested by one commenter,[443] because, consistent with our historical approach to materiality determinations, we believe that an issuer should determine whether changes in the offer terms or disclosure are material based on the facts and circumstances.

In addition, as discussed further in Section II.C.6 below, if any change, addition or update constitutes a material change to information previously disclosed, the issuer must check the box on the cover of Form C indicating that investors must reconfirm their investment commitments.

A number of commenters recommended that we specify a filing deadline for amendments reflecting a material change,[444] and that we require investors be notified in some manner of the amendment.[445] We are not, however, amending the requirement as suggested by those commenters. We appreciate the need for investors to know this information in a timely fashion, but we believe that with the requirement that investors reconfirm their commitments, it will be in an issuer's interest to file an amendment as soon as practicable and to notify investors so that it

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443 *See* ODS Letter.

444 *See, e.g.*, Commonwealth of Massachusetts Letter; Grassi Letter; Hackers/Founders Letter; RocketHub Letter.

445 *See, e.g.*, Arctic Island Letter 5; CFA Institute Letter; Grassi Letter; Joinvestor Letter; RoC Letter; RocketHub Letter. *But see* Public Startup Letter 2.

will be in a position to close the offering. Therefore, we do not believe further procedural requirements are necessary.

Issuers will be permitted, but not required, to amend the Form C to provide information with respect to other changes that are made to the information presented on the intermediary's platform and provided to investors.[446] If an issuer amends the Form C to provide such information, it is not required to check the box indicating that investors must reconfirm their investment commitments.

2. Ongoing Reporting Requirements

a. Proposed Rules

Securities Act Section 4A(b)(4) requires, "not less than annually, [the issuer to] file with the Commission and provide to investors reports of the results of operations and financial statements of the issuer, as the Commission shall, by rule, determine appropriate, subject to such exceptions and termination dates as the Commission may establish, by rule."

To implement the ongoing reporting requirement in Section 4A(b)(4), we proposed in Rules 202 and 203 of Regulation Crowdfunding to require an issuer that sold securities in reliance on Section 4(a)(6) to file a report annually, no later than 120 days after the end of the most recently completed fiscal year covered by the report. To implement the requirement that issuers provide the report to investors, we proposed in Rule 202(a) to require issuers to post the annual report on their websites. Under proposed Rule 202(a), the issuer would be required to disclose information similar to that required in the offering statement, including disclosure about its financial condition that meets the highest financial statement requirements that were applicable to its offering statement.

[446] *See* Instruction to paragraph (a)(2) of Rule 203 of Regulation Crowdfunding.

We also proposed in Rule 202(b) to require issuers to file the annual report until one of the following events occurs: (1) the issuer becomes a reporting company required to file reports under Exchange Act Sections 13(a) or 15(d); (2) the issuer or another party purchases or repurchases all of the securities issued pursuant to Section 4(a)(6), including any payment in full of debt securities or any complete redemption of redeemable securities; or (3) the issuer liquidates or dissolves in accordance with state law.

b. Comments on the Proposed Rules

Commenters expressed a range of views on the proposed ongoing reporting requirements.[447]

Frequency. With respect to frequency, a number of commenters supported the proposed requirement of annual reporting,[448] while a few recommended quarterly reporting.[449] Some commenters supported requiring issuers to file reports to disclose the occurrence of material events on an ongoing basis,[450] and several recommended that the Commission provide a list of

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447 For commenters generally supporting the proposed ongoing reporting requirements, *see, e.g.*, CfPA Letter; Commonwealth of Massachusetts Letter; Grassi Letter; Jacobson Letter; Leverage PR Letter; StartEngine Letter 1.

For commenters generally opposing the proposed ongoing reporting requirements, *see, e.g.*, ABA Letter; Campbell R. Letter; EMKF Letter; Guzik Letter 1; NFIB Letter; Public Startup Letter 2; RocketHub Letter; SeedInvest Letter 1; Stephenson, *et al* Letter.; Traklight Letter; WealthForge Letter; Winters Letter.

448 *See, e.g.*, AICPA Letter; CFIRA Letter 7; EY Letter; Grassi Letter; RoC Letter; RocketHub Letter; Traklight Letter.

449 *See, e.g.*, ASSOB Letter; CCI Letter; Denlinger Letter 1 (recommending quarterly reporting to provide investors and the secondary market timely information).

450 *See, e.g.*, ABA Letter (recommending amending Form C-AR within 15 calendar days of the material event); Angel Letter 1 (recommending prompt disclosure through postings on the issuer's website or social media); Denlinger Letter 1; EY Letter (recommending disclosure within 30 days of the end of the month in which the material event occurred, with such disclosure scaled for different tiers of issuers); Hackers/Founders Letter (recommending quarterly updates); RocketHub Letter (recommending quarterly updates).

events that would trigger such disclosure.[451] Two other commenters opposed such a requirement.[452]

Provision of Reports. Generally, commenters supported requiring issuers to post the annual report on their websites,[453] although some commenters favored a more limited distribution.[454] Similarly, a number of commenters supported requiring issuers to file the annual report on EDGAR,[455] while two commenters opposed such requirement.[456] In addition, most commenters opposed requiring physical delivery of the report directly to investors,[457] although some commenters supported requiring direct delivery in some form[458] or directly notifying investors of the availability of the annual report.[459]

Financial Statements. Commenters expressed differing views about the proposed ongoing financial statements requirements, particularly the level of public accountant involvement required. While a few supported requiring certain issuers to provide audited or reviewed financial

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451 *See, e.g.*, Denlinger Letter 1; EY Letter; Grassi Letter; RocketHub Letter.

452 *See* Heritage Letter; Public Startup Letter 2.

453 *See, e.g.*, ABA Letter; Angel Letter 1; CFA Institute Letter; Commonwealth of Massachusetts Letter; Grassi Letter; Jacobson Letter; Joinvestor Letter; RFPIA Letter; Traklight Letter.

454 *See, e.g.*, Crowdpassage Letter 3 (opposing the public availability of ongoing financial statements and recommending they be distributed through a password protected website accessible to investors); Frutkin Letter (recommending the annual report be provided to investors via e-mail, on a password-protected website accessible to investors or by mailing the report first-class to investors); Public Startup Letter 2.

455 *See, e.g.*, Commonwealth of Massachusetts Letter; Frutkin Letter; Grassi Letter; RocketHub Letter; Traklight Letter.

456 *See* Crowdpassage Letter 3 (opposing public availability of ongoing financial statements); Public Startup Letter 2.

457 *See, e.g.*, CFIRA Letter 7; CFIRA Letter 8; CfPA Letter; Crowdpassage Letter 3; Grassi Letter; Jacobson Letter; Public Startup Letter 2; Traklight Letter.

458 *See, e.g.*, Arctic Island Letter 5; CCI Letter; RocketHub Letter.

459 *See, e.g.*, Arctic Island Letter 5; CFA Institute Letter (recommending advance notice as to when and where annual reports will be available); RocketHub Letter.

statements on an ongoing basis,[460] a substantial number opposed an ongoing audit or review requirement.[461] Further, a number of commenters recommended that if ongoing financial statements are to be required for some issuers, the level of review be based on a higher offering amount threshold than the threshold used to determine the level of involvement of the accountant in the offering.[462]

Other Content. A number of commenters recommended that the ongoing annual reports require a more limited set of disclosure than the information required in the offering statement.[463]

Exceptions/Termination of Ongoing Reporting Requirement. A number of commenters recommended that there be exceptions to the ongoing reporting requirements for certain issuers,[464] expressing concern that the ongoing reporting obligations were too costly and could potentially extend indefinitely.[465] Others were opposed to such exceptions.[466]

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460 *See, e.g.*, ABA Letter; Denlinger Letter 1; Grassi Letter.

461 *See, e.g.*, AEO Letter; Arctic Island Letter 5; AWBC Letter; CrowdCheck Letter 4; EarlyShares Letter; EMKF Letter; Frutkin Letter; Graves Letter; Guzik Letter 1; iCrowd Letter; McGladrey Letter; Milken Institute Letter; NFIB Letter; PBA Letter; Peers Letter; RocketHub Letter; SeedInvest Letter 1; Seyfarth Letter; StartupValley Letter; Stephenson, *et al.* Letter; Traklight Letter; WealthForge Letter.

462 *See, e.g.*, Arctic Island Letter 5;CrowdCheck Letter 4; EarlyShares Letter; EY Letter; Grassi Letter; Graves Letter; iCrowd Letter; Milken Institute Letter; PBA Letter; Seyfarth Letter; Traklight Letter.

463 *See, e.g.*, EarlyShares Letter; EMKF Letter; McGladrey Letter; Milken Institute Letter; PBA Letter; RocketHub Letter.

464 *See, e.g.*, Heritage Letter (issuers raising $100,000 or less); RocketHub Letter (issuers raising $250,000 or less, although recommending that intermediaries be permitted to require ongoing reports on their platform even if exempted by the Commission); SeedInvest Letter 1 (recommending excepting issuers from ongoing reporting when: (1) raising less than $350,000; (2) securities are structured such that there can be no investment decisions; (3) an institutional investor, venture capitalist, or angel investor is leading the deal for investors; or (4) all investors have contractually waived the right to receive ongoing reports with informed consent); SeedInvest Letter 4. *See also* form letters designated as Type A (supporting SeedInvest Letter 1).

465 *See* SeedInvest Letter 1 (noting that the ongoing reporting obligations were an "obstacle to making crowdfunding a viable option for startups and small businesses" as the cost structure would be "out of proportion with the amounts proposed to be raised.")

466 *See, e.g.*, Commonwealth of Massachusetts Letter; Denlinger Letter 1; Grassi Letter; Public Startup Letter 2.

We also received a range of comments about when the ongoing reporting requirements should terminate, with two supporting requiring issuers to file an annual report until one of the enumerated events occurs,[467] and others suggesting alternatives to such requirement.[468]

Some commenters recommended that the ongoing reporting requirements be a condition to the Section 4(a)(6) exemption[469] while several others generally opposed such concept.[470]

c. Final Rules

After considering the comments received, we are adopting the ongoing reporting requirements generally as proposed, with a substantial modification to the level of public accountant involvement required and another modification to provide for termination of the ongoing reporting obligation in two additional circumstances.

Frequency. The final rules require an issuer that sold securities in reliance on Section 4(a)(6) to file an annual report with the Commission, no later than 120 days after the end of the fiscal year covered by the report.[471] We believe that this ongoing reporting requirement should benefit investors by enabling them to consider updated information about the issuer, thereby allowing them to make more informed investment decisions.

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467 *See, e.g.*, Grassi Letter; Whitaker Chalk Letter.

468 *See, e.g.*, ABA Letter; EY Letter (recommending the ongoing reporting obligations terminate after a certain amount of time if the issuer has 300 or fewer security holders); Grassi Letter; PBA Letter (recommending the reporting obligations terminate after three consecutive annual reports or after an issuer repurchases two-thirds of the outstanding securities issued in reliance on Section 4(a)(6), so long as the issuer made a bona fide offer to repurchase all of such securities); Public Startup Letter 2; RocketHub Letter (recommending the reporting obligations terminate after three annual reports).

469 *See, e.g.*, Parsont Letter (with a notice and cure provision); RocketHub Letter (recommending the ongoing reporting requirements be a condition for a minimum of three years).

470 *See, e.g.*, Public Startup Letter 2; Wefunder Letter; Whitaker Chalk Letter (recommending that (i) a condition, if any, apply only to the first annual report; (ii) that the failure to file the annual report restrict an issuer's ability to raise capital in the future; or (iii) issuers, certain officers, directors and shareholders have the option to escrow their shares for up to 24 months, with certain penalties for failure to file the annual report).

471 *See* Rule 202(a) of Regulation Crowdfunding.

We recognize the view of some commenters[472] that there may be major events that occur between annual reports about which investors would want to be updated, and we note that some commenters also recommended quarterly reporting.[473] However, we agree with those commenters[474] who said an annual requirement is sufficient. We believe a more frequent filing requirement would require an allocation of resources to the reporting function of Regulation Crowdfunding issuers that we do not believe is justified in light of the smaller amounts that will be raised pursuant to the exemption. We note that under Tier 1 of Regulation A, issuers can raise significantly more money – up to $20 million – without any ongoing reporting requirement other than to file a Form 1-Z exit report upon completion or termination of the offering. While not required, nothing in the rules prevents an issuer from updating investors when major events occur. Nor do our rules prevent intermediaries from requiring more frequent reporting. However, we do not believe that it is necessary in the final rules to require reporting on a more frequent basis than the annual ongoing reporting directly contemplated by the statute.

Provision of Reports. We also are adopting as proposed the requirement that an issuer post the annual report on its website.[475] Consistent with the proposal, the final rules do not require delivery of a physical copy of the annual report. As discussed in the Proposing Release and as supported by a number of commenters, we believe that investors in this type of Internet-based offering will be familiar with obtaining information on the Internet and that providing information

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472 *See, e.g.*, ABA Letter; Angel Letter 1; Denlinger Letter 1; EY Letter; Grassi Letter; Hackers/Founders Letter; RocketHub Letter.

473 *See, e.g.*, ASSOB Letter; CCI Letter; Denlinger Letter 1.

474 *See, e.g.*, AICPA Letter; CFIRA Letter 7; EY Letter; Grassi Letter; RoC Letter; RocketHub Letter; Traklight Letter.

475 *See* Rule 202(a) of Regulation Crowdfunding.

in this manner will be cost efficient. While some commenters[476] suggested that limiting distribution of the annual report to investors through use of a password-protected website would help protect an issuer's commercially-sensitive information, we believe such a requirement would add complexity for issuers and investors without providing significant protection of commercially-sensitive information since the reports could still be accessed by the public on EDGAR.

Consistent with the proposal, the final rule does not require an issuer to provide direct notification via e-mail or otherwise of the posting of the report, as was suggested by some commenters.[477] As discussed above in Section II.B.1.a.(i)(g), however, we are revising the final rules to require an issuer to disclose in the offering statement where on the issuer's website investors will be able to find the issuer's annual report and the date by which the annual report will be available on the issuer's website.[478] We believe these changes will help investors to locate the annual report. As discussed in the Proposing Release, we believe that many issuers may not have e-mail addresses for investors, especially after the shares issued pursuant to Section 4(a)(6) are traded by the original purchasers. Nonetheless, to the extent e-mail addresses for investors are available, an issuer could refer investors to the posted report via e-mail.

Financial Statements. After considering the comments, we are persuaded by the commenters that opposed requiring that an audit or review of the financial statements be included in the annual report.[479] Therefore, instead of requiring financial statements in the annual report

476 *See, e.g.*, Crowdpassage Letter 3; Frutkin Letter.

477 *See, e.g.*, Arctic Island Letter 5 (intermediary should notify); Frutkin Letter; RocketHub Letter.

478 *See* Rule 201(w) of Regulation Crowdfunding.

479 *See, e.g.*, AEO Letter; Arctic Island Letter 5; AWBC Letter; CrowdCheck Letter 4 ("ongoing audit requirement will create an unpredictable on-going burden"); EarlyShares Letter; EMKF Letter ("audited financial statements, particularly for ongoing reporting requirements, are so cost-prohibitive for startups that

that meet the highest standard previously provided, the final rules require financial statements of the issuer certified by the principal executive officer of the issuer to be true and complete in all material respects.[480] However, issuers that have available financial statements that have been reviewed or audited by an independent certified public accountant because they prepare them for other purposes must provide them and will not be required to have the principal executive officer certification.[481]

Many commenters expressed concerns with the costs associated with preparing reviewed and audited financial statements on an ongoing basis. Commenters also noted the absence of comparable ongoing reporting requirements under Tier 1 of Regulation A and other offering exemptions.[482] While we recognize that Regulation Crowdfunding is different in many respects from Regulation A, we believe that crowdfunding issuers should not have more onerous ongoing reporting compliance costs than issuers that use another public offering exemption that permits higher maximum offering amounts. The changes to the ongoing reporting requirements in the rules we are adopting today will alleviate some of the costs on crowdfunding issuers. At the same time, we also believe, consistent with the views of at least one commenter,[483] that investors still

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they make absolutely no sense as an appropriate use of funds."); Frutkin Letter; Graves Letter; Guzik Letter 1; iCrowd Letter; McGladrey Letter; Milken Institute Letter; NFIB Letter; PBA Letter; Peers Letter; RocketHub Letter; SeedInvest Letter 1; Seyfarth Letter; StartupValley Letter; Stephenson, *et al.* Letter; Traklight Letter; WealthForge Letter.

480 *See* Rule 202(a) of Regulation Crowdfunding.

481 *Id.*

482 *See, e.g.*, CrowdCheck Letter 4; EMKF Letter; EY Letter;

483 *See* CrowdCheck Letter 4 ("While the on-going audit requirement is designed to provide investors and potential secondary purchasers of the company's securities with updated information about the company, it is unnecessary given the other, less burdensome, on-going disclosure requirements contained in the statute and proposed regulation.").

will be provided with sufficient ongoing financial information about the issuer under the final rules.

Other Content. With the exception of the financial statement requirement described above, the final rule adopts as proposed the requirement that the annual report include the information required in the offering statement. Although an issuer will not be required to provide the offering-specific information that it filed at the time of the offering (because the issuer will not be offering or selling securities),[484] it will be required to disclose information about the company and its financial condition, as required in connection with the offer and sale of the securities.[485] While we appreciate the recommendations of commenters for a more limited set of disclosure in the annual report, we believe that the disclosure costs of ongoing reporting for issuers will be less than in the initial offering statement, because they will be able to use the offering materials as a basis to prepare the annual reports. We believe investors will benefit from the availability of annual updates to the information they received when making the decision to invest in the issuer's securities, since these updates will allow them to be informed about issuer developments as they decide whether to continue to hold or sell, or how to vote, the securities. Under the statute and the final rules, the securities will be freely tradable after one year. Therefore, this information also

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484 *See* Rule 202(a) of Regulation Crowdfunding. An issuer will not be required to provide information about: (1) the stated purpose and intended use of the proceeds of the offering; (2) the target offering amount and the deadline to reach the target offering amount; (3) whether the issuer will accept investments in excess of the target offering amount; (4) whether, in the event that the offer is oversubscribed, shares will be allocated on a pro-rata basis, first come-first served basis, or other basis; (5) the process to complete the transaction or cancel an investment commitment once the target amount is met; (6) the price to the public of the securities being offered; (7) the terms of the securities being offered; (8) the name, SEC file number and CRD number (as applicable) of the intermediary through which the offering is being conducted; and (9) the amount of compensation paid to the intermediary.

485 *See* Rule 202(a) of Regulation Crowdfunding. Issuers will be required to provide disclosure about its directors and officers, business, current number of employees, financial condition (including financial statements), capital structure, significant factors that make an investment in the issuer speculative or risky, material indebtedness and certain related-party transactions.

will benefit potential future holders of the issuer's securities and help them to make more informed investment decisions.

Exceptions/Termination of Ongoing Reporting Requirement. After considering the comments, we are providing for termination of the ongoing reporting obligation in the three circumstances that we proposed as well as the following two additional circumstances: (1) when the issuer has filed at least one annual report and has fewer than 300 holders of record; and (2) when the issuer has filed at least three annual reports and has total assets that do not exceed $10 million. Accordingly, under Rule 202(b), issuers will be required to file the annual report until the earliest of the following events occurs:

(1) the issuer is required to file reports under Exchange Act Sections 13(a) or 15(d);

(2) the issuer has filed at least one annual report and has fewer than 300 holders of record;

(3) the issuer has filed at least three annual reports and has total assets that do not exceed $10 million;

(4) the issuer or another party purchases or repurchases all of the securities issued pursuant to Section 4(a)(6), including any payment in full of debt securities or any complete redemption of redeemable securities; or

(5) the issuer liquidates or dissolves in accordance with state law.

We believe the addition of the two termination events, which are generally consistent with the suggestions of commenters,[486] should help alleviate commenters' concerns about related costs for certain issuers that may not have achieved a level of financial success that would sustain an ongoing reporting obligation. The 300 shareholder threshold reflected in Rule 202(b)(2) is

[486] *See, e.g.*, ABA Letter; EY Letter (recommending the reporting obligations terminate after a certain amount of time if the issuer has 300 or fewer security holders); PBA Letter; RocketHub Letter (recommending the reporting obligations terminate after three consecutive annual reports).

consistent with the threshold used to determine whether an Exchange Act reporting company is eligible to suspend its Section 15(d)[487] or terminate its Section 13[488] reporting obligations. The option for an issuer to conclude ongoing reporting after three annual reports as reflected in Rule 202(b)(3) should help address concerns raised by some commenters that the reporting obligation could potentially extend indefinitely, while still requiring larger issuers with more than $10 million in total assets to continue reporting. We chose the $10 million threshold in order to be consistent with the total asset threshold in Section 12(g)(1) of the Exchange Act.[489] Under that provision, a company that has total assets exceeding $10 million and a class of securities held of record by a certain number of persons must register that class of securities with the Commission.

As proposed, Rule 203(b)(3) provides that any issuer terminating its annual reporting obligations will be required to file with the Commission, within five business days from the date on which the issuer becomes eligible to terminate its reporting obligation, a notice that it will no longer file and provide annual reports pursuant to the requirements of Regulation Crowdfunding. The issuer also must check the box for "Form C-TR: Termination of Reporting" on the cover of Form C.[490]

We are not persuaded by the suggestion of one commenter[491] that ongoing reports should be a condition to the Section 4(a)(6) exemption. As two commenters noted at the pre-proposal stage, under such an approach, compliance with the exemption would not be known at the time of

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487 *See* 17 CFR 240.12h-3.

1488 15 U.S.C. 78m.

489 15 U.S.C. 78*l*(g)(1).

490 *See* cover page of Form C.

491 *See* Parsont Letter

the transaction.[492] This, in turn, would create substantial uncertainty for issuers because there would be an indefinite possibility of a potential future violation of the exemption. We have modified the final rules from the proposal to clarify that the availability of the crowdfunding exemption is not conditioned on compliance with the annual reporting, progress update or termination of reporting obligations.[493] Nevertheless, issuers offering and selling securities in reliance on Section 4(a)(6) remain obligated to comply with these reporting requirements. Moreover, as discussed in Section II.A.4 above, the final rules deny issuers the benefit of relying on the exemption under Section 4(a)(6) for future offerings until they file, to the extent required, the two most recently required annual reports.[494] In addition, the final rules require the issuer to disclose in its offering statement and annual report if it, or any of its predecessors, previously failed to comply with the ongoing reporting requirements of Regulation Crowdfunding.

3. Form C and Filing Requirements

a. Proposed Rules

Securities Act Section 4A(b)(1) requires issuers who offer or sell securities in reliance on Section 4(a)(6) to "file with the Commission and provide to investors and the relevant broker or funding portal, and make available to potential investors" certain disclosures. The statute does not specify a format that issuers must use to present the required disclosures and file these disclosures with the Commission. We proposed in Rule 203 of Regulation Crowdfunding to require issuers to file the mandated disclosure using new Form C, which would require certain disclosures to be

492 *See* Letter from Andrea L. Seidt, Comm'r, Ohio Div. of Sec. *available at* http://www.sec.gov/comments/jobs-title-iii/jobstitleiii-199.pdf; Letter from John R. Fahy, Partner, Whitaker Chalk Swindle Schwartz, *available at* http://www.sec.gov/comments/jobs-title-iii/jobstitleiii-175.htm.

493 *See* Rule 100(b)(4) of Regulation Crowdfunding.

494 *See* Rule 100(b)(5) of Regulation Crowdfunding.

presented in a specified format, while allowing the issuer to customize the presentation of other disclosures required by Section 4A(b)(1) and the related rules.

We proposed to require issuers to use an XML-based fillable form to input certain information. Information not required to be provided in text boxes in the XML-based fillable form would be filed as attachments to Form C.

Under the proposed rules, Form C would be used for all of an issuer's filings with the Commission related to the offering made in reliance on Section 4(a)(6). The issuer would check one of the following boxes on the cover of the Form C to indicate the purpose of the Form C filing:

- "Form C: Offering Statement" for issuers filing the initial disclosures required for an offering made in reliance on Section 4(a)(6);
- "Form C-A: Amendment" for issuers seeking to amend a previously-filed Form C for an offering;
- "Form C-U: Progress Update" for issuers filing a progress update required by Section 4A(b)(1)(H) and the related rules;
- "Form C-AR: Annual Report" for issuers filing the annual report required by Section 4A(b)(4) and the related rules; and
- "Form C-TR: Termination of Reporting" for issuers terminating their reporting obligations pursuant to Section 4A(b)(4) and the related rules.

EDGAR would automatically provide each filing with an appropriate tag depending on which box the issuer checks so that investors could distinguish among the different filings.[495]

Section 4A(b)(1) requires issuers to file the offering information with the Commission, provide it to investors and the relevant intermediary and make it available to potential investors.[496] Under the proposed rules, issuers would satisfy the requirement to file the information with the Commission by filing the Form C: Offering Statement, including any amendments and progress updates, on EDGAR. To satisfy the requirement to provide the disclosures to the relevant intermediary, we proposed that issuers provide to the relevant intermediary a copy of the disclosures filed with the Commission. To satisfy the requirement to provide the disclosures, or make them available, as applicable, to investors, we proposed that issuers provide the information to investors electronically by referring investors, such as through a posting on the issuer's website or by e-mail, to the information on the intermediary's platform. The proposed rules would not require issuers to provide physical copies of the information to investors.

b. Comments on the Proposed Rules

Commenters generally supported the proposed Form C requirement.[497] Two commenters supported the proposal to use one form with different EDGAR tags for each type of filing,[498] while another commenter recommended creating multiple forms in order to minimize the length

495 EDGAR would tag the offering statement as "Form C," any amendments to the offering statement as "Form C-A," progress updates as "Form C-U," annual reports as "Form C-AR" and termination reports as "Form C-TR."

496 Section 4A(b)(4) requires issuers to file with the Commission and provide to investors, not less than annually, reports of the results of operations and financial statements of the issuer. As discussed above in Section II.B.2, to satisfy this requirement, the rules require an issuer to post the annual report on its website and file it with the Commission.

497 *See, e.g.*, Angel Letter 1 (specifically supporting the XML requirements); CFIRA Letter 7; Consumer Federation Letter; Grassi Letter; Hackers/Founders Letter; Traklight Letter; RocketHub Letter.

498 *See* Grassi Letter; RocketHub Letter.

of the form.[499] Two commenters recommended that the Commission modify Form C and its variants to require an issuer to indicate the jurisdictions in which the securities will be or are sold, with one of those commenters recommending ongoing disclosure of the amount sold in each state.[500]

Commenters were divided on the EDGAR filing requirement. Some commenters supported the filing requirement, with a few of those specifically supporting the proposal that issuers file the Form C in electronic format only.[501] Some commenters generally opposed the filing requirements or opposed specific aspects of the requirements.[502]

A few commenters requested clarification whether all offering material made available on the intermediary's platform must be filed on Form C.[503] Two commenters recommended that not all materials be required to be filed as exhibits.[504] A number of commenters noted that issuers would likely use various types of media for their offerings, some of which cannot be filed on

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499 *See* CFIRA Letter 7.

500 *See*, Commonwealth of Massachusetts Letter (recommending Form C require an issuer to check boxes indicating the jurisdictions in which securities will be sold); NASAA Letter (recommending Form C-U (offering update form) and Form C-AR (annual report form) require disclosure of the states where interests in the offering have been sold and the amount sold in each state).

501 For commenters supporting the EDGAR filings requirement generally, *see, e.g.*, CFIRA Letter 7; Traklight Letter. For those specifically supporting the electronic filing proposal, *see, e.g.*, Arctic Island Letter 5; CFIRA Letter 7; RocketHub Letter; Wilson Letter.

502 *See, e.g.*, Angel Letter 1; CFIRA Letter 1; CrowdCheck Letter 1; Mollick Letter; Public Startup Letter 2; RocketHub Letter; WealthForge Letter (recommending that the Commission require the filing of a Form C within 15 days of the offering first receiving an investment and at the completion of the offering).

503 *See, e.g.*, CrowdCheck Letter 1; Grassi Letter; Stephenson Letter.

504 *See, e.g.*, CFIRA Letter 1 (recommending that only "those documents most suited to police against fraud" be filed with the Commission because the intermediary serves as the primary repository of the offering materials); CrowdCheck Letter 1 (recommending the Commission permit issuers to use "free writing" disclosure materials in certain circumstances without having to file them with the Commission).

EDGAR.[505] A number of commenters recommended that the Commission adopt other disclosure formats, such as a question-and-answer format.[506]

A number of commenters generally supported the proposal to refer investors to information on the intermediary's platform.[507] With respect to the proposed methods (website posting or e-mail), one commenter stated that issuers would not have investors' e-mail addresses,[508] and another commenter noted that maintaining investors' email addresses would require significant resources.[509]

505 *See, e.g.*, CFIRA Letter 6; CFIRA Letter 7; CrowdCheck Letter 1; Grassi Letter; Hackers/Founders Letter; RocketHub Letter; Wefunder Letter; Wilson Letter.

506 *See, e.g.*, Guzik Letter 1; Guzik Letter 2; Guzik Letter 3 (encouraging the Commission to provide an optional simplified disclosure format, perhaps in a question and answer format); Hackers/Founders Letter (encouraging the Commission to require a standard format and to allow issuers to provide additional information); Hamilton Letter (suggesting the Commission provide prototypes of Form C and sample disclosures); RocketHub (seeking a simple, standardized general form other than U-7 or A-1 to provide legal certainty); Saunders Letter (proposing that Form C be completed by selecting from a database of stock responses); SBA Office of Advocacy Letter (describing recommendations from its roundtable attendees to adopt a simple question and answer format similar to that previously used in Regulation A or to provide "standard boilerplate disclosures for some of the more complicated nonfinancial disclosures, such as risk factors," that are not required by the JOBS Act).

We also received several comments prior to the Proposing Release on whether the Commission should require a specific format for the required disclosure. Several commenters recommended that the Commission require the disclosure on a form modeled after, or require the use of NASAA's Small Company Offering Registration Form (U-7). *See, e.g.*, Coan Letter; Liles Letter 1; Vim Funding Letter; NASAA Letter. One commenter suggested modeling the required disclosure format after then-current Form 1-A, which is used for securities offerings made pursuant to Regulation A, but which has since been modified as a result of recently adopted amendments to Regulation A. *See* 17 CFR 230.251 et seq.; *Amendments to Regulation A*, Release No. 33-9741 (March 25, 2015) [80 FR 21805 (April 20, 2015)] Regulation A Adopting Release"); Commonwealth of Massachusetts Letter

507 *See, e.g.*, Grassi Letter; Joinvestor Letter; PeoplePowerFund Letter; Public Startup Letter 2; Wefunder Letter; Wilson Letter.

508 *See* Wefunder Letter.

509 *See* Grassi Letter.

c. Final Rules

We are adopting Form C and the related filing requirements[510] with a few modifications from the proposed rules.[511]

First, the final rules will amend Regulation S-T to permit an issuer to submit exhibits to Form C in Portable Document Format ("PDF") as official filings.[512] We appreciate the views of commenters that issuers would likely use various types of media for their offerings,[513] and believe that permitting these materials to be filed in PDF format will allow for more diverse presentations of information to be reasonably available to investors through a standardized, commonly available media. Under the final rules, issuers may customize the presentation of their non-XML disclosures and file those disclosures as exhibits to the Form C. For example, an issuer may provide the required disclosures by uploading to EDGAR, as an exhibit to Form C, a PDF version of the relevant information presented on the intermediary's platform, including charts, graphs, and a transcript or description of any video presentation or any other media not reflected in the PDF.

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510 An issuer that does not already have EDGAR filing codes, and to which the Commission has not previously assigned a user identification number, which we call a "Central Index Key (CIK)" code, will need to obtain the codes by filing electronically a Form ID [17 CFR 239.63; 249.446; 269.7 and 274.402] at https://www.filermanagement.edgarfiling.sec.gov. The applicant also will be required to submit a notarized authenticating document as a Portable Document Format (PDF) attachment to the electronic filing. The authenticating document will need to be manually signed by the applicant over the applicant's typed signature, to include the information contained in the Form ID and to confirm the authenticity of the Form ID. *See* 17 CFR 232.10(b)(2).

511 *See* Rule 203 of Regulation Crowdfunding. We have made some technical changes in the final rules that do not affect their substantive requirements. To maintain consistency with other Commission rules and to keep electronic filing requirements consolidated in Regulation S-T, we have deleted from proposed Rules 201, 202 and 203 the phrase "on EDGAR" where it appeared after "file with the Commission." We also have deleted the instruction to proposed Rule 203(a)(1) as the list of information set forth in that instruction was duplicative of the XML-based portion of Form C itself.

512 *See* Rule 101(a)(1)(xvii) of Regulation S-T. Regulation S-T generally allows PDF documents to be filed only as unofficial copies. *See* Rule 104 of Regulation S-T. However, Rule 101 provides for certain exceptions to this restriction. *See, e.g.*, Rule 101(ix)(allowing a PDF attachment to Form ID); Rule 101(a)(xiv)(requiring the filing of Form NRSRO and related exhibits in PDF as official filings).

513 *See, e.g.*, CFIRA Letter 6; CFIRA Letter 7; CrowdCheck Letter 1; Grassi Letter; Hackers/Founders Letter; RocketHub Letter; Wefunder Letter; Wilson Letter.

This approach should provide key offering information in a standardized format and give issuers flexibility in the presentation of other required disclosures. We believe this flexibility is important given that we expect that issuers engaged in offerings in reliance on Section 4(a)(6) would encompass a wide variety of industries at different stages of business development.

We are adopting the XML-based fillable form as proposed with a few modifications.[514] As suggested by some commenters,[515] the XML-based portion of Form C will require issuers to indicate by checkbox the jurisdictions in which securities are intended to be offered. We also are changing the name of proposed Form C-A to Form C/A to be consistent with the naming convention of our other amendment forms and adding Form C-AR/A to allow, and facilitate identification of, the amendment of an issuer's Form C-AR annual report. In addition, we are adding an instruction to clarify that the issuer should mark the appropriate box on the cover of Form C to indicate which form it is filing. We also are splitting the "Form, jurisdiction and date of organization" field into three fields to facilitate more accurate tracking of this data. We also inserted the statement required by paragraph (g) of Rule 201 immediately following the data required by that paragraph, so that statement appears together with the relevant data. Finally, we are modifying certain other field names and the General Instructions to Form C to clarify them or to reflect applicable changes to the disclosure requirements discussed above.

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[514] As discussed in Section II.B.1, issuers will input in the proposed XML-based filing the following information: name, legal status and contact information of the issuer; name, SEC file number and CRD number (as applicable) of the intermediary through which the offering will be conducted; the amount of compensation paid to the intermediary to conduct the offering, including the amount of referral and other fees associated with the offering; any other direct or indirect interest in the issuer held by the intermediary, or any arrangement for the intermediary to acquire such an interest; number of securities offered; offering price; target offering amount; whether oversubscriptions will be accepted and, if so, how they will be allocated; maximum offering amount (if different from the target offering amount); deadline to reach the target offering amount; current number of employees of the issuer; selected financial data for the prior two fiscal years; and the jurisdictions in which the issuer intends to offer the securities.

[515] *See, e.g.*, Commonwealth of Massachusetts Letter; NASAA Letter.

We believe that requiring certain information to be submitted in XML format will support the assembly and transmission of those required disclosures to EDGAR on Form C.[516] It also will make certain key information about each offering available to investors and market observers in electronic format and allow the Commission to observe the implementation of the crowdfunding exemption under Section 4(a)(6). Information will be available about the types of issuers using the exemption, including the issuers' size, location, securities offered and offering amounts and the intermediaries through which the offerings are taking place. We believe the addition of the requirement to indicate the jurisdictions in which the issuer intends to offer the securities, as suggested by several commenters, will facilitate oversight by state regulators, who retain antifraud authority over crowdfunding transactions, while imposing only minimal costs on issuers.

In addition, in a change from the proposed rules, the final Form C includes an optional Question and Answer ("Q&A") format that issuers may elect to use to provide the disclosures that are not required to be filed in XML format.[517] Issuers opting to use this format would prepare their disclosures by answering the questions provided and filing that disclosure as an exhibit to the Form C. A number of commenters noted that an optional format such as this would be less burdensome for small issuers while still providing the Commission and investors with the required information.[518] We believe that this option may help to facilitate compliance and ease burdens on by providing a mechanism by which issuers can easily confirm that they have provided all required information.

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516 The Commission will make the information available via EDGAR both in a traditional text-based format for reading and as downloadable XML-tagged data for analysis.

517 *See* Item 1 of General Instruction III to Form C of Regulation Crowdfunding.

518 *See, e.g.*, Guzik Letter 1; Guzik Letter 2; Guzik Letter 3; Hackers/Founders Letter; Hamilton Letter; RocketHub Letter; Saunders Letter; SBA Office of Advocacy Letter.

Consistent with the proposal, we are adopting a single Form C for all filings under Regulation Crowdfunding.[519] We believe that the use of one form will be more efficient than requiring multiple forms, will not result in unduly lengthy forms, and will simplify the filing process for issuers and their preparers. EDGAR will automatically provide each filing with an appropriate tag depending on which box the issuer checks so that investors can distinguish among the different filings.

We also are adopting, largely as proposed, the requirements to provide the offering information to investors and the relevant intermediary and make it available to potential investors under Section 4A(b)(1).[520] In addition, as discussed above in Section II.B., we moved the definition of "investor" from proposed Rule 300(c)(4) to Rule 100(d) to clarify that for purposes of all of Regulation Crowdfunding, "investor" includes any investor or any potential investor, as the context requires.[521] In connection with this clarifying change, we have deleted the phrase "and make available to potential investors" each time it appeared in the rule text to avoid redundancy.[522]

The final rules provide that issuers will satisfy the requirement to file the offering information with the Commission and provide it to the relevant intermediary by filing the Form C: Offering Statement and any amendments and progress updates and providing to the relevant intermediary a copy of the disclosures filed with the Commission.[523] The initial offering

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519 *See* Rule 203 of Regulation Crowdfunding.

520 *See* Rule 203(a) of Regulation Crowdfunding.

521 *See* Rule 100(d) of Regulation Crowdfunding.

522 *See* Rule 203(a) of Regulation Crowdfunding.

523 *See* Instructions 1 and 2 to paragraph (a) of Rule 203 of Regulation Crowdfunding. We anticipate that issuers seeking to engage in an offering in reliance on Section 4(a)(6) may likely work with an intermediary to prepare the disclosure that would be provided on the intermediary's platform and filed with the Commission.

statement should include all of the information that is provided on the intermediary's website.[524] We also are adopting as proposed the requirements to file with the Commission and provide, or make available, as applicable, to investors and the relevant intermediary an amendment to the offering statement to disclose any material changes, additions or updates to information provided to investors through the intermediary's platform.[525] Issuers may, but are not required to, file an amendment to reflect other changes, additions or updates to information provided to investors through the intermediary's platform that it considers not material.

To satisfy the requirement to provide the disclosures, or make them available, as applicable, to investors, the final rules allow issuers to provide the information to investors electronically by referring investors to the information on the intermediary's platform through a posting on the issuer's website or by e-mail.[526] As discussed in the proposal and noted by commenters, many issuers may not have e-mail addresses for investors. Accordingly, the final rules permit issuers to provide this information to investors through a website posting.[527] However, to the extent e-mail addresses for investors are available to issuers, issuers may contact investors via e-mail to direct them to the posted information. We continue to believe that investors in this type of Internet-based offering will be familiar with obtaining information on the Internet and that providing the information in this manner will be cost-effective for issuers. As discussed in the Proposing Release, we believe Congress contemplated that crowdfunding would, by its very nature, occur over the Internet or other similar electronic media

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In some cases, intermediaries may offer, as part of their service, to file the disclosure with the Commission on behalf of the issuer.

524 *See* Rule 203(a)(1) of Regulation Crowdfunding.

525 *See* Rule 203(a)(2) of Regulation Crowdfunding.

526 *See* Instruction 2 to Rule 203(a) of Regulation Crowdfunding.

527 *See, e.g.*, Grassi Letter; Wefunder Letter.

that is accessible to the public.[528] Therefore, consistent with the proposed rules, the final rules do not require issuers to provide physical copies of the information to investors.

4. Prohibition on Advertising Terms of the Offering

a. Proposed Rules

Securities Act Section 4A(b)(2) provides that an issuer shall "not advertise the terms of the offering, except for notices which direct investors to the funding portal or broker." Consistent with the statute, proposed Rule 204 of Regulation Crowdfunding would allow an issuer to publish a notice advertising the terms of an offering in reliance on Section 4(a)(6) so long as the notice includes the address of the intermediary's platform on which additional information about the issuer and the offering may be found. The proposal did not impose limitations on how the issuer distributes the notices. As proposed, the notice could include no more than: (1) a statement that the issuer is conducting an offering, the name of the intermediary through which the offering is being conducted and a link directing the investor to the intermediary's platform; (2) the terms of the offering; and (3) factual information about the legal identity and business location of the issuer, limited to the name of the issuer of the security, the address, phone number and website of the issuer, the e-mail address of a representative of the issuer and a brief description of the business of the issuer. Under the proposed rules, "terms of the offering" would include: (1) the amount of securities offered; (2) the nature of the securities; (3) the price of the securities; and (4)

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528 We note that Section 301 of the JOBS Act states that "[Title III] may be cited as the 'Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012'." *See* Section 301 of the JOBS Act. *See also* 158 Cong. Rec. S1689 (daily ed. March 15, 2012) (statement of Sen. Mark Warner) ("There is now the ability to use the Internet as a way for small investors to get the same kind of deals that up to this point only select investors have gotten..., where we can now use the power of the Internet, through a term called crowdfunding."); *id.* at S1717 (Statement of Sen. Mary Landrieu) ("this crowdfunding bill—which is, in essence, a way for the Internet to be used to raise capital...").

the closing date of the offering period. The proposed rules would not, however, restrict an issuer's ability to communicate other information that does not refer to the terms of the offering.

The proposed rules also would allow an issuer to communicate with investors about the terms of the offering through communication channels provided by the intermediary on the intermediary's platform, so long as the issuer identifies itself as the issuer in all communications.

b. Comments Received

Commenters were mostly supportive of these provisions. Several commenters expressed support for the proposed content of advertising notices[529] and the definition of "terms of the offering."[530] A number of commenters also supported the proposal's absence of a restriction on an issuer's ability to communicate information that does not refer to the terms of the offering.[531] Several commenters requested clarification on various aspects of the proposal.[532]

Several commenters recommended that, consistent with the proposal, the Commission not restrict the media or format that may be used for advertising notices,[533] with some pointing to the changing nature of social media and potential new user interfaces.[534] Two commenters, however, stated that communications about the offering should always be conducted through the intermediary.[535] A number of commenters also supported allowing an issuer to communicate with

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529 *See, e.g.*, CFIRA Letter 6; Commonwealth of Massachusetts Letter; RocketHub Letter.

530 *See, e.g.*, Arctic Island Letter 5; CFIRA Letter 6; Heritage Letter; Joinvestor Letter; RocketHub Letter.

531 *See, e.g.*, ABA Letter; CFIRA Letter 6; Consumer Federation Letter; Hackers/Founders Letter; Public Startup Letter 2; RocketHub Letter.

532 *See, e.g.*, ABA Letter (recommending the rule text include a safe harbor for regularly released factual business information so long as it does not refer to the terms of the offering); CIFRA Letter 6 (requesting more guidance on advertising formats and content and the definition of "terms of the offering").

533 *See, e.g.*, Arctic Island Letter 5; Joinvestor Letter; Public Startup Letter 2; RoC Letter; RocketHub Letter.

534 *See, e.g.*, Arctic Island Letter 5; Public Startup Letter 2; RocketHub Letter.

535 *See* Hackers/Founders Letter (supporting the issuer being able to repost the communications elsewhere so long as it first appeared through the intermediary); Joinvestor Letter.

investors about the terms of the offering through communication channels provided by the intermediary on the intermediary's platform, so long as the issuer identifies itself in all communications.[536]

Some commenters opposed the proposed advertising rules, with some stating that the advertising restrictions are unnecessary because sales must occur through an intermediary's platform, which would contain all of the relevant disclosures and investor acknowledgments.[537] One commenter asked that an issuer be given broader leeway to publicize its business or offering on its own website or social media platform so long as the specific terms of the offering can be found only through the intermediary's platform.[538] One commenter recommended allowing advertising notices to have a section for supplemental information highlighting certain intangible purposes such as a particular social cause.[539]

Two other commenters recommended that any advertising notices be filed with the Commission and/or the relevant intermediary.[540] Several other commenters supported the proposed approach of not having advertising notices filed with the Commission or the intermediary, citing concerns about various formats of the communications, inability to capture all third-party communications, and the costs associated with trying to capture the data.[541]

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536 *See, e.g.*, ASSOB Letter; CFIRA Letter 6; Commonwealth of Massachusetts Letter; Consumer Federation Letter; Hackers/Founders Letter; Odhner Letter; Public Startup Letter 2; RoC Letter; RocketHub Letter; Wefunder Letter. Some of these commenters also recommended that all interested persons, such as officers, directors and other agents, should identify themselves in all communications on the intermediary's platform. *See* CIFRA Letter 6; Hackers/Founders Letter.

537 *See, e.g.*, FundHub Letter 1; Seed&Spark Letter (noting the proposed advertising restrictions will restrict the ability of filmmakers to market and raise money for their films); Arctic Island Letter 5; PeoplePowerFund Letter.

538 *See* Fryer Letter.

539 *See* RocketHub Letter.

540 *See, e.g.*, Commonwealth of Massachusetts Letter; CFIRA Letter 6.

541 *See, e.g.*, Arctic Island Letter 5; ASSOB Letter; Public Startup Letter 2; RocketHub Letter.

c. Final Rules

We are adopting the prohibition on advertising terms of the offering substantially as proposed, with minor changes to the rule text for clarity.[542] Under the final rules, an advertising notice that includes the terms of the offering can include no more than: (1) a statement that the issuer is conducting an offering, the name of the intermediary through which the offering is being conducted and a link directing the investor to the intermediary's platform; (2) the terms of the offering; and (3) factual information about the legal identity and business location of the issuer, limited to the name of the issuer of the security, the address, phone number and website of the issuer, the e-mail address of a representative of the issuer and a brief description of the business of the issuer. Consistent with the proposal, the final rules define "terms of the offering" to include: (1) the amount of securities offered; (2) the nature of the securities; (3) the price of the securities; and (4) the closing date of the offering period.[543]

The permitted notices will be similar to "tombstone ads" under Securities Act Rule 134,[544] except that the notices will be required to direct an investor to the intermediary's platform through which the offering is being conducted, such as through a link directing the investor to the platform.

Although at least one commenter recommended allowing advertising notices to have a section for supplemental information highlighting certain intangible purposes such as a particular

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542 *See* Rule 204 of Regulation Crowdfunding.

543 *See* Instruction to Rule 204 of Regulation Crowdfunding.

544 17 CFR §230.134.

social cause,[545] we do not believe a separate section is necessary. Instead, this type of information may be included as part of the "brief description of the business."

Two commenters[546] expressed concern that the proposed rule would not allow enough flexibility for brief, informal social media communications, but we disagree. A notice cannot include more than the enumerated matters, but an issuer has the flexibility not to include each of the enumerated matters in the notice, which may facilitate certain types of social media communications. For example, an issuer would be able to note on its own website or on social media that it is conducting an offering and direct readers to the materials on the intermediary's platform. There is no requirement for legends on these notices because the issuer will be directing investors to the materials on the intermediary's platform that will include those required legends.

We believe that this approach will provide flexibility for issuers while protecting investors by limiting the advertising of the terms of the offering to the information permitted in the notice and directing them to the intermediary's platform where they can access the disclosures necessary for them to make informed investment decisions.

Consistent with the recommendation of several commenters,[547] the final rules do not impose limitations on how the issuer distributes the notices. For example, an issuer could place notices in newspapers or post notices on social media sites or the issuer's own website. We believe the final rules will allow issuers to leverage social media to attract investors, while at the same time protecting investors by limiting the ability of issuers to advertise the terms of the offering without directing them to the required disclosure. We are not adopting a requirement that

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545 *See* RocketHub Letter.

546 *See* FundHub Letter 1; Fryer Letter ("a rigid tombstone approach is inconsistent with the structure and informality of modern social media communication tools.")

547 *See, e.g.*, Arctic Island Letter 5; Joinvestor Letter; Public Startup Letter 2; RoC Letter; RocketHub Letter.

all notices be filed with the Commission or relevant intermediary, as requested by some commenters.[548] Other commenters expressed concerns about the costs that would be associated with such a requirement, and given that investors will be directed to the required disclosure on the intermediary's platform, we believe the final rules appropriately take these factors into account.[549]

Further, the final rules allow an issuer to communicate with investors about the terms of the offering through communication channels provided by the intermediary on the intermediary's platform, so long as the issuer identifies itself as the issuer in all communications. We believe that one of the central tenets of the concept of crowdfunding is that the members of the crowd decide whether or not to fund an idea or business after sharing information with each other. As part of those communications, we believe it is important for the issuer to be able to respond to questions about the terms of the offering or even challenge or refute statements made through the communication channels provided by the intermediary. Therefore, the final rules do not restrict issuers from participating in those communications so long as the issuer identifies itself as the issuer in all communications.

Based on the suggestion of a few commenters,[550] we are clarifying in the final rules that the prohibition on advertising the terms of the offering and related requirements apply to persons acting on behalf of the issuer.[551] For example, persons acting on behalf of the issuer are required under Rule 204(c) to identify their affiliation with the issuer in all communications on the intermediary's platform.[552]

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[548] *See, e.g.*, Hackers/Founders Letter; Joinvestor Letter.

[549] *See, e.g.*, ASSOB Letter; RocketHub Letter.

[550] *See, e.g.*, CIFRA Letter 6; Hackers/Founders Letter.

[551] *See* Rule 204 of Regulation Crowdfunding.

[552] *See also* Section II.B.5 for disclosures required by persons promoting the offering.

In addition, the final rules do not restrict an issuer's ability to communicate other information that might occur in the ordinary course of its operations and that does not refer to the terms of the offering. As stated in the Proposing Release, we believe that this is consistent with the statute because Section 4A(b)(2) restricts the advertising of the terms of the offer. The Commission has interpreted the term "offer" broadly, however, and has explained that "the publication of information and publicity efforts, made in advance of a proposed financing which have the effect of conditioning the public mind or arousing public interest in the issuer or in its securities constitutes an offer…"[553] In this regard, we also note that Securities Act Rule 169[554] permits non-Exchange Act reporting issuers engaged in an initial public offering to continue to publish, subject to certain exclusions and conditions, regularly released factual business information that is intended for use by persons other than in their capacity as investors.

While one commenter requested a safe harbor for regularly released factual business information so long as it does not refer to the terms of the offering,[555] we do not believe that a safe harbor is necessary. Ultimately, whether or not a communication is limited to factual business information depends on the facts and circumstances of that particular communication. However, issuers may generally look to the provisions of Rule 169 for guidance in making this determination in the Regulation Crowdfunding context.

553 *Securities Offering Reform*, Release No. 33-8591 (July 19, 2005) [70 FR 44722 (Aug. 3, 2005)] at 44731. The term "offer" has been interpreted broadly and goes beyond the common law concept of an offer. *See, e.g., Diskin v. Lomasney & Co.*, 452 F.2d 871 (2d. Cir. 1971).

554 17 CFR 230.169.

555 *See* ABA Letter.

5. Compensation of Persons Promoting the Offering

a. Proposed Rules

Consistent with Securities Act Section 4A(b)(3), proposed Rule 205 of Regulation Crowdfunding would prohibit an issuer from compensating, or committing to compensate, directly or indirectly, any person to promote the issuer's offering through communication channels provided by the intermediary, unless the issuer takes reasonable steps to ensure that the person clearly discloses the receipt (both past and prospective) of compensation each time the person makes a promotional communication. Further, a founder or an employee of the issuer that engages in promotional activities on behalf of the issuer through the communication channels provided by the intermediary would be required to disclose, with each posting, that he or she is engaging in those activities on behalf of the issuer.

Under the proposed rules, an issuer would not be able to compensate or commit to compensate, directly or indirectly, any person to promote its offerings outside of the communication channels provided by the intermediary, unless the promotion is limited to notices that comply with the proposed advertising rules.

b. Comments Received

Commenters were generally supportive of promoter disclosure and the proposed rule.[556] A number of commenters supported the broad applicability of the proposed rules to persons acting

556 *See, e.g.*, CFA Institute Letter; Consumer Federation Letter (supporting proposal but generally questioning the wisdom of allowing paid promoters to participate in the communication channels at all); NASAA Letter; NFIB Letter; Public Startup Letter 2.

on behalf of the issuer.[557] Some commenters recommended that the issuer or intermediary bear more responsibility for ensuring that the identity of the promoters be prominently disclosed.[558]

A number of commenters also supported the requirement in the proposal that an issuer not compensate or commit to compensate, directly or indirectly, any person to promote its offerings outside of the communication channels provided by the intermediary, unless the promotion is limited to notices that comply with the proposed advertising rules.[559]

c. Final Rules

We are adopting, as proposed, final rules about the compensation of persons promoting the offering, with one clarifying change.[560] We anticipate that communication channels provided by the intermediary will provide a forum through which investors could share information to help the members of the crowd decide whether or not to fund the issuer. We believe that it will be important for investors to know whether persons using those communication channels are persons acting on behalf of the issuer or persons receiving compensation from the issuer (or from persons acting on behalf of the issuer), to promote the issuer's offering because of the potential for self-interest or bias in communications by these persons.

A number of commenters supported the broad applicability of the proposed rules to persons acting on behalf of the issuer.[561] The text of the proposed rule included a sentence stating

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557 *See, e.g.*, CFA Institute Letter; CFIRA Letter 6; Commonwealth of Massachusetts Letter; Consumer Federation Letter; Hackers/Founders Letter; Joinvestor Letter; RocketHub Letter; MCS Letter.

558 *See, e.g.*, ASSOB Letter; Commonwealth of Massachusetts Letter; Joinvestor Letter; MCS Letter; RoC Letter; RocketHub Letter.

559 *See, e.g.*, ASSOB Letter; Consumer Federation Letter; Joinvestor Letter; Public Startup Letter 2; RoC Letter; RocketHub Letter.

560 *See* Rule 205 of Regulation Crowdfunding.

561 *See, e.g.*, CFA Institute Letter; CFIRA Letter 6; Commonwealth of Massachusetts Letter; Consumer Federation Letter; Hackers/Founders Letter; Joinvestor Letter; RocketHub Letter; MCS Letter.

that the disclosure obligation would apply to "a founder or an employee of the issuer that engages in promotional activities on behalf of the issuer through the communication channels." Based on comments received, we are removing that sentence and adding an instruction to clarify that the requirement applies broadly to all persons acting on behalf of the issuer, regardless of whether or not the compensation they receive is specifically for the promotional activities. The change is intended to clarify that the disclosure requirement applies to persons hired specifically to promote the offering as well as to persons (including, but not limited to, founders, employees and directors) who are otherwise employed by the issuer or who undertake promotional activities on behalf of the issuer.

While we appreciate the views of commenters who suggested that we impose additional requirements on issuers or intermediaries to ensure that the identity of promoters is prominently disclosed, we believe the requirement that the issuer take reasonable steps to ensure that promoters clearly disclose the receipt of compensation for communications is sufficient to achieve the objectives of this provision without being overly prescriptive. There are a number of reasonable steps the issuer can take to ensure compliance. An issuer could, for example, contractually require any promoter to include the required statement about receipt of compensation, confirm that the promoter is adhering to the intermediary's terms of use that require promoters to affirm whether or not they are compensated by the issuer, monitor communications made by such persons and take the necessary steps to have any communications that do not have the required statement removed promptly from the communication channels, or retain a person specifically identified by the intermediary to promote all issuers on its platform.

As proposed, the final rules also specify that the issuer shall not compensate or commit to compensate, directly or indirectly, any person to promote its offerings outside of the

communication channels provided by the intermediary, unless the promotion is limited to notices that comply with the advertising rules discussed above in Section II.B.4.[562] This prohibition should prevent issuers from circumventing the restrictions on advertising by compensating a third party to do what the issuer cannot do directly.

6. Other Issuer Requirements

a. Oversubscriptions

The proposed rules would not limit an issuer's ability to accept investments in excess of the target offering amount, subject to the $1 million annual limit.[563] Issuers would be required to disclose how much they would be willing to accept in oversubscriptions, how the oversubscriptions would be allocated, and the intended purpose of those additional funds.

Commenters were generally supportive of this approach to oversubscriptions.[564] Some commenters supported the proposed flexibility to allow issuers to determine how to allocate oversubscribed offerings,[565] while other commenters recommended that the Commission require issuers to allocate oversubscriptions using a prescribed method.[566] Two commenters recommended that the Commission limit the maximum oversubscription amount to a certain percentage of the target offering amount,[567] while two other commenters opposed such a limit.[568]

[562] *See* Rule 205(b) of Regulation Crowdfunding.

[563] *See* proposed Rule 201(h) and Instruction to paragraph (i) of Rule 201 of Regulation Crowdfunding, and cover page of Form C.

[564] *See, e.g.*, CFA Institute letter; EMKF letter; Jacobson letter; Wefunder letter.

[565] *See, e.g.*, ASSOB Letter; CFA Institute Letter; EMKF Letter; Public Startup Letter 2; RocketHub Letter; Wefunder letter.

[566] *See, e.g.*, Fund Democracy Letter (pro-rata); Consumer Federation Letter (same as Fund Democracy); Joinvestor letter (first-come, first-served or algorithmic random selection); PeoplePowerFund Letter (first-come, first-served).

[567] *See* Joinvestor Letter (10%); RFPIA Letter (20%).

[568] *See* Jacobson Letter; Public Startup Letter 2.

One commenter recommended that the Commission revise the proposed rules to clarify that issuers would be required to disclose the "other" basis upon which oversubscriptions would be allocated.[569]

We are adopting the rule relating to oversubscriptions as proposed, with one clarifying change.[570] We do not believe, as some commenters suggested, that it is necessary to limit the maximum oversubscription amount. Nor do we believe it is necessary to prescribe how to allocate oversubscribed offerings so long as the issuer discloses, at the commencement of the offering, how securities in such offerings will be allocated, and the intended purpose of those additional funds. This disclosure should provide investors with information they need to make informed investment decisions while providing issuers flexibility to structure the offering as they believe appropriate. In response to a comment received,[571] we are clarifying in the final rules that, regardless of the structure, the issuer must describe how securities in oversubscribed offerings will be allocated.

b. Offering Price

As discussed above in Section II.B.1.a.i.(e), proposed Rule 201(l) would require an issuer to disclose the offering price of the securities or, in the alternative, the method for determining the price, provided that prior to any sale of securities, each investor is provided in writing the final price and all required disclosure. The proposed rules would not require issuers to set a fixed price or prohibit dynamic pricing.

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569 *See* Fund Democracy Letter.

570 *See* Rule 201(h) to Regulation Crowdfunding.

571 *See* Fund Democracy Letter.

We received a few comments supporting the proposed approach or expressing opposition to requiring a fixed price,[572] while another commenter suggested the Commission require issuers to set a fixed price.[573]

We are adopting the final rules as proposed.[574] While we appreciate the view of at least one commenter[575] that a fixed price may be simpler for investors to understand, we believe that the statute contemplated flexible pricing by providing that issuers may disclose the method for determining the price, provided that the final price and required disclosures are provided to each investor prior to any sales. We also believe the cancellation rights in the final rules[576] will provide investors a reasonable opportunity to cancel their investment commitment if they wish to do so after the price is fixed.

c. Types of Securities Offered and Valuation

The proposed rules would not limit the type of securities that may be offered in reliance on Section 4(a)(6) nor prescribe a method for valuing the securities. Issuers would be required to describe the terms of the securities and the valuation method in their offering materials.

A number of commenters generally supported not limiting the types of securities that may be offered and sold in reliance of Section 4(a)(6).[577] Comments were more varied on valuation methodology. Some commenters recommended that the Commission neither require nor prohibit

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572 *See, e.g.*, CFA Institute Letter (stating that disclosure of changes and methods used to determine share prices, along with investors' rights to cancel their investment commitments, provide reasonable safeguards); Wilson Letter; Public Startup Letter 2.

573 *See* RocketHub Letter.

574 *See* Rule 201(l) of Regulation Crowdfunding. *See also* Section II.C.6 for a discussion of cancellation provisions.

575 *See* RocketHub Letter.

576 *See* Rules 201(j) and 201(k) of Regulation Crowdfunding.

577 *See, e.g.*, CFA Institute Letter; Concerned Capital Letter; Crowdstockz Letter; Hackers/Founders Letter; Joinvestor Letter; Public Startup Letter 2; RocketHub Letter; Tiny Cat Letter; Wilson Letter.

a specific valuation methodology,[578] while others recommended that the Commission prescribe a set of valuation standards that have universal application for startups.[579] Two commenters recommended that the Commission require issuers to base the valuation of their securities on the price at which the issuer previously sold securities,[580] and another commenter recommended that the Commission consider whether additional standards are needed to ensure that securities are fairly valued and that approaches to valuation that put investors at a disadvantage be prohibited.[581] One commenter generally supported requiring issuers to describe how securities being offered are being valued,[582] while another commenter generally opposed such requirement.[583]

We are adopting, as proposed, final rules that neither limit the type of securities that may be offered in reliance on Section 4(a)(6) nor prescribe a method for valuing the securities.[584] We noted in the proposal that the statute refers to "securities" and does not limit the type of securities that could be offered pursuant to the exemption. Issuers are required to describe the terms of the securities and the valuation method in their offering materials.[585] We believe this approach is consistent with the statute and will provide flexibility to issuers to determine the types of

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578 *See, e.g.*, Hackers/Founders Letter; Heritage Letter; PeoplePowerFund Letter; Public Startup Letter 2; RocketHub Letter; Wilson Letter.

579 *See, e.g.*, 11 Wells Letter; Active Agenda Letter; Borrell Letter; Ellenbogen Letter; Greer Letter; Mountain Hardwear Letter; Moyer Letter; NaviGantt Letter; Vidal Letter.

580 *See, e.g.*, Public Startup Letter 3; Wefunder Letter.

581 *See* Consumer Federation Letter.

582 *See* CFIRA Letter 7.

583 *See* Thomas Letter 2 (recommending that if issuers are required to describe the valuation method in their offering materials, the rule should provide "safe harbor" language that issuers can use in providing such description.)

584 *See* Rule 201(m) of Regulation Crowdfunding.

585 *See* Rule 201(m)(1) and (4) of Regulation Crowdfunding.

securities that they offer to investors and how those securities are valued, while providing investors with the information they need to make an informed investment decision.

While some commenters suggested that the Commission should provide specific valuation methods or standards for securities-based crowdfunding transactions, we are not persuaded that there would be sufficient benefits to being prescriptive in this regard. Methods and valuations of early stage companies vary significantly, and any attempt to choose a particular valuation methodology could limit flexibility and have the result of endorsing one approach over another without necessarily having a sound basis for doing so. We believe the requirement that issuers describe the methods they use to value their securities in their offering materials, including the requirement that they describe examples of methods for how such securities may be valued by the issuer in the future, will provide investors with the information they need to make an informed investment decision.

The final rules do not limit the types of securities that may be offered in reliance on Section 4(a)(6), and thus debt securities may be offered and sold in crowdfunding transactions. As we stated in the Proposing Release, in general, the issuance of a debt security raises questions about the applicability of the Trust Indenture Act of 1939 ("Trust Indenture Act").[586] Although the Trust Indenture Act applies to any debt security sold through the use of the mails or interstate commerce, including debt securities sold in transactions that are exempt from Securities Act registration, Trust Indenture Act Section 304(b) provides an exemption for any transaction that is exempted by Securities Act Section 4 from the provisions of Section 5 of the Act.[587] An issuer offering debt securities in reliance on Section 4(a)(6), therefore, would be able to rely on this

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[586] 15 U.S.C. 77aaa *et seq.*

[587] 15 U.S.C. 77ddd(b).

exemption.[588] Based on the availability of this exemption, we are not adopting a specific exemption from the requirements of the Trust Indenture Act for offerings of debt securities made in reliance on Section 4(a)(6).

C. Intermediary Requirements

1. Definitions of Funding Portals and Associated Persons

a. Proposed Rules

Securities Act Section 4(a)(6)(C) requires a crowdfunding transaction to be conducted through a broker or funding portal that complies with the requirements of Securities Act Section 4A(a). The term "broker" is generally defined in Exchange Act Section 3(a)(4) as any person that effects transactions in securities for the account of others. Exchange Act Section 3(a)(80) defines the term "funding portal" as any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to Securities Act Section 4(a)(6), that does not: (1) offer investment advice or recommendations; (2) solicit purchases, sales or offers to buy the securities offered or displayed on its website or portal; (3) compensate employees, agents or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal; (4) hold, manage, possess or otherwise handle investor funds or securities; or (5) engage in such other activities as the Commission, by rule, determines appropriate.[589]

In the Proposing Release, we explained that because a funding portal would be engaged in the business of effecting securities transactions for the accounts of others through crowdfunding, it

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588 Trust Indenture Act Section 304(a)(8) [15 U.S.C. 77ddd(a)(8)] and Rule 4a-1 [17 CFR 260.4a-1] also provide an exemption to issue up to $5 million of debt securities without an indenture in any 12-month period.

589 Congress in the JOBS Act inadvertently created two Sections 3(a)(80) in the Exchange Act, the other being the definition of "emerging growth company" (added by Section 101(b) of Title I of the JOBS Act).

would be a "broker" within the meaning of Section 3(a)(4) of the Exchange Act.[590] Accordingly, proposed Rule 300(c)(2) of Regulation Crowdfunding would define "funding portal" consistent with the statutory definition of "funding portal," with the substitution of the word "broker" for the word "person."

We also stated in the Proposing Release that the proposed rules would apply not only to funding portals, but also to their associated persons in many instances. The terms "person associated with a broker or dealer" and "associated person of a broker or dealer" are defined in Exchange Act Section 3(a)(18).[591] Proposed Rule 300(c)(1) of Regulation Crowdfunding would similarly define the term "person associated with a funding portal or associated person of a funding portal" to mean any partner, officer, director or manager of a funding portal (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling or controlled by a funding portal, or any employee of a funding portal, other than persons whose functions are solely clerical or ministerial. The proposed rules would provide, however, that persons who are excluded from the definition of associated person of a funding portal because their functions are solely clerical or ministerial would remain subject to our sanctioning authority under Exchange Act Sections 15(b)(4) and 15(b)(6).[592] This definition is consistent with, and modeled on, the language of Exchange Act Section 3(a)(18).[593]

590 *See* Proposing Release at 78 FR 66458. *See also* discussion in Section II.D.2.

591 15 U.S.C. 78c(a)(18).

592 Section 15(b)(4) (15 U.S.C. 78*o*(b)(4)) authorizes the Commission to bring administrative proceedings for the imposition of sanctions, up to and including the revocation of a broker's registration, when the broker violates the federal securities laws (and for other misconduct). Section 15(b)(6) (15 U.S.C. 78*o*(b)(6)) provides similar sanctioning authority with respect to persons associated with a broker, including the ability to bar such persons from associating with any Commission registrant.

593 We note, however, that the definition in proposed Rule 300(c)(1) does not include persons under common control with the funding portal, unlike the definition in Exchange Act Section 3(a)(18) which includes such persons as associated persons of broker-dealers.

In proposed Rule 300(c)(4), we also defined "investor" as any investor or any potential investor, as the context requires.

b. Comments on the Proposed Rules

The Proposing Release requested comments on whether there were funding portal activities, other than those in Exchange Act Section 3(a)(80), that we should prohibit, and whether any prohibitions should be modified or removed. We also requested comments about whether further guidance was necessary on the provisions of the Exchange Act and the rules and regulations thereunder that would apply to funding portals.

Some commenters stated that the Commission should not provide any further guidance or prohibitions on funding portal activity in addition to those required by statute.[594] One of these commenters stated that the proposed regulations for funding portal activities are "sufficient for investor protection and proper regulatory oversight."[595] Another commenter opposed removing or modifying the statutory limitations on funding portal activities, stating that if funding portals wish to engage in the prohibited activities, they could do so by registering, and being appropriately regulated as, broker-dealers.[596]

c. Final Rules

After considering the comments, we are adopting, as proposed, the definitions of "associated person of a funding portal or person associated with a funding portal" and "funding

594 *See, e.g.*, RocketHub Letter; Tiny Cat Letter (stating that the proposed regulations provide a "healthy level of investor protection, but are not overly burdensome and we wholeheartedly appreciate the [C]ommission's general attitude of restraint"). Another commenter also opposed additional prohibitions, stating that "to add prohibitions would be an illegal Rule not authorized by the JOBS Act legislation." *See* Public Startup Letter 2. This commenter made a similar argument with respect to various aspects of the rule. We note, however, that the JOBS Act provides the Commission the authority to provide other requirements for the protection of investors and in the public interest. *See, e.g.*, Securities Act Section 4A(a)(12); 4A(b)(5).

595 *See* Tiny Cat Letter.

596 *See* Consumer Federation Letter.

portal" in Rules 300(c)(1) and(2), respectively. In particular, we believe that, at the present time, the statutory prohibitions on a funding portal in Exchange Act Section 3(a)(80), as reflected in the final rule definition of a funding portal, provide appropriate investor protections.

We also are adopting the definition of "investor" from the proposed rules but have moved the definition to Rule 100(d), and made a modification to clarify that the definition applies to all of Regulation Crowdfunding.[597] Although commenters did not address the definition of "investor," we are making this change to address any potential confusion about whether the definition is applicable to all of Regulation Crowdfunding.

2. General Requirements for Intermediaries

a. Registration and SRO Membership

(1) Proposed Rules

Securities Act Section 4A(a)(1) requires that a person acting as an intermediary in a crowdfunding transaction register with the Commission as a broker or as a funding portal.[598] Proposed Rule 300(a)(1) of Regulation Crowdfunding would implement this requirement by providing that a person acting as an intermediary in a transaction involving the offer or sale of securities made in reliance on Section 4(a)(6) must be registered with the Commission as a broker under Exchange Act Section 15(b), or as a funding portal pursuant to Section 4A(a)(1) and proposed Rule 400 of Regulation Crowdfunding. As discussed below, we also proposed to make the information that a funding portal provides on the proposed registration form (*i.e.*, Form

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[597] *See* Section II.B.1.

[598] As we noted in the Proposing Release, facilitating crowdfunded transactions (which involve the offer or sale of securities by an issuer and not secondary market activity) alone would not require an intermediary to register as an exchange or as an alternative trading system (*i.e.*, registration as a broker-dealer subject to Regulation ATS). *See* Proposing Release at 78 FR 66459 (discussing secondary market activity and exchange or ATS registration).

Funding Portal), other than personally identifiable information or other information with a significant potential for misuse, accessible to the public.[599]

Securities Act Section 4A(a)(2) requires an intermediary to register with any applicable self-regulatory organization ("SRO"), as defined in Exchange Act Section 3(a)(26).[600] Exchange Act Section 3(h)(1)(B) separately requires, as a condition of the exemption from broker registration, that a funding portal be a member of a national securities association that is registered with the Commission under Exchange Act Section 15A. Proposed Rule 300(a)(2) would implement these provisions by requiring an intermediary in a transaction involving the offer or sale of securities made in reliance on Section 4(a)(6) to be a member of FINRA or any other national securities association registered under Exchange Act Section 15A. Currently, FINRA is the only registered national securities association.

We also proposed definitions for the terms "intermediary" and "SRO" in proposed Rules 300(c)(3) and 300(c)(5) of Regulation Crowdfunding, respectively. As proposed, intermediary would mean a broker registered under Section 15(b) of the Exchange Act or a funding portal registered under proposed Rule 400 of Regulation Crowdfunding and would include, where relevant, an associated person of the registered broker or registered funding portal. SRO was proposed to have the same meaning as in Section 3(a)(26) of the Exchange Act.

599 *See* Section II.D.1 (discussing registration requirements).

600 15 U.S.C. 78c(a)(26). Exchange Act Section 3(a)(26) defines an "SRO" to include, among other things, a "registered securities association." *Id.*

(2) Comments on the Proposed Rules

Commenters generally supported FINRA being the appropriate SRO and national securities association for intermediaries.[601] In the Proposing Release, we asked if we were to approve the registration of another national securities association under Exchange Act Section 15A in the future, in addition to FINRA, whether it would it be appropriate for us to require membership in both the existing and new association. Commenters urged that intermediaries be required to register with only one such national securities association.[602]

Certain commenters expressed concern about potential competitive advantages of registered broker-dealers over funding portals, suggesting that the Commission should prohibit brokers from engaging in transactions conducted pursuant to Section 4(a)(6) until funding portals can become registered,[603] or provide funding portals a grace period so they may be able to operate before their registration becomes effective.[604] Another commenter, however, suggested that licensed broker-dealers should be immediately authorized to provide services associated with a "registered crowdfunding portal" to any issuer looking to self-host or to an issuer that has "an offline mechanism available for crowdfunding."[605]

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601 *See, e.g.*, Joinvestor Letter; RocketHub Letter. One commenter stated that funding portals should not be required to register with the Commission or become FINRA members because, unlike brokers, they serve only as an "information delivery service." *See* Perfect Circle Letter. We note, however, that registration is a statutory requirement under Securities Act Section 4A(a)(1).

602 *See, e.g.*, Joinvestor Letter; Public Startup Letter 2; RocketHub Letter; Vann Letter.

603 *See, e.g.*, RocketHub Letter.

604 *See, e.g.*, Joinvestor Letter.

605 Public Startup Letter 2.

In response to our requests for comment in the Proposing Release, commenters were also divided on whether the Commission should require minimum qualification, testing and licensure requirements for funding portals and their associated persons.[606]

(3) Final Rules

After considering the comments, we are adopting Rule 300(a) generally as proposed but deleting specific references to FINRA in the final rule, as well as the rest of Regulation Crowdfunding and Form Funding Portal, when referring to a registered national securities association. Although we recognize that FINRA is currently the only registered national securities, we believe it is redundant to specifically include its name when referring to registered national securities associations in the rule text and Form Funding Portal.

We are cognizant of the fact that funding portals must register with the Commission and become compliant with an entirely new set of rules. The effective date for the final rules (which is 180 days after publication in the Federal Register, except for § 227.400, Form Funding Portal, and the amendments to Form ID, which are effective January 29, 2016) is designed to provide a sufficient amount of time for funding portals to register and establish the necessary infrastructure to comply with other requirements being imposed in Regulation Crowdfunding before any intermediaries – either broker-dealers or funding portals – may engage in crowdfunding activities. We believe this should address commenters' concerns that broker-dealers otherwise may gain a

606 Comments in support included Hakanson Letter; Reichman Letter; RocketHub Letter. *See also* CrowdCorp Letter (stating that the Commission should establish a separate licensing scheme for persons who help prepare issuer disclosure documents and advise issuers, but who are not brokers or funding portals). Comments opposed included Public Startup Letter 2; Startup Valley Letter.

competitive advantage if they were able to engage in crowdfunding activities before funding portals are able to comply with the requirements needed to begin operation.[607]

While FINRA is the only registered national securities association at present, we recognize that a new national securities association or associations could register with us in the future. At that time, a funding portal could choose to become a member of the new association(s) instead of, or in addition to, its FINRA membership. As we noted above, we requested comment on whether we should require membership in both the existing national securities association (FINRA) and a new national securities association, if we were to approve another national securities association in the future. We have considered commenters' views and have determined not to require that funding portals be members of multiple securities associations (should new associations be registered in the future). Because all registered national securities associations must satisfy the same statutory standards set forth in Exchange Act Section 15A, we do not believe at this time that requiring membership in additional associations would add significant investor protections.

After considering comments, we have determined not to impose any licensing, testing or qualification requirements for associated persons of funding portals. We believe that a registered national securities association is well-positioned, given the requirements for registration as a national securities association, as well as the statutory and regulatory requirements that apply to

607 We note that broker-dealers may nonetheless have a competitive advantage to the extent that they are able to provide a wider range of services than those permitted funding portals under the statute. However, we believe this competitive advantage is balanced to a significant degree by a strong regulatory regime tailored to that wider range of services.

such a registered entity, to determine whether to propose additional requirements such as licensing, testing or qualification requirements for associated persons of funding portals.[608]

We also are adopting as proposed the definitions for the terms "intermediary" in Rule 300(c)(3). However, we are removing the definition of "self-regulatory organization" and "SRO" from the final rules because the term is already defined in Exchange Act Section 3(a)(26).

b. Financial Interests

(1) Proposed Rules

Securities Act Section 4A(a)(11) requires an intermediary to prohibit its directors, officers or partners (or any person occupying a similar status or performing a similar function) from having any financial interest in an issuer using its services. In the Proposing Release, we proposed to use our discretion to extend the prohibition to the intermediary itself. Thus, proposed Rule 300(b) of Regulation Crowdfunding would prohibit the intermediary, as well as its directors, officers or partners (or any person occupying a similar status or performing a similar function), from having: (1) a financial interest in an issuer using its services; and (2) from receiving a financial interest in the issuer as compensation for services provided to, or for the benefit of, the issuer, in connection with the offer and sale of its securities. Proposed Rule 300(b) defined "a financial interest in an issuer" to mean a direct or indirect ownership of, or economic interest in, any class of the issuer's securities.

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[608] All SROs are required to file proposed rules and rule changes with us under Exchange Act Section 19(b) and Rule 19b–4. In general, the Commission reviews proposed SRO rules and rule changes and publishes them for comment. The Commission then approves or disapproves them, or the rules become effective immediately or by operation of law.

(2) Comments on the Proposed Rules

In general, commenters supported the Commission's proposed financial interest prohibition as it applies to an intermediary's directors, officers or partners (or any person occupying a similar status or performing a similar function),[609] as well as the proposed definition of financial interest.[610] In contrast, however, many commenters opposed the Commission's proposed prohibition on an intermediary itself having or receiving a financial interest in the issuer,[611] while some supported this proposed prohibition.[612]

Commenters who supported our proposal to extend the prohibition on financial interests to the intermediary suggested that such prohibitions may help to mitigate conflicts of interests.[613] One commenter stated that an intermediary having a financial interest in the issuer would skew the incentives of the intermediary toward its own interests rather than the integrity of the transaction, and also stated its view that disclosure of this interest could not cure this problem.[614]

Several commenters who opposed the prohibition on an intermediary having a financial interest in the issuer suggested that the prohibition would reduce the number and types of

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609 *See, e.g.*, CFA Institute Letter; Consumer Federation Letter; Jacobson Letter.

610 *See, e.g.*, Hackers/Founders Letter; Joinvestor Letter; Tiny Cat Letter. *See also* Consumer Federation Letter (stating that the Commission should "monitor practices in this area once rules are adopted to ensure that the intended limits appropriate to intermediaries' gatekeeper functions are not being circumvented through the use of other types of payments or financial arrangements").

611 *See, e.g.*, AngelList Letter; Anonymous Letter 3; Arctic Island Letter 6; EMKF Letter; Growthfountain Letter; Guzik Letter 1; Hackers/Founders Letter; Heritage Letter; Milken Institute Letter; Propellr Letter 1; Public Startup Letter 2; RoC Letter; RocketHub Letter; Seyfarth Letter; Thomas Letter 1.

612 *See, e.g.*, CFA Institute Letter; Clapman Letter; Consumer Federation Letter; Jacobson Letter; Joinvestor Letter.

613 *See, e.g.,* CFA Institute Letter; Consumer Federation Letter ("An intermediary that is compensated through receipt of a financial interest in an issuer may have an incentive to take steps to ensure that the issuer reaches its funding target so that the offering can move forward or engage in other practices designed to artificially inflate the value of its securities."); Jacobson Letter.

614 *See* Jacobson Letter.

intermediaries that might otherwise participate in crowdfunding activities.[615] These commenters asserted that allowing an intermediary to take this financial interest would provide an option through which issuers could provide payment to the intermediary for its services, and also permit co-investments, which would ultimately benefit investors.[616] These commenters also asserted that such a financial interest could align the interests of intermediaries with those of investors.[617] One commenter suggested that "by removing an upfront cost and incentivizing an ongoing relationship between the intermediary and the issuer, equity compensation for intermediaries fulfils the Commission's twin aims of efficient capital markets and investor protection."[618] Another commenter noted that permitting the intermediary to take a financial interest in the issuer would encourage the development of funding portals that are sponsored by or affiliated with Community Development Financial Institutions ("CDFIs").[619] Yet another commenter suggested that

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615 *See, e.g.*, Hackers/Founders Letter ("Furthermore, rules that preclude the [i]ntermediary from holding any financial interest would overly restrict the [i]ntermediary environment; for example, such restrictions might prevent a diverse set of platforms from developing that serve the specific needs of different communities. The impact of which might disproportionately impact certain communities, such as the not-for-profit community.").

616 *See, e.g.*, EMKF Letter ("The current proposed rules with a fee-based system is a recipe for disaster. No credible startups that have viable alternatives would choose to pay 5-15% of their fundraising round in cash to an intermediary.").

617 *See, e.g.*, AngelList Letter ("So long as the program was consistently applied without judgment by the intermediary, the net effect would purely be to align the interests of the intermediary with the investor."). *See also* EMKF Letter; Hackers/Founders Letter; Heritage Letter; Milken Institute Letter; RoC Letter; Thomas Letter 1.

618 Seyfarth Letter.

619 *See* Concerned Capital Letter (suggesting the Commission broaden the definition of intermediaries to encourage portals sponsored by and/or affiliated with U.S. Treasury-recognized CDFIs and exempt such portals from the prohibitions against having a financial interest in issuers). *See also* City First Letter (suggesting that the Commission allow CDFIs to act as co-lenders).

The Community Development Financial Institutions Fund, which was established by the Riegle Community Development and Regulatory Improvement Act of 1994, is a government program that promoted access to capital and local economic growth by, among other things, investing in, supporting and training CDFIs that provide loans, investments, financial services and technical assistance to underserved populations and communities. *See generally* http://www.cdfifund.gov/what_we_do/programs_id.asp?programID=9. A certified Community Development Financial Institution ("CDFI") is a specialized financial institution that works in market niches that are underserved by traditional financial institutions. CDFIs provide a unique

permitting the intermediary to take a financial interest in the issuer would incentivize intermediaries to screen potential issuers for possible fraud or wrongdoing.[620] Other commenters supported permitting the intermediary to take a financial interest in the issuer so long as the terms of the financial interests taken by the intermediary are the same as or not more favorable than those taken by investors in the offering.[621] Commenters suggested additional measures, such as adequate disclosure,[622] a five percent interest limitation,[623] and restrictions on the ability of an intermediary to transfer its interests in the issuer, could help to address any conflicts of interest concerns.[624]

(3) Final Rules

After considering the comments, we are adopting Rule 300(b), as proposed, with respect to an intermediary's directors, officers or partners (or any person occupying a similar status or performing a similar function). Rule 300(b), as adopted, prohibits an intermediary's directors, officers or partners (or any person occupying a similar status or performing a similar function) from having any financial interest in an issuer using its services. Rule 300(b) also specifically prohibits these persons from receiving a financial interest in the issuer as compensation for services provided to, or for the benefit of, the issuer, in connection with the offer and sale of its

range of financial products and services in economically distressed target markets, such as mortgage financing for low-income and first-time homebuyers and not-for-profit developers, flexible underwriting and risk capital for needed community facilities, and technical assistance, commercial loans and investments to small start-up or expanding businesses in low-income areas. CDFIs include regulated institutions such as community development banks and credit unions, and non-regulated institutions such as loan and venture capital funds.

620 *See* Anonymous Letter 3.

621 *See, e.g.,* Hackers/Founders Letter; Propellr 1 Letter; Public Startup Letter 2; RocketHub Letter.

622 *See, e.g.,* Growthfountain Letter; Hackers/Founders Letter; Propellr Letter 1; RoC Letter; RocketHub Letter.

623 *See* RocketHub Letter.

624 *See* Hackers/Founders Letter.

securities. Consistent with the proposal, Rule 300(b), as adopted, defines "a financial interest in an issuer" to mean a direct or indirect ownership of, or economic interest in, any class of the issuer's securities.[625]

We are not adopting, however, the proposed complete prohibition on the intermediary itself having or receiving a financial interest in an issuer using its services. Although intermediaries are generally prohibited under the rule as adopted from having such a financial interest, as discussed below, in response to comments, we have amended the rule to permit an intermediary to have a financial interest in an issuer that is offering or selling securities in reliance on Section 4(a)(6) through the intermediary's platform, provided that: (1) the intermediary receives the financial interest from the issuer as compensation for the services provided to, or for the benefit of, the issuer in connection with the offer or sale of such securities being offered or sold in reliance on Section 4(a)(6) through the intermediary's platform; and (2) the financial interest consists of securities of the same class and having the same terms, conditions and rights as the securities being offered or sold in reliance on Section 4(a)(6) through the intermediary's platform.

We are mindful of concerns raised by commenters that a prohibition could have a chilling effect on the ability of small issuers to use the crowdfunding exemption. These issuers may be small businesses or neighborhood establishments that may not have the liquid capital to

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625 As we explained in the Proposing Release, the prohibition is intended to protect investors from the conflicts of interest that may arise when the persons facilitating a crowdfunding transaction have a financial stake in the outcome. 78 FR at 66461. The prohibition extends to "any person occupying a similar status or performing a similar function," and applies with respect to both direct or indirect ownership of, or economic interest in, any class of the issuer's securities. In addition, we note that Section 15(b) of the Securities Act creates liability for persons who aid and abet violations of the Securities Act or the rules and regulations thereunder, such as would occur if a third person knowingly or recklessly provided substantial assistance to a director, officer or partner (or any person occupying a similar status or position), for example, by accepting and holding, on the officer's behalf, a financial interest in the issuer in circumvention of the prohibition.

compensate intermediaries for services. As commenters noted, allowing an intermediary to have or receive a financial interest in the issuer could provide a method for the issuer to pay an intermediary for its services, which may facilitate capital formation. This may, in turn, encourage the development of funding portals that are, for example, affiliated with CDFIs, as one commenter suggested.[626] As commenters further noted, permitting such a financial interest may also help to align the interests of intermediaries and investors, and provide an additional incentive to screen for fraud. We believe at this time the interest of promoting capital formation for small businesses, and developing a workable framework for securities-based crowdfunding, counsels against extending the prohibition on financial interests to the intermediary itself.

However, we are cognizant of the potential conflicts of interest that may arise, and therefore we are placing certain conditions on the ability of intermediaries to have a financial interest in an issuer that is offering or selling securities in reliance on Section 4(a)(6) through the intermediary's platform.[627] First, the intermediary must receive the financial interest from the issuer as compensation for the services provided to, or for the benefit of, the issuer in connection with the offer or sale of such securities being offered or sold in reliance on Section 4(a)(6).[628] We believe that this limitation, which will allow intermediaries to receive securities as payment for services but not otherwise permit them to invest in the offering, addresses commenters' concerns

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[626] *See* Concerned Capital Letter.

[627] *See* notes 613-614 and accompanying text.

[628] As noted above in Section II.C.2, an intermediary must be either a registered funding portal or a registered broker-dealer, and must be a member of a registered national securities association. FINRA rules currently require that its broker-dealer members charge reasonable fees for their services and observe just and equitable principles of trade in the conduct of their business. FINRA has also filed a proposed rule change with the Commission to apply certain rules to funding portals, including requiring them to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their businesses. *See* Proposed Rule Change to Adopt the Funding Portal Rules and Related Forms and FINRA Rule 4518, SR-FINRA-2015-040 (Oct. 9, 2015).

that a prohibition could have a "chilling effect" on the ability of small issuers to use the crowdfunding exemption, while serving to mitigate concerns relating to intermediaries taking steps to "artificially inflate" the value of securities in the offerings.[629] Second, we have considered the comments in support of limiting an intermediary's financial interest by requiring that such interest be the same as or not more favorable than those taken by investors in the offering,[630] and have determined to prohibit intermediaries from receiving a financial interest unless it is in securities that are of the same class, and that have the same terms, conditions and rights as the securities in the offering. We believe that this limitation will further serve to mitigate any potential conflicts by helping to align the interests of the intermediary with those of the investors in the offering.[631]

We are persuaded that the disclosures otherwise required by Regulation Crowdfunding also will help to address any potential conflicts of interest arising from an intermediary having or receiving a financial interest in an issuer. Among other things, Rule 302(d) requires an intermediary to clearly disclose the manner in which it will be compensated in connection with offerings and sales of securities made in reliance on Section 4(a)(6) at account opening and Rule 303(f) requires disclosure of remuneration received by an intermediary (including securities received as remuneration) on confirmations.[632] We believe that these disclosures will provide

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629 *See* Consumer Federation Letter.

630 *See* note 621.

631 The rule does not preclude an intermediary from receiving securities as compensation for services from the same issuer for a subsequent offering conducted by the issuer in reliance on Section 4(a)(6) as long as the securities received are compensation for services provided during the subsequent offering and are of the same class and have the same terms, conditions and rights as the securities being offered in the subsequent offering.

632 *See* Sections II.C.4.d and II.C.5.f. *See also* Rule 302(c) of Regulation Crowdfunding (requiring intermediaries to inform investors, at the time of account opening, that promoters must clearly disclose in all

investors with relevant information concerning any intermediary's financial interests (including whether such interest was acquired on the same terms that are available to investors), which, in turn, will help investors to make better informed investment decisions. In addition, the intermediary must comply with all other applicable requirements of Regulation Crowdfunding, including the statutory limitations on a funding portal's activities.[633]

Commission staff expects to review the compensation structure of intermediaries during the study of the federal crowdfunding exemption it plans to undertake no later than three years following the effective date of Regulation Crowdfunding.[634]

3. Measures to Reduce Risk of Fraud

Securities Act Section 4A(a)(5) requires an intermediary to "take such measures to reduce the risk of fraud with respect to [transactions made in reliance on Section 4(a)(6)], as established by the Commission, by rule, including obtaining a background and securities enforcement regulatory history check on each officer, director, and person holding more than 20 percent of the outstanding equity of every issuer whose securities are offered by such person." As discussed

communications on the platform the receipt of compensation and the fact that he or she is engaging in promotional activities on behalf of the issuer).

633 *See* Exchange Act Section 3(a)(80) (defining "funding portal" and establishing certain limitations on their activities consistent with the statute, such as prohibiting a funding portal from offering investment advice or recommendation; soliciting purchases, sales or offers to buy securities offered or displayed on its website or portal; or holding, managing, possessing, or otherwise handling investor funds or securities). In this regard, compliance with disclosures required by Regulation Crowdfunding generally would not cause a funding portal to provide investment advice or recommendations. Nonetheless, a funding portal should seek to ensure that disclosure of its financial interest(s) in an issuer is not inconsistent with the statutory prohibition on providing investment advice or recommendations. For example, a funding portal must not present its financial interest in an issuer as a recommendation or endorsement of that issuer. *See* Section II.D.3. We also note that if a funding portal holds, owns or proposes to acquire securities issued by an issuer, or multiple issuers, that individually or in aggregate exceed more than 40% of the value of the funding portal's total assets (excluding government securities and cash items) on an unconsolidated basis, the funding portal may fall within the definition of investment company under Section 3(a)(1)(C) of the Investment Company Act. We generally would expect, however, that such funding portal would seek to rely on the exclusion from the definition of investment company in Section 3(c)(2) of the Investment Company Act for (among other things) a person primarily engaged in the business of acting as a broker.

634 *See* Section II.

below, after considering the comments, we are adopting Rule 301 of Regulation Crowdfunding substantially as proposed, with a few changes to Rule 301(c)(2).

a. Issuer compliance

(1) Proposed Rule

We proposed in Rule 301(a) of Regulation Crowdfunding to require that an intermediary have a reasonable basis for believing that an issuer seeking to offer or sell securities though the intermediary's platform complies with the requirements of Section 4(a)(6) and the related requirements of Regulation Crowdfunding. For this requirement, we proposed that an intermediary may reasonably rely on an issuer's representations about compliance unless the intermediary has reason to question the reliability of those representations.

(2) Comments on Proposed Rule

Commenters generally agreed that intermediaries play a significant role in preventing and detecting fraud and should take measures to reduce potential fraud. Some commenters, however, expressed concerns about the proposed "reasonable basis" standard for an intermediary's belief about an issuer's compliance with applicable laws stating that the standard should be higher.[635] Others commenters supported the standard.[636]

A number of commenters expressed concern about the proposed reliance on issuer representations.[637] Some commenters suggested an intermediary should be required to conduct

635 *See, e.g.*, AFR Letter; ASTTC Letter; Computershare Letter; Consumer Federation Letter; CSTTC Letter; Grassi Letter; Merkley Letter; NYSSCPA Letter.

636 *See, e.g.*, RocketHub Letter; STA Letter.

637 *See, e.g.*, AFR Letter; Computershare Letter; Consumer Federation Letter; Merkley Letter.

some type of due diligence on the issuer, as opposed to relying on issuer representations.[638] Another commenter went further by suggesting that an intermediary should also have an ongoing obligation to monitor communications by issuers during the course of the offering to detect and prevent violations of the securities laws and the regulations thereunder.[639] Another commenter stated that an issuer's representation should not suffice unless it is detailed enough to evidence a reasonable awareness by the issuer of its key obligations and the ability to comply with those obligations.[640]

One commenter argued that the language of the proposed rule was contradictory because relying on representations made by the issuer is not the same as establishing a reasonable basis for believing the issuer is in compliance.[641]

One commenter recommended that the Commission "consider a tiered approach to compliance obligations" where, as the size of the offering or other risk factors increased, intermediaries would be required to conduct more rigorous compliance reviews.[642] Under such an approach, this commenter stated that for small offerings that cap investments at a low level, $500 for example, and where there is no participation by individuals with a history of security law violations, the intermediary would be permitted to rely on representations by issuers to satisfy its

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638 *See, e.g.*, CSTTC Letter; Grassi Letter; NYSSCPA Letter; Consumer Federation Letter (stating that an intermediary's responsibility is rendered meaningless without establishing specific standards that require due diligence in order to reasonably conclude the issuer is in compliance).

639 *See* AFR Letter ("[T]he Commission's proposal to allow intermediaries to rely on self-certification by issuers makes a mockery of its proposed requirement that intermediaries have 'a reasonable basis for believing that an issuer seeking to offer and sell securities in reliance on Section 4(a)(6), through the intermediary's platform, complies with the requirements in Securities Act Section 4A(b) and the related requirements in Regulation Crowdfunding.'").

640 *See* STA Letter.

641 *See* ABA Letter.

642 *See* IAC Recommendation; *see also* BetterInvesting Letter.

obligation to ensure compliance. As the size of the offering, the size of permitted investments, or other risk factors increase, the commenter stated that the Commission should consider requiring intermediaries to conduct more rigorous compliance reviews.

(3) Final Rule

Rule 301(a), as adopted, requires that an intermediary have a reasonable basis for believing that an issuer seeking to offer and sell securities in reliance on Section 4(a)(6) through the intermediary's platform complies with the requirements in Securities Act Section 4A(b) and the related requirements in Regulation Crowdfunding. While some commenters argued for higher or different standards, such as requiring intermediaries to conduct due diligence on issuers or monitor communications by issuers during the course of the offering, we believe that a reasonable basis standard is appropriate, particularly in view of the issuer's own obligation to comply with the requirements in Section 4A(b) and the related requirements in Regulation Crowdfunding. We are mindful as well of the associated costs of a potentially higher standard. Consistent with the proposal, Rule 301(a) also permits intermediaries to reasonably rely on representations of the issuer, unless the intermediary has reason to question the reliability of those representations.

In satisfying the requirements of Rule 301(a), we emphasize that an intermediary has a responsibility to assess whether it may reasonably rely on an issuer's representation of compliance through the course of its interactions with potential issuers.[643] We agree with comments that an intermediary seeking to rely on an issuer representation should consider whether the

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643 In addition, an intermediary's potential liability under Securities Act Section 4A(c), as added by the JOBS Act, may encourage intermediaries to develop adequate procedures to fully assess whether reliance on an issuer's representation is reasonable. We also note that Congress provided a defense to any such liability if an intermediary did not know, and in the exercise of reasonable care could not have known, of the untruth or omission. Therefore, and as identified in the Proposing Release, we continue to believe that there are appropriate steps that intermediaries might take in exercising reasonable care in light of this liability provision. *See* Section II.E.5 (discussing scope of statutory liability).

representation is detailed enough to evidence a reasonable awareness by the issuer of its obligations and its ability to comply with those obligations. The specific steps an intermediary should take to determine whether it can rely on an issuer representation may vary, but should be influenced by and tailored according to the intermediary's knowledge and comfort with each particular issuer. We believe this approach is generally consistent with the view of one commenter that suggested a tiered approach to compliance obligations where intermediaries should conduct more rigorous compliance reviews and background checks as risk factors increase.[644]

b. Records of Securities Holders

(1) Proposed Rule

We proposed in Rule 301(b) of Regulation Crowdfunding a requirement that an intermediary have a reasonable basis for believing that an issuer has established means to keep accurate records of the holders of the securities it would offer and sell through the intermediary's platform. We proposed that an intermediary may reasonably rely on an issuer's representations about compliance unless the intermediary has reason to question the reliability of those representations. We did not propose a particular form or method of recordkeeping of securities, nor did we propose to require that an issuer use a transfer agent or other third party.[645] We noted, however, that requiring a registered transfer agent to be involved after the offering could introduce a regulated entity with experience in maintaining accurate shareholder records,[646] and we asked in

644 We also emphasize that when an intermediary seeks to rely on the representations of others to form a reasonable basis, the intermediary should have policies and procedures regarding under what circumstances it can reasonably rely on such representations and when additional investigative steps may be appropriate. *See* Section II.D.4.

645 Proposing Release, 78 FR at 66462

646 *Id.*

the Proposing Release whether we should require an issuer to use a regulated transfer agent to keep such records and whether there were less costly means by which an issuer could rely on a third party to assist with the recordkeeping.[647]

(2) Comments on Proposed Rule

Commenters agreed that an intermediary should have a basis for believing that an issuer has established a means to keep accurate records.[648] Commenters were divided, however, between those who supported[649] and those who opposed[650] any requirement mandating the use of a registered transfer agent. Commenters supporting the required use of registered transfer agents cited potential benefits, including reducing internal costs and providing corporate transparency;[651] having the transfer agent serve as the issuer's paying agent, proxy agent, exchange agent, tender agent and mailing agent for ongoing reports;[652] providing a back-up and recovery system for records;[653] and conducting internal audits to protect against theft.[654] Some commenters also highlighted potential problems when non-registered transfer agents or the issuer maintains records, including improper registration of multiple owners, duplicate records, missing certificate

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647 *Id.* at 66464.

648 *See, e.g.*, Arctic Island Letter 5; ASTTC Letter; CFIRA Letter 8; Computershare Letter; CST Letter; CSTTC Letter; FAST Letter; Grassi Letter; Joinvestor Letter; Public Startup Letter 2; RocketHub Letter; STA Letter; Tiny Cat Letter.

649 *See, e.g.*, ASTTC Letter; ClearTrust Letter; CST Letter; CSTTC Letter; Empire Stock Letter; Equity Stock Letter; FAST Letter; Sharewave Letter; Stalt Letter.

650 *See, e.g.*, Arctic Island Letter 5; CapSchedule Letter; CFIRA Letter 8; Computershare Letter; Grassi Letter; Joinvestor Letter; NYSSCPA Letter; Public Startup Letter 2; RocketHub Letter; Tiny Cat Letter.

651 *See* CST Letter.

652 *See* Empire Stock Letter.

653 *See* FAST Letter.

654 *Id.*

numbers, inability to trace ownership, and inability to maintain records;[655] and incorrect handling of corporate actions, failure to observe restrictions on transfers, and failure to follow abandoned property reporting requirements.[656] One commenter suggested that the Commission should identify specific areas for an intermediary to consider about an issuer's recordkeeping capabilities when determining whether or not to provide access to that issuer.[657] This commenter also urged the Commission to create a safe harbor whereby an intermediary would be deemed to have met the recordkeeping requirement if the issuer has retained a registered transfer agent or registered broker-dealer.[658]

Commenters that opposed the mandatory use of a registered transfer agent pointed to cost concerns.[659] Some of these commenters stated that alternatives to transfer agents will develop, including CPA firms,[660] registered broker-dealers[661] and software applications or other potential low-cost alternatives.[662] Some commenters stated that intermediaries should be permitted to provide the relevant recording services to issuers.[663] One commenter suggested funding portals

655 *See, e.g.*, ClearTrust Letter; STA Letter; Stalt Letter.

656 *See* STA Letter.

657 *Id.*

658 *Id.* The commenter also stated that such a safe harbor would encourage third-party recordkeepers to register as transfer agents and thereby enhance protection to investors. The commenter further stated that the safe harbor should not apply if a community bank is utilized because it would not have similar recordkeeping experience. *See also* Computershare Letter (stating that a safe harbor should apply if another regulated entity, such as a broker-dealer or a bank, is engaged to perform the services, which in turn may encourage the use of professional regulated recordkeepers, thus enhancing overall protection in the crowdfunding market).

659 *See, e.g.*, AICPA Letter; Arctic Island Letter 5; CapSchedule Letter; CFIRA Letter 8; Computershare Letter; Grassi Letter; Joinvestor Letter; RocketHub Letter; STA Letter; Tiny Cat Letter.

660 *See, e.g.*, Grassi Letter; NYSSCPA Letter.

661 *See* Public Startup Letter 2.

662 *See* Arctic Island Letter 5.

663 *See, e.g.*, Joinvestor Letter; RocketHub Letter.

should only be permitted to do so with respect to securities purchased on their platform or transferred among platforms, such that they would not be permitted to act as "full-fledged [b]rokerage firms or transfer agents."[664]

(3) Final Rules

After considering the comments, we are adopting Rule 301(b), as proposed, with one modification. Rule 301(b) as adopted requires an intermediary to have a reasonable basis for believing that an issuer has established means to keep accurate records of the holders of the securities it would offer and sell through the intermediary's platform, and provides that in satisfying this requirement, an intermediary may rely on the representations of the issuer concerning its means of recordkeeping unless the intermediary has reason to question the reliability of those representations. We also are adding a provision to Rule 301(b) as adopted stating that an intermediary will be deemed to have satisfied this requirement if the issuer has engaged the services of a transfer agent that is registered under Section 17A of the Exchange Act.[665] As we noted in the Proposing Release, we believe that the recordkeeping function may be provided by the issuer, a broker, a transfer agent or some other (registered or unregistered) person. We recognize that, as a commenter explained, recordkeeping functions can be extensive and could include, for example, the ability to (1) monitor the issuance of the securities the issuer offers and sells through the intermediary's platform, (2) maintain a master security holder list reflecting the owners of those securities, (3) maintain a transfer journal or other such log recording any transfer of ownership, (4) effect the exchange or conversion of any applicable securities, (5) maintain a control book demonstrating the historical registration of those securities, and (6) countersign or

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664 *See* RocketHub Letter.

665 15 U.S.C. 78q-1(c). We also note that an issuer's exemption from Section 12(g) is conditioned on, among other things, that issuer engaging a registered transfer agent. *See* Section II.E.4.

legend physical certificates of those securities. While the use of a registered transfer agent could introduce a regulated entity with experience in maintaining accurate shareholder records, as noted in the Proposing Release, we believe the issuer should have flexibility in establishing such means, and that such flexibility may allow for competition among service providers that could reduce operating costs for funding portals. We continue to believe that accurate recordkeeping can be accomplished by diligent issuers or through a variety of third parties. We note also that, for investors to have confidence in crowdfunding, issuers and intermediaries must have a shared interest in ensuring stability and accuracy of records. Therefore, intermediaries should consider the numerous obligations required of a record holder when determining whether an issuer has established a reasonable means to keep accurate records of the security holders being offered and sold securities through the intermediary's platform.

At the same time, mindful of the role that may be played by registered transfer agents in maintaining accurate shareholder records, we are providing a safe harbor for compliance with Rule 301(b) for those issuers that use a registered transfer agent. While we do not intend to provide regulated entities with a competitive advantage over other recordkeeping options that comply with the rule's requirements, we believe it is appropriate to provide certainty as to Rule 301(b) compliance in instances in which an issuer has engaged the services of a transfer agent that is registered under Section 17A of the Exchange Act.

c. Denial of Platform Access

(1) Proposed Rule

We also proposed in Rule 301(c)(1) of Regulation Crowdfunding a requirement that an intermediary deny access by an issuer to its platform if it has a reasonable basis for believing that an issuer, or any of its officers, directors or any person occupying a similar status or performing a

similar function, or any 20 Percent Beneficial Owner is subject to a disqualification under proposed Rule 503.[666] In satisfying this requirement, we proposed to require an intermediary to, at a minimum, conduct a background and securities enforcement regulatory history check on each issuer whose securities are to be offered by the intermediary and on each officer, director or 20 Percent Beneficial Owner.

We further proposed in Rule 301(c)(2) to require an intermediary to deny access to its platform if the intermediary believes the issuer or offering presents the potential for fraud or otherwise raises concerns about investor protection. In satisfying this requirement, the proposed rule would require that an intermediary deny access if it believes that it is unable to adequately or effectively assess the risk of fraud of the issuer or its potential offering. In addition, we proposed in Rule 301(c)(2) that if an intermediary becomes aware of information after it has granted access that causes it to believe the issuer or the offering presents the potential for fraud or otherwise raises concerns about investor protection, the intermediary would be required to promptly remove the offering from its platform, cancel the offering, and return (or, for funding portals, direct the return of) any funds that have been committed by investors in the offering.

(2) Comments on Proposed Rule

Commenters generally supported proposed Rule 301(c).[667] Commenters noted with approval the discretion the proposed rules would provide intermediaries.[668] The "reasonable basis" standard in proposed Rule 301(c)(1) also garnered comments. One commenter suggested

666 *See* Section II.E.6 (discussing Rule 503 of Regulation Crowdfunding, which describes disqualification).

667 *See, e.g.,* CFA Institute Letter; StartupValley Letter.

668 *Id.*

that the reasonable basis standard was not strong enough.[669] One commenter stated that having a reasonable basis standard in the disqualification determination would be "difficult to imagine" unless the Commission maintains a database for intermediaries to search.[670]

Commenters had varied views on the proposed requirement in Rule 301(c)(1) for an intermediary to perform a background check on the issuer and certain of its affiliated persons. Several commenters supported the requirement, but a few commenters suggested ways to decrease costs.[671] One commenter stated that only low-cost, minimum requirements should be implemented,[672] while another commenter suggested that the background checks be required only after an issuer has met its target offering amount so as to prevent unnecessary expense to the intermediary.[673] Representing a different view, one commenter opposed a requirement for background checks to be conducted on all persons related to an issuer.[674] Another commenter noted that the checks would be appropriate, but did not support the requirement.[675]

Commenters were divided as to whether we should set specific requirements for background checks. One commenter stated that the proposal "fails to set even the most general of standards for these checks" and "instead relies on intermediaries to use their experience and judgment to reduce the risk of fraud."[676] The same commenter stated that the proposed approach

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669 *See* NYSSCPA Letter (opposing the use of two different standards within Rule 301(c) as it could lead to confusion and presents vulnerability for fraud to occur through the "weakest link," and suggesting instead that a "prudent care" standard should be used for both requirements).

670 *See* Public Startup Letter 2.

671 *See, e.g.*, AFR Letter; CFA Institute Letter; Grassi Letter; Joinvestor Letter; NYSSCPA Letter.

672 *See* RocketHub Letter.

673 *See* Anonymous Letter 4.

674 *See* Zhang Letter.

675 *See* Public Startup Letter 2.

676 *See* Consumer Federation Letter.

is flawed and as such the checks are likely to be ineffective, especially because many intermediaries are likely to be inexperienced.[677] Several commenters requested further clarification and specification about required checks.[678] However, other commenters stated that the Commission should not specify steps for an intermediary to take in conducting checks.[679]

With respect to our request for comment on whether intermediaries should be required to make the results of background checks public, several commenters opposed the requirement,[680] while some supported it.[681] Another commenter stated its view that the results should not be made public unless a regulator called them into question.[682] Another commenter explained that issuers should be able to publish the results if they choose, but no such requirement should be placed on intermediaries.[683] One commenter urged us to "require that a summary of the sources consulted as part of the background check be posted on the [portal's] website."[684]

As to proposed Rule 301(c)(2) requiring a funding portal to deny access if the intermediary believes the issuer or offering presents the potential for fraud or otherwise raises concerns

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677 *Id.*

678 *See, e.g.*, BetterInvesting Letter; Heritage Letter; IAC Recommendation; Jacobson Letter; NSBA Letter. *See also* RocketHub Letter (stating that intermediaries "should be allowed to satisfy their obligations by checking commonly used databases for criminal background, bankruptcy filings, and tax liens, as well as cross check against the Office of Foreign Assets Control (OFAC) sanctions lists, and Specially Designated Nationals (SDN) and Blocked Persons lists"); Bullock Letter (recommending fingerprinting for key issuer personnel and noting that most sheriff's departments in most U.S. counties can take fingerprints for a small fee).

679 *See, e.g.*, StartupValley Letter; Vann Letter.

680 *See, e.g.*, Grassi Letter; Joinvestor Letter; NYSSCPA Letter; Public Startup Letter 2; StartupValley Letter.

681 *See, e.g.*, AFR Letter; Consumer Federation Letter.

682 *See* Joinvestor Letter.

683 *See* Public Startup Letter 2.

684 IAC Recommendation (suggesting that "[r]equiring posting of information about the sources consulted in compiling the reports would better enable investors to evaluate the thoroughness of the background check, thus creating an incentive for intermediaries to conduct thorough reviews in the absence of clear Commission guidelines"); *see also* BetterInvesting Letter.

regarding investor protection, one commenter stated that the proposed requirement conflicts with the restrictions on a funding portal's ability to limit the offerings on its platform in proposed Rule 402(b)(1).[685]

Regarding the standard for denial based on potential fraud or investor protection concerns in the proposed rule, one commenter suggested a stronger standard,[686] while another suggested a weaker standard.[687] Other commenters suggested that the standard for an intermediary to deny access to its platform is unclear.[688] One commenter urged the Commission to require that a funding portal post on its website a description of its standards for determining which offerings present a risk of fraud."[689]

One commenter stated the intermediaries should be required to report denied issuers, noting that it would not only help prevent fraud but also assist other intermediaries in excluding issuers already discovered to be disqualified.[690] Other commenters disagreed with this suggestion,[691] while one commenter stated that reporting should be required only if the

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685 *See* Guzik Letter 1 (noting that under the proposed rules, an intermediary which is not a broker-dealer is prohibited from, at least in that commenter's view, "curating," that is, "excluding companies from its platform based upon qualitative factors, such as quality of management, valuation of the company, market size, need for additional capital, pending litigation, or other qualitative factors which increase the risk to an investor").

686 *See* note 669 (discussing the NYSSCPA Letter, which suggested a "prudent care" standard for denying issuers under Rule 301(c)).

687 *See* Grassi Letter (stating that an intermediary "should not be required to vet issuers for potential fraud other than would be done through the normal course of assessing whether they wish to do business with a particular issuer").

688 *See, e.g.*, BetterInvesting Letter; Heritage Letter; IAC Recommendation; Jacobson Letter; NSBA Letter.

689 *See* IAC Recommendation; *see also* BetterInvesting Letter.

690 *See* Joinvestor Letter. *See also* ASSOB Letter and Vann Letter.

691 *See, e.g.*, Public Startup Letter 2 (opposing the requirement but suggesting that the Commission maintain a database of known bad actors).

Commission or another agency created a database for such information.[692] One of these commenters suggested that intermediaries should be required to notify a potential issuer when the intermediary uses information from a third party to deny the issuer.[693]

(3) Final Rules

After considering the comments, we are adopting Rule 301(c)(1) as proposed. Rule 301(c)(1) requires an intermediary to deny access to its platform if the intermediary has a reasonable basis for believing that an issuer, or any of its officers, directors (or any person occupying a similar status or performing a similar function), or any 20 Percent Beneficial Owner is subject to a disqualification under Rule 503 of Regulation Crowdfunding. We believe that a "reasonable basis" standard for denying access is an appropriate standard for Rule 301(c)(1), in part because this requirement on an intermediary is buttressed by the fact that an issuer independently is subject to the disqualification provisions under Rule 503, as discussed below.[694] In addition, Rule 301(c)(1) implements the requirement of Section 4A(a)(5) that an intermediary conduct a background and securities enforcement regulatory history check on each issuer whose securities are to be offered by the intermediary, as well as on each of its officers, directors (or any person occupying a similar status or performing a similar function) and 20 Percent Beneficial Owners.

While we understand commenters' concerns about the cost of the requirement that intermediaries conduct background checks on issuers and certain affiliated persons, we are not eliminating or limiting the requirement as suggested by commenters because we believe the

692 *See* StartupValley Letter.

693 *See* Vann Letter.

694 *See* Section II.E.6 (discussing issuer disqualification).

requirement is an important tool for intermediaries to employ when determining whether or not they have a reasonable basis to allow issuers on their platforms. Even though a number of commenters requested that the Commission provide specific requirements for background and securities enforcement regulatory history checks, we are not establishing specific procedures in the final rules. As we indicated in the Proposing Release, we believe that the better approach is to allow an intermediary to be guided by its experience and judgment to design systems and processes to help reduce the risk of fraud in securities-based crowdfunding.[695] We also believe that such flexibility could mitigate cost concerns related to conducting the background and securities enforcement regulatory history checks.

We are not developing a database of denied issuers as suggested by some commenters because we do not believe it would significantly increase investor protection. The requirement to deny an issuer access to a crowdfunding platform under the final rules based on fraud or other investor protection concerns is important to the viability of crowdfunding, and the legitimacy of the intermediary. This obligation is the responsibility of each intermediary, which must make a determination about whether to deny access to an issuer. While a third party may decide to create a database of denied issuers at some point and an intermediary could use such a database to help make its determination as to whether it was required to deny access to an issuer, such a database could not be used as a substitute for an intermediary making its own determination.

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695 We disagree with the commenter that suggested that this method is ineffective because intermediaries lack experience. *See* Consumer Federation Letter. Crowdfunding is a new form of capital formation. We believe, broker-dealers and funding portals will gain the relevant experience that will appropriately position them to develop requirements for conducting background checks required by the rule. In addition, we believe that an intermediary's interest in developing a successful platform will motivate it to conduct rigorous background checks.

We also are not requiring an intermediary to make publicly available the results of the background checks or the sources consulted. We believe that the goal of the background check is sufficiently served by the exclusion of an issuer from the intermediary's platform. We do not believe that making the results or sources publicly available adds a significant degree of investor protection under these circumstances, given the potential problems that could arise from such public disclosure of the results, such as the risk of disclosing personally identifiable information or other information with significant potential for misuse. In addition, we are concerned that such requirements could add to the cost of administration and could expose the individuals at the issuer that are subject to a background check to harm, for example, if there were errors in the information made publicly available.

We are adopting Rule 301(c)(2) substantially as proposed, but with certain revisions. As adopted, Rule 301(c)(2) now contains a "reasonable basis" standard as opposed to the initially proposed "believes" standard. Rule 301(c)(2) requires denial of access to its platform when the intermediary has a reasonable basis for believing that the issuer or offering presents the potential for fraud or otherwise raises concerns about investor protection.[696] In a conforming change, Rule 301(c)(2) also requires (i) an intermediary deny access to an issuer if it reasonably believes that it is unable to adequately or effectively assess the risk of fraud of the issuer or its potential offering, and (ii) if the intermediary becomes aware of information after it has granted the issuer access to its platform that causes it to reasonably believe that the issuer or the offering presents the potential for fraud or otherwise raises concerns regarding investor protection, the intermediary must

696 *See* Section II.D.2. (discussing modified Rule 402(b)(1), which relates to a funding portal's ability to deny access to an issuer).

promptly remove the offering from its platform, cancel the offering and return to investors any funds they may have committed.

We believe that a "reasonable basis" standard is appropriate for Rule 301(c)(2) because it is a more objective standard.[697] Under this standard, an intermediary may not ignore facts about an issuer that indicate fraud or investor protection concerns such that a reasonable person would have denied access to the platform or cancelled the offering. Rule 301(c)(2) is intended to give an intermediary an objective standard regarding the circumstances in which it must act to protect its investors from potentially fraudulent issuers or ones that otherwise present red flags concerning investor protection. This objective standard also will make it easier for an intermediary to assess whether it would be compliant with Rule 301(c)(2) when deciding if it should deny an issuer access or cancel its offering.[698] Thus, we believe these measures likely will promote compliance and help to reduce the risk of fraud with respect to crowdfunding transactions, as required by Section 4A(a)(5). This standard also will provide the Commission with a clear basis to review whether an intermediary's decision not to deny access to its platform or cancel an offering was reasonable given the facts and circumstances.

We are not requiring that an intermediary report the issuers that have been denied access to its platforms, as some commenters suggested, or that the intermediary post a summary of the sources consulted as part of the background check on its platform along with a description of the

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697 Adding the reasonable basis standard to Rule 301(c)(2) also provides a consistent standard across Rule 301, including Rules 301(a), (b) and (c)(1).

698 Aside from the requirement to deny access to issuers under Rule 302(c)(2), it is important to note that intermediaries are permitted to determine whether and under what terms to allow an issuer to offer and sell securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through their platforms. *See* Rule 402(b)(1) and Section II.D.3. The objective standard under Rule 301(c)(2) also helps to clarify that a funding portal would not be providing investment advice or recommendations, if it denies access to or cancels an offering because it has a reasonable basis for believing that there is a potential for fraud or other investor protection concerns. *See* Rule 402(b)(10) of Regulation Crowdfunding and Section II.D.3.i.

intermediary's standards for determining which offerings present a risk of fraud. We also are not adopting a requirement, as suggested by a commenter, that an intermediary notify a potential issuer when the intermediary utilizes third-party information to deny access to the issuer. As with background checks, discussed above, we believe that the investor protection goal is sufficiently served by the exclusion of an issuer from the intermediary's platform. In addition, we are concerned that such requirements could add to the cost of administration and could expose the issuers in question to harm, for example, if there were errors in the information made publicly available. Likewise, we do not believe that requiring an intermediary to post to its website a summary of the sources consulted as part of the background check and a description of the intermediary's standards for determining which offerings present a risk of fraud would sufficiently increase investor protection to justify the burdens, such as those outlined above, that would be associated with imposing such requirements. We also note that providing this information on an intermediary's website may give potentially fraudulent issuers or those that otherwise present investor protection concerns a roadmap to an intermediary's proprietary procedures for screening for fraud that could assist such issuers with impeding or obstructing intermediaries from detecting offerings that present a risk of fraud.

4. Account Opening

a. Accounts and Electronic Delivery

(1) Proposed Rule

Proposed Rule 302(a)(1) of Regulation Crowdfunding would prohibit an intermediary or its associated persons from accepting an investment commitment in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) unless the investor has opened an account with the intermediary, and the intermediary has obtained from the investor consent to electronic

delivery of materials. Proposed Rule 302(a)(2) would require an intermediary to provide all information required by Subpart C of Regulation Crowdfunding, including, but not limited to, educational materials, notices and confirmations, through electronic means.

Proposed Rule 302(a)(2) also would require an intermediary to provide such information through an electronic message that either contains the information, includes a specific link to the information as posted on the intermediary's platform, or provides notice of what the information is and that it is located on the intermediary's platform or the issuer's website. As proposed, Rule 302(a)(2) stated that electronic messages would include, but not be limited to, messages sent via e-mail.

(2) Comments on the Proposed Rule

One commenter suggested that intermediaries who are brokers should not be required to open new accounts for persons who are existing customers of the broker.[699] In response to our request for comments on whether an intermediary should be required to obtain specific information from investors, and if so what type of information should be required, some commenters generally supported requiring an intermediary to gather specific information from investors, particularly identifying information that could help prevent duplicate or fraudulent accounts and information about other intermediary accounts and investments.[700] A few of these commenters supported the Commission requiring intermediaries to collect investors' social

[699] *See* Arctic Island Letter 2.

[700] *See, e.g.*, Consumer Federation Letter; Jacobson Letter; RocketHub Letter.

security numbers.[701] One commenter opposed the Commission requiring intermediaries to obtain particular information from investors.[702]

With respect to electronic delivery, some commenters urged that it should be sufficient for the intermediary simply to make Subpart C materials, such as educational materials, notices and confirmations, available on the intermediary's platform for investors to access.[703] Other commenters broadly opposed permitting intermediaries to satisfy their information delivery requirement by providing an electronic message that informs an investor that information can be found on the intermediary's platform or an issuer's website.[704] One commenter suggested that investors may not actually receive required disclosures because they will not spend the time to find the information.[705] Another commenter suggested that the Commission should "continue to rely instead on the strong and effective policy for electronic delivery of disclosure adopted by the Commission in the mid-1990s."[706] The same commenter noted that it would be "a simple matter to require that any electronic message through which disclosures are delivered include, at a minimum, the specific URL where the required disclosures can be found."[707]

One commenter stated it was concerned that earlier Commission policies on electronic delivery might be read as implying that paper delivery might be permitted in certain

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[701] *See, e.g.*, Consumer Federation Letter; RocketHub Letter.

[702] *See* Public Startup Letter 3.

[703] *See, e.g.*, ASSOB Letter; CrowdCheck Letter 1; RocketHub Letter; Wefunder Letter; Vann Letter.

[704] *See, e.g.*, BetterInvesting Letter; AFR Letter; IAC Recommendation; Consumer Federation Letter ("The definition of electronic delivery must be revised to ensure the disclosures themselves, and not just notices of the availability of disclosures, are delivered to investors.").

[705] *See* Consumer Federation Letter. *See also* Clapman Letter (suggesting that all issuers and their materials must be "publicly accessible for all investors to have the same opportunity to invest" and stating that "no clubs, or paid to view investment style platforms would therefore be allowed").

[706] IAC Recommendation; *see also* BetterInvesting Letter.

[707] IAC Recommendation; *see also* BetterInvesting Letter.

circumstances.[708] This commenter did agree, however, that any electronic message through which disclosures are delivered include, at a minimum, the specific URL where the required disclosures can be found.[709]

In response to our request for comments on whether exceptions to the consent to electronic delivery should be allowed, one commenter stated that account creation and delivery of communication should be completed digitally and that there should be no exemption to allow paper delivery as a substitute.[710] Another commenter stated that investors should be allowed to waive these delivery requirements entirely.[711]

(3) Final Rules

After considering the comments, we are adopting as proposed the account opening and electronic delivery requirements in Rule 302(a). We are not prescribing particular requirements for account opening. Rather, we believe that the final rule provides flexibility to intermediaries given that intermediaries are better positioned than the Commission to determine what information and processes it will require, both as a business decision and to ensure compliance with all applicable regulatory requirements. Therefore, for example, an intermediary can decide whether or not to open a new account for an existing customer. We also are not prescribing under the final rule, as a commenter suggested, that an intermediary be required to collect identifying information that could help prevent duplicative or fraudulent accounts. We believe that even without prescribing particular account opening requirements intermediaries should be able to

708 *See* CFIRA Letter 12.

709 *Id.*

710 *See* RocketHub Letter.

711 *See* Public Startup Letter 3.

identify, by collecting basic account opening information, those accounts that appear to be duplicative or present red flags of potential fraud.

However, the final rules do not permit investors to waive the electronic delivery requirements entirely, as one commenter suggested.[712] We believe that electronic delivery of materials in connection with crowdfunding offerings serves an important and basic investor protection function by conveying information, such as offering materials, that will help investors to make better informed investment decisions and by a method that is appropriately suited to the electronic and Internet-based nature of crowdfunding transactions.

As explained in Section II.A.3, Rule 100(a)(3) of Regulation Crowdfunding requires that crowdfunding transactions be conducted exclusively through an intermediary's platform. Rule 302(a) implements this requirement by requiring that investors consent to electronic delivery of materials in connection with crowdfunding offerings.[713] This requirement applies to all investors, including an existing customer of a registered broker that has not already consented to electronic delivery of materials. Therefore, this requirement will prohibit intermediaries from accepting an investment commitment in a Section 4(a)(6) offering from any investor that has not consented to electronic delivery.

We are adopting substantially as proposed Rule 302(a)(2), which requires that all information required to be provided by an intermediary under Subpart C be provided through electronic means. We have considered the comments but do not believe that it would be sufficient – or consistent with our previous statements about electronic media – for the intermediary simply

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712 *Id.*

713 Certain requirements of Regulation Crowdfunding that require timely actions by issuers and investors will be facilitated by requiring consent to electronic delivery of documents. *See, e.g.*, Section II.C.6 (discussing the five-day periods for investor reconfirmations based on material changes and issuer cancellation notices).

to make Subpart C materials, such as educational materials, notices and confirmations, available on the intermediary's platform for investors to access.[714] Rather, unless otherwise indicated in the relevant rules of Subpart C,[715] the intermediary must provide the information either through (1) an electronic message that contains the information, (2) an electronic message that includes a specific link to the information as posted on the intermediary's platform, or (3) an electronic message that provides notice of what the information is and notifies investors that this information is located on the intermediary's platform or on the issuer's website.[716] We have added to the rule text other examples of electronic messages that are permissible in addition to e-mail messages – specifically text, instant messages, and messages sent using social media.

b. Educational Materials

(1) Proposed Rules

Securities Act Section 4A(a)(3) states that an intermediary must "provide such disclosures, including disclosures related to risks and other investor education materials, as the Commission shall, by rule, determine appropriate," but it does not elaborate on the scope of this requirement. As described in further detail below, proposed Rule 302(b)(1) of Regulation Crowdfunding would

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[714] *See Use of Electronic Media*, Release No. 34-42728 (Apr. 28, 2000) [65 FR 25843, 25853 (May 4, 2000)] (discussing the "access equals delivery" concept and citing *Use of Electronic Media for Delivery Purposes*, Release No. 34-36345 (Oct. 6, 1995) [60 FR 53548, 53454 (Oct. 13, 1995)]).

[715] For example, Rule 303(a) separately requires that an intermediary must make issuer information publicly available on its platform, and so we do not believe that it is necessary to further require intermediaries to send an electronic message regarding the posting of issuer materials.

[716] As noted above, this electronic message could include a specific link to the information as posted on the intermediary's platform. However, we are not requiring intermediaries to provide a link to direct investors to the intermediary's platform or the issuer's website where the information is located. We believe that the final rule provides some flexibility to intermediaries when providing required information through electronic messages given that intermediaries are well-positioned to determine how best to ensure compliance with all applicable regulatory requirements. We also believe that, because of the widespread use of the Internet, as well as advances in technology that allow funding portals to send various electronic messages, our final rule requires sufficient notice to investors.

require intermediaries to deliver to investors, at account opening, educational materials that are in plain language and otherwise designed to communicate effectively and accurately certain specified information. Proposed Rules 302(b)(1)(i)-(viii) would require the materials to include:

- the process for the offer, purchase and issuance of securities through the intermediary;
- the risks associated with investing in securities offered and sold in reliance on Section 4(a)(6);
- the types of securities that may be offered on the intermediary's platform and the risks associated with each type of security, including the risk of having limited voting power as a result of dilution;
- the restrictions on the resale of securities offered and sold in reliance on Section 4(a)(6);
- the types of information that an issuer is required to provide in annual reports, the frequency of the delivery of that information, and the possibility that the issuer's obligation to file annual reports may terminate in the future;
- the limits on the amounts investors may invest, as set forth in Section 4(a)(6)(B);
- the circumstances in which the issuer may cancel an investment commitment;
- the limitations on an investor's right to cancel an investment commitment;
- the need for the investor to consider whether investing in a security offered and sold in reliance on Section 4(a)(6) is appropriate for him or her; and
- that following completion of an offering, there may or may not be any ongoing relationship between the issuer and intermediary.

Proposed Rule 302(b)(2) would further require intermediaries to make the current version of the educational materials available on their platforms, and to make revised materials available to all

investors before accepting any additional investment commitments or effecting any further transactions in securities offered and sold in reliance on Section 4(a)(6).

(2) Comments on Proposed Rules

Commenters generally supported distribution of educational materials through intermediaries.[717] Some stated that intermediaries should be required to submit educational materials to the Commission or to FINRA because oversight and review is needed for materials that will be used by unsophisticated investors,[718] while others stated that intermediaries should not be required to submit educational materials to the Commission or to FINRA because it would be cumbersome and expensive.[719] One commenter stated that the proposed requirements should be modified to state that education must be done prior to an investor's first investment in a Section 4(a)(6) offering, not at account opening.[720]

Some commenters suggested that additions be made to the scope of information proposed to be required in an intermediary's educational materials,[721] to include information about exit strategies;[722] principles of investing in crowdfunding and how to evaluate investment

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[717] *See, e.g.*, Arctic Island Letter 6; CFA Institute Letter; Cole Letter; Consumer Federation Letter; Gimpelson Letter 2; Heritage Letter; Jacobson Letter; NSBA Letter; Patel Letter; RocketHub Letter; STA Letter; StartupValley Letter; Wefunder Letter.

[718] *See, e.g.*, Consumer Federation Letter; Gimpelson Letter 2; Jacobson Letter. *See also* RocketHub Letter (stating that "if educational materials are submitted to the Commission for approval, such approval should act to limit liability of the Portal under the Act").

[719] *See, e.g.*, Arctic Island Letter 6; Joinvestor Letter; StartupValley Letter; Wefunder Letter.

[720] *See* Arctic Island Letter 6. The commenter also stated that the educational material requirements should only apply to unaccredited investors, but we note that the requirement under Section 4A(a)(4) runs to "each investor." As discussed above, we believe that Congress intended for crowdfunding transactions under Section 4(a)(6) to be available equally to all types of investors. Consistent with that approach, we do not believe at this time it would be appropriate to tailor the educational requirements for any particular type of investor or to create an exemption for accredited investors. Further, issuers can rely on other exemptions to offer and sell securities to accredited investors or institutional investors.

[721] *See, e.g.*, Anonymous Letter 1; Gimpelson Letter 2; RocketHub Letter; STA Letter; Angel Letter 1.

[722] *See* Anonymous Letter 1.

opportunities in privately held companies;[723] the risks associated with crowdfunding investments;[724] and reasons for investors to maintain their own personal records concerning crowdfunding investments.[725] One commenter suggested that educational materials "should include an industry standard disclosure document on the benefits and risks of crowdfunding investments."[726] This commenter indicated that "having these generic risk factors in the industry standard educational materials will help focus the company specific disclosure on the factors that are most important."[727]

Some commenters suggested that intermediaries should be required to design questionnaires to increase investor knowledge and to monitor whether investors actually access materials.[728] One commenter suggested that in addition to an "interactive questionnaire," the Commission should also "require that investors reaffirm each time they invest that they understand the risks associated with crowdfunding, can afford to lose their entire investment, and do not expect to need the funds being invested in the near term."[729]

Some commenters stated that we should develop model educational materials for investors or specify the content for intermediaries.[730] One commenter suggested that the Commission, state

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723 *See* Gimpelson Letter 2.

724 *See* RocketHub Letter.

725 *See* STA Letter.

726 *See* Angel Letter 1.

727 *Id.* (suggesting an issuer-specific disclosure document).

728 *See, e.g.*, AFR Letter; BetterInvesting Letter; Consumer Federation Letter; IAC Recommendation. One commenter also suggested requiring intermediaries to post a list of previous offerings on their web sites with information about the offerings. *See* Angel Letter 1.

729 IAC Recommendation; *see also* BetterInvesting Letter.

730 *See, e.g.*, CFA Institute Letter; Guzik Letter 1; Heritage Letter; Jacobson Letter; Joinvestor Letter; NSBA Letter; STA Letter. *See also* CfPA Letter (stating that guidance on the requirements for educational materials and certification of compliance should be created and administered by an industry-related body with approval and oversight by the Commission).

securities regulators, and FINRA, together, should develop "a sample guide" designed to alert investors to the risks of crowdfunding including, among other things, "the high failure rate of small startup companies, the fact that shares will not be set based on market data and may therefore be mispriced, the lack of liquidity, and the risk that, absent appropriate protections, the value of their shares could be diluted."[731] This commenter also suggested that the guide "should include explicit warnings that investors should not invest in crowdfunding unless they can afford to lose the entire amount of their investment or if they expect to have an immediate need for the funds."[732] This commenter also stated that regulators should test the materials with investors to ensure their effectiveness.[733]

One commenter stated that we should not limit or specify the type of electronic media being used to communicate educational material.[734] Finally, one commenter opposed all the educational requirements for intermediaries, and suggested instead that the Commission itself, rather than intermediaries, should provide investor educational materials to both investors and issuers with funding portals linking to, for example, the SEC webpage or an open source website containing any Commission drafted educational materials.[735]

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[731] IAC Recommendation; *see also* BetterInvesting Letter.

[732] *Id.*

[733] *Id.* (suggesting that the Commission should take additional steps "to strengthen requirements with regard to content and delivery of educational materials in order to increase the likelihood both that they will be read and that they will clearly convey the essential information"); *see also* CFIRA Letter 12 (agreeing with IAC's suggestion that the Commission "could establish a set of standard educational requirements for the industry that could be adopted by intermediaries").

[734] *See* Gimpelson Letter 2.

[735] *See* Public Startup Letter 3.

(3) Final Rules

After considering the comments, we are adopting Rule 302(b) relating to educational materials substantially as proposed, but adding one further requirement as to the content of the materials. We believe that, consistent with Section 4A(a)(3) it is appropriate that intermediaries, rather than the Commission (as a commenter suggested), be required to provide such disclosures, including disclosures related to risks and other investor education materials as the Commission determines to be appropriate. We believe that intermediaries are better equipped and positioned, as compared to the Commission, to provide educational materials to investors that are reasonably tailored to an intermediary's offerings and investors, particularly in light of their access to and interactions with investors.

We further believe that the scope of information that we are requiring to be included in an intermediary's educational materials is appropriate. In the Proposing Release we discussed our rationales for requiring the different types of disclosures in the educational materials. As we noted in the Proposing Release, we generally drew upon the statutory provisions when including disclosures required in the educational materials relating to the risks of investing in securities offered and sold in reliance on Section 4(a)(6), investors' cancellation rights, resale restrictions and issuer reporting.[736] The circumstances in which an investor can cancel an investment commitment and obtain a return of his or her funds are particularly important to an investor's understanding of the investment process and may affect an investor's decision to consider any offerings made pursuant to Section 4(a)(6). The items required to be included, pursuant to Rule 302(b)(1)(i) through (viii), in the educational materials are basic terms, relevant to transactions conducted in reliance on Section 4(a)(6), of which all investors should be aware before making an

[736] *See* Securities Act Sections 4A(a)(4), 4A(a)(7), 4A(e), and 4A(b)(4).

investment commitment. Furthermore, information on the various types of securities that can be available for purchase on the intermediary's platform, any applicable resale restrictions, and the risks associated with each type of security, including the risk of having limited voting power as a result of dilution can affect an investor's decision to consider any offerings made pursuant to Section 4(a)(6). In addition, we are adding Rule 302(b)(1)(ix) to require the educational materials to indicate that under certain circumstances an issuer may cease to publish annual reports and, therefore, an investor may not continually have current financial information about the issuer. We are adding this requirement because we believe that it is important for investors to be able to consider the ongoing availability of information about an issuer's financial condition when they assess whether to invest in that issuer.

The final rule provides each intermediary with sufficient flexibility to determine: (1) the content of the educational materials, outside of the minimum specified information required to be included under Rule 302(b)(1)(i)-(viii), and (2) the overall format and manner of presentation of the materials. We believe this flexibility will allow the intermediary to prepare and present educational materials in a manner reasonably tailored to the types of offerings on the intermediary's platform and the types of investors accessing its platform. While we have determined not to provide model educational materials, impose additional content (beyond those proposed) or format requirements, mandate particular language or manner of presentation, or require that an intermediary design an investor questionnaire, as suggested by commenters, the final rules do not prohibit an intermediary from providing additional educational materials if they choose. For example, because the final rules do not require an intermediary to design a questionnaire, intermediaries maintain the flexibility in meeting the rule's requirements to determine whether such a disclosure format would be cost effective and appropriate particularly in

light of that intermediary's particular business model. We further note the suggestion by some commenters that we require additional information in the educational materials, including, for example, requiring an intermediary to discuss exit strategies, how to evaluate investment opportunities in privately held companies, and the reasons for investors to maintain their own personal records concerning crowdfunding investments. Although these suggestions may provide investors with some useful information, we are not persuaded that imposing such additional requirements in the final rule is necessary at this time as it is unclear that those suggestions would significantly strengthen the investor protections that will result from Rule 302(b) as adopted. We also believe that adding such requirements may overly complicate these educational materials and increase the costs associated with preparing them. Therefore, we have determined to allow intermediaries the flexibility to prepare educational materials reasonably tailored to their offerings and investors, provided the materials meet the standards and include the information required to be provided under Rule 302(b).[737]

We also recognize that FINRA or any other registered national securities association may implement additional educational materials requirements. We are not, however, as one commenter suggested,[738] requiring at this time that intermediaries submit their educational materials to the Commission or to a registered national securities association for review and approval. We note, however, that a registered national securities association could propose such a requirement as its oversight of intermediaries in this new market evolves. Any such proposed

[737] We note that educational materials may be subject to examination and inspection. *See* Section II.D.5. (describing the recordkeeping obligations of funding portals).

[738] *See* RocketHub Letter (stating that "if educational materials are submitted to the Commission for approval, such approval should act to limit liability of the Portal under the Act").

requirement would be considered by the Commission, and subject to public notice and opportunity for comment, pursuant to Exchange Act Section 19(b) and Rule 19b-4.

Rule 302(b)(2) requires an intermediary to keep its educational materials accurate. Accordingly, an intermediary must update the materials as needed to keep them current. In addition, if an intermediary makes a material revision to its educational materials, the rule requires that the intermediary make the revised educational materials available to all investors before accepting any additional investment commitments or effecting any further crowdfunding transactions. An intermediary will also be required to obtain a representation that an investor has reviewed the intermediary's most recent educational materials before accepting an investment commitment from the investor.[739]

We believe that these requirements will benefit investors by helping to ensure that they receive information about key aspects of investing through the intermediary's platform, including aspects that may have changed since the last time they received the materials, prior to making investment commitments, as that information can influence their investment decisions. We also believe that requiring intermediaries to update materials on an ongoing basis, rather than at certain specified intervals, will help to ensure that those materials are updated as circumstances warrant, which, in turn, will provide investors with more current information and increase investor protection.

c. Promoters

(1) Proposed Rule

Securities Act Section 4A(b)(3) provides that an issuer shall "not compensate or commit to compensate, directly or indirectly, any person to promote its offerings through communication

[739] *See* Rule 303(b)(2)(i) of Regulation Crowdfunding.

channels provided by a broker or funding portal, without taking such steps as the Commission shall, by rule, require to ensure that such person clearly discloses the receipt, past or prospective, of such compensation, upon each instance of such promotional communication." Under Rule 205 of Regulation Crowdfunding, as discussed above, an issuer can compensate persons to promote its offerings through communications channels provided by the intermediary on its platform, where certain conditions are met.[740]

We separately proposed in Rule 302(c) of Regulation Crowdfunding to require the intermediary to inform investors, at the account opening stage, that any person who promotes an issuer's offering for compensation, whether past or prospective, or who is a founder or an employee of an issuer that engages in promotional activities on behalf of the issuer on the intermediary's platform, must clearly disclose in all communications on the platform the receipt of the compensation and the fact that he or she is engaging in promotional activities on behalf of the issuer.

(2) Comments on Proposed Rules

Some commenters suggested that the promoter disclosures should not be made at account opening where they may be ignored.[741] One commenter proposed that the disclosures should be made "prior to any participant on the platform being able to post comments, reviews, ratings, or other promotional activities."[742]

[740] *See* Rule 205 of Regulation Crowdfunding and the discussion in Section II.B.5.

[741] *See, e.g.*, Arctic Island Letter 6; Wefunder Letter.

[742] *See* Arctic Island Letter 6.

(3) Final Rules

We are adopting, as proposed, Rule 302(c) requiring intermediaries to inform investors, at the time of account opening, that promoters must clearly disclose in all communications on the platform the receipt of the compensation and the fact that he or she is engaging in promotional activities on behalf of the issuer. As noted in the Proposing Release, in addition to the information required under Rule 302(c), promoters will also be required to comply with Section 17(b) of the Securities Act, which requires promoters to fully disclose to investors the receipt, whether past or prospective, of consideration and the amount of that compensation.[743] We believe that the disclosures required by Rule 302(c) will help alert investors at the outset, rather than after the account is opened, of the fact that information about the promotional activities of issuers or representatives of issuers will be disclosed at a later time on the platform, pursuant to Rule 303(c)(4). We believe that the account opening is the appropriate time for this disclosure because it gives investors notice of potential promotional activities by issuers and their representatives prior to making investment commitments. As discussed below, Rule 303(c)(4) separately mandates that intermediaries require any person, when posting a comment in the communication channels, to clearly disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or receives compensation, whether in the past or prospectively, to promote an issuer's offering. We believe that the disclosure requirements of Rule 302(c), when coupled with the additional disclosure requirements in Rule 303(c)(4), will promote a transparent information sharing process whereby investors are able to discern the sources of information that they are receiving and any potential conflicts of interest by those sources.

743 *See* Proposing Release at 78 FR 66467-68. *See also* Section 17(b) of the Securities Act (15 U.S.C. 77q(b)).

d. Compensation Disclosure

(1) Proposed Rule

Proposed Rule 302(d) of Regulation Crowdfunding would require that intermediaries, when establishing an account for an investor, clearly disclose the manner in which they will be compensated in connection with offerings and sales of securities made in reliance on Section 4(a)(6). This requirement would help to ensure investors are aware of any potential conflicts of interest that may arise from the manner in which the intermediary is compensated. Rule 201(o) of Regulation Crowdfunding, which is discussed in Section II.B.1, separately requires an issuer to disclose in its offering materials, among other things, the amount of compensation paid to the intermediary for conducting a particular offering, including the amount of referral and any other fees associated with the offering.

(2) Comments on Proposed Rule

Several commenters supported the disclosure of intermediary compensation.[744] One commenter stated that the account opening is not an appropriate time to mention compensation, asserting that the account opening stage should be dedicated to discussing the risk of startup investing.[745] One commenter suggested that the best way for an intermediary to disclose compensation is through a "Costs and Fees" page on its website.[746] Another commenter requested that the Commission define compensation as any fees or compensation collected by the

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744 *See, e.g.*, Arctic Island Letter 6; ASSOB Letter; CFA Institute Letter; Commonwealth of Massachusetts Letter; Joinvestor Letter; StartupValley Letter; Wefunder Letter.

745 *See* Wefunder Letter.

746 *See* StartupValley Letter.

intermediary in connection with a Section 4(a)(6) transaction, subject to Commission and FINRA rules.[747]

(3) Final Rules

We are adopting Rule 302(d) as proposed. We believe that requiring intermediaries to provide information to investors about the manner in which they will be compensated at account opening, rather than at a subsequent time, will provide investors with notice of how the intermediary is being compensated at a threshold stage in the relationship (*i.e.*, account opening), which, in turn, will help investors make better-informed decisions. We note that the final rules – unlike the proposed rules – allow intermediaries to receive a financial interest in the issuer as compensation, subject to certain limitations.[748] Therefore, an intermediary that receives or may receive a financial interest in an issuer in the future as compensation for its services is required to disclose that compensation at account opening. We also note that Rule 201(o), which is discussed in Section II.B.1 and separately requires an issuer to disclose in its offering materials a description of the intermediary's interests in the issuer's transaction, including the amount of compensation paid or to be paid to the intermediary for conducting a particular offering, the amount of referral and any other fees associated with the offering. We are not defining compensation as one commenter suggested, as we believe the final rule's requirement to clearly disclose the manner in which an intermediary will be compensated in connection with offerings and sales of securities made in reliance on Section 4(a)(6) is sufficiently clear, and because we are also concerned that a definition of compensation could be both under- and over-inclusive in a new and evolving crowdfunding market.

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747 *See* CFIRA Letter 4.

748 *See* Section II.C.2.b.

5. Requirements with Respect to Transactions

a. Issuer Information

(1) Proposed Rule

Securities Act Section 4A(a)(6) requires each intermediary to make available to the Commission and investors, not later than 21 days prior to the first day on which securities are sold to any investor (or such other period as the Commission may establish), any information provided by the issuer pursuant to Section 4A(b).[749] Accordingly, we proposed Rule 303(a) of Regulation Crowdfunding to implement this provision by requiring each intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) to make available to the Commission and to investors any information required to be provided by the issuer under Rules 201 and 203(a) of proposed Regulation Crowdfunding. As proposed, Rule 303(a) would require that this information: (1) be publicly available on the intermediary's platform, in a manner that reasonably permits a person accessing the platform to save, download or otherwise store the information; (2) be made publicly available on the intermediary's platform for a minimum of 21 days before any securities are sold in the offering, during which time the intermediary may accept investment commitments; and (3) remain publicly available on the intermediary's platform until the offer and sale of securities is completed or cancelled (including any additional information provided by the issuer). In addition, under Proposed Rule 303(a)(4), an intermediary would be prohibited from requiring any person to establish an account with the intermediary in order to access this information.

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[749] As discussed in Section II.B, Securities Act Section 4A(b) establishes the requirements for an issuer that offers or sells securities in reliance on Section 4(a)(6).

(2) Comments on the Proposed Rule

Several commenters suggested that so long as issuer information is made available on the intermediary's platform, the rules should not mandate the delivery of this information, in addition to or in lieu of, making the information available on the intermediary's platform.[750]

One commenter stated that having information about a deal publicly available on the intermediary's website will increase the potential for fraud—specifically, potential fraud involving "data scraping" from websites (*i.e.*, copying data from these websites in order to use that data for fraudulent purposes).[751] This same commenter suggested that that there should be two levels of disclosure: the first, would be available to all and would contain certain general information about the issuer and the terms of deal, and the second would be made available only after investors proceed through a membership registration process and would contain disclosure documents, financial information, legal disclosures and further information.[752]

As to the amount of time that an intermediary should display issuer materials prior to the first day on which securities are sold to any investor, some commenters supported the 21-day time frame as a sufficient minimum period that offering information should be made available through the intermediary's platform.[753]

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750 *See, e.g.*, Arctic Island Letter 6 (suggesting that an electronic copy of the signed subscription agreement and risk disclosures should be sent to the investor via email, and that "[e]verything else can be referenced by the investor online at any time"); ASSOB Letter; CrowdCheck Letter (suggesting that the Commission remove the requirement in the proposed rules that would effectively limit the presentation of information to only formats that can be saved and downloaded by prospective investors); RocketHub Letter; Wefunder Letter; Vann Letter (stating that no particular means of delivery to investors should be required because "technologies may change" and intermediaries should be allowed to use whatever means "appropriate").

751 *See* StartupValley Letter.

752 *Id. See also* Early Shares Letter (suggesting a permission-based system for the disclosure of certain "sensitive" information about the offering).

753 *See, e.g.*, ASSOB Letter; RocketHub Letter.

Although one commenter objected to intermediaries displaying any issuer materials,[754] several commenters supported requiring intermediaries to continue to display issuer materials for some period of time after completion of the offering.[755] One commenter, however, stated that intermediaries should not be required to display issuer materials for closed offerings.[756] Another commenter stated that "[o]nce an offering is complete, an issuer should have the right to limit publicly available information."[757]

We also requested comments as to whether an intermediary should make efforts to ensure that an investor has actually reviewed the relevant issuer information. A few commenters expressed concern with requiring intermediaries to ensure that an investor has reviewed the relevant issuer information.[758] Another commenter suggested that an investor "should demonstrate, through a representation of acknowledgment, that they have reviewed all relevant issuer information."[759]

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754 *See* Public Startup Letter 3.

755 *See, e.g.*, Arctic Island Letter 6 (stating that an issuer's offering materials should be permanently displayed so it can easily be referenced in the future); ASSOB Letter (suggesting a period of at least two years after receiving funding from the offering); Jacobson Letter (suggesting a period of at least six years after an offering closes); RocketHub Letter (recommending that issuer materials should remain displayed for an additional 30 days after completion of the offering and further suggesting that "[i]ntermediaries should have the right, at their own discretion, to continue to display the entire offering, or parts of it, for as long as they see fit").

756 *See* Whitaker Chalk Letter (stating that removing such materials from the intermediary's platform would prevent the public from relying on "stale" information and opposing the requirement that intermediaries keep public any such "stale" information so long as the information remain subject to the intermediary's recordkeeping requirements).

757 *See* RocketHub Letter.

758 *See, e.g.*, Arctic Island Letter 6 (stating that such a requirement "could make things incredibly messy and expensive"); Wefunder Letter.

759 RocketHub Letter.

(3) Final Rules

After considering the comments, we are adopting, as proposed, Rule 303(a). As stated in the Proposing Release, we believe that the requirement in Rule 303(a) that the information must be made publicly available on the intermediary's website satisfies the requirement under Section 4A(d) for the Commission to "make [available to the states], or . . . cause to be made [available] by the relevant broker or funding portal, the information" issuers are required to provide under Section 4A(b) and the rules thereunder. Moreover, this approach should help investors, the Commission, FINRA (and any other applicable registered national securities association) and other interested parties, such as state regulators, to access information without impediment. Therefore, we believe that this rule is not only consistent with the statute but that it also enhances investor protection by having issuer information about a crowdfunding security publicly available on the intermediary's website. While we considered the concern expressed by one commenter that having such information available on the intermediary's website would increase the potential for "data scraping,"[760] we believe the expected benefits of the requirement to investors and other interested persons, as discussed above, justifies the risk of potential harm from such potential activities.

We note that commenters who addressed the issue generally supported a 21-day time frame as the minimum period that offering information should be made available through the intermediary's platform prior to the first day on which securities are sold to any investor. Under the final rules, the information must remain available on the platform until the offering is completed or canceled. While some commenters suggested that the rule should require intermediaries to continue to display issuer materials for some period of time after completion of

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[760] *See* StartupValley Letter.

the offering, we are not prescribing such a requirement nor are we prohibiting intermediaries from doing so if they so choose. Although we appreciate that historical issuer information may provide helpful background for investors generally, we are concerned that imposing such a requirement could potentially result in persons relying on potentially stale issuer information particularly given the nature of the crowdfunding market (*i.e.*, we assume that each issuer generally will conduct only one offering per year).[761] We note that intermediaries nonetheless are required to retain the information in accordance with their obligation to make and preserve for a period of time records with respect to any written materials that are used as part of an intermediary's business, including issuer materials made available on their platforms.[762]

While the intermediary plays an important gatekeeper function, the investor has responsibility for his or her actions as well. To that end, we are not requiring that an intermediary ensure that an investor has actually reviewed the relevant issuer information. We believe that the requirements of Rule 303(a) provide an investor with the relevant issuer information and an adequate period of time in which to evaluate the investment opportunity before investing. We are not at this time imposing additional requirements on the intermediary in this regard.

761 As discussed in Section IV.B.1, we assume, for purposes of the Paperwork Reduction Act, that each issuer will conduct one offering per year.

762 Registered brokers would have to maintain records pursuant to Exchange Act Section 17 and the rules thereunder. 15 U.S.C. 78q; 17 CFR 240.17a *et seq*. Funding portals would be subject to the recordkeeping requirements of proposed Rule 404 of Regulation Crowdfunding. *See* Section II.D.5 (discussing the recordkeeping requirements we are adopting for funding portals).

b. Investor Qualification

(1) Compliance with Investment Limits

(a) Proposed Rule

Securities Act Section 4(a)(6)(B) limits the aggregate amount of securities that can be sold by an issuer to an investor in reliance on Section 4(a)(6) during a 12-month period. Securities Act Section 4A(a)(8) requires that intermediaries "make such efforts as the Commission determines appropriate, by rule" to ensure that no investor has made purchases in the aggregate, from all issuers, that exceed the limits in Section 4(a)(6).

Proposed Rule 303(b)(1) of Regulation Crowdfunding would implement this latter provision by requiring that, each time before accepting an investment commitment on its platform (including any additional investment commitment from the same person), an intermediary must have a reasonable basis for believing that the investor satisfies the investment limits established by Section 4(a)(6)(B). The proposed rule would allow an intermediary to rely on an investor's representations concerning annual income, net worth and the amount of the investor's other investments in securities sold in reliance on Section 4(a)(6) through other intermediaries unless the intermediary has a reasonable basis to question the reliability of the representation.

(b) Comments on the Proposed Rule

A number of commenters supported the proposed requirements for enforcing investment limits and intermediary responsibility for investor compliance,[763] while a few commenters

[763] *See, e.g.*, BetterInvesting Letter; CFA Institute Letter; CFIRA Letter 12; Finkelstein Letter; IAC Recommendation; Milken Institute Letter. *See also* NAAC Letter (stating that unsophisticated investors might not comply with the investment limits or be targets for fraudulent schemes, and recommending "verified and stringent determinations as to the income and net worth qualifications of any potential investors.").

opposed the requirements.[764] Several commenters suggested ways to strengthen the requirements, such as by: requiring that an intermediary conduct more stringent checks,[765] having the Commission maintain a registry of those who have purchased crowdfunding securities,[766] requiring that investors electronically upload financial documents for verification of income or net worth,[767] requiring notices detailing investment limits and highlighting their importance,[768] and precluding an investor who violates the investment limits from bringing a cause of action against an issuer.[769] Some commenters suggested that the Commission require intermediaries to create a tool for investors to use, such as a questionnaire, to assemble the underlying data on which investment limits are calculated and to perform those calculations electronically.[770] However, another commenter disagreed with this suggestion.[771] One commenter suggested intermediaries' platforms be required to provide to investors prior to accepting an investment commitment a detailed statement of the investment limits that are applicable to investors that also includes a

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764 *See, e.g.,* Moskowitz Letter (stating that select investors on the secondary market could purchase shares in excess of the investment limit and suggesting that the limits be removed altogether); Phillips Letter.

765 *See, e.g.,* Moskowitz Letter; NAAC Letter.

766 *See* Clapman Letter. *See also* CFA Institute Letter (suggesting that the Commission require intermediaries to "cross check each investor's information against other files on record with the Commission to ensure compliance with the law's limitations").

767 *See, e.g.,* Consumer Federation Letter; Finkelstein Letter.

768 *See* Milken Institute Letter.

769 *Id.*

770 *See, e.g.,* CFA Institute Letter (suggesting that "investors be required to complete online questionnaires denoting the different classes of asset holdings permitted by the law, with a specific and prominent notification that the value of one's primary residence is excluded"); IAC Recommendation (stating that the tool, such as an electronic work sheet, would assist investors in identifying categories of assets and liabilities such as bank accounts, investment accounts, and house value, for purposes of the net worth calculation, and prompt them to deduct outstanding liabilities and exclude the value of principle residence). *See also* BetterInvesting Letter.

771 *See* CFIRA Letter 12 (disagreeing with IAC's suggestion "that portals create a 'tool' to walk investors through the creation of what is essentially a personal balance sheet").

penalty of perjury certification by the investor.[772] A few commenters emphasized a need to warn investors that the value of their primary residence should be excluded for purposes of the net worth calculation.[773] Commenters also suggested that the Commission adopt an approach similar to that under the capital gains tax rules that would limit benefits and loss recovery for investors who invest outside of their limits.[774]

Several commenters opposed the proposal to allow an intermediary to rely on the representations of an investor.[775] Some urged the Commission to provide for verification through either a third-party service or through the intermediaries themselves in lieu of reliance on investor representations.[776] Other commenters suggested that intermediaries should be required to take certain affirmative steps to verify investor representations.[777] One commenter stated that the strongest possible approach to a verification requirement should be imposed for investments beyond $2,000.[778] Another commenter suggested that the Commission create penalties for

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772 *See* Milken Institute Letter ("This would underscore the importance of the investor caps . . . and properly place the burden of compliance on the actor who can verify income or wealth at the lowest cost -- the investor.").

773 *See, e.g.*, Brown J. Letter; CFA Institute Letter; Consumer Federation Letter.

774 *See, e.g.*, Milken Institute Letter (supporting the proposed investment caps, but agreeing with precluding loss recovery); Phillips Letter.

775 *See, e.g.*, Accredify Letter (stating that self-certifications are not an effective way to implement the investment limit requirements and suggesting that intermediaries be required to use existing services to check individuals' investment limits); AFL-CIO Letter; AFR Letter; Brown J. Letter; Commonwealth of Massachusetts Letter; Consumer Federation Letter; Farnkoff Letter; Letter Finkelstein Letter; Jacobson Letter; Merkley Letter (noting that permitting self-certification would expose investors to precisely the risks that the statute aimed to prevent, and should not be permitted for investments over $2,000); Saunders Letter; Verinvest Letter.

776 *See, e.g.*, Accredify Letter; Commonwealth of Massachusetts Letter; Farnkoff Letter ("A third-party verification regime overseen by the SEC or FINRA would provide the safest protection from fraudsters and reduce risks of liability for funding portals."); Saunders Letter; Verinvest Letter.

777 *See, e.g.*, AFL-CIO Letter; Jacobson Letter.

778 *See* Merkley Letter (suggesting that the Commission could reconsider possible options to relax any strict initial approach after the first few years of the final rules being in effect, and stating that "it would be incredible if the verification requirements for ordinary investors in crowdfunding were permitted to be less than for accredited investors under Rule 506(c)").

intermediaries who fail to meet their duties regarding investment limits.[779] One commenter suggested the Commission should require crowdfunding portals to collect enough data from investors to avoid the most likely errors in calculating the investment limit and to prevent evasion of those limits. This commenter also suggested that the Commission should require portals to collect social security numbers to help prevent individuals from evading limits by opening multiple accounts under false names.[780]

Other commenters supported the proposal to allow an intermediary to rely on the representations of an investor.[781] Some of these commenters warned against costly compliance requirements such as, for example, requiring verification of investment limits by both the issuer and the intermediary,[782] or burdening a broker-dealer with a vetting requirement for someone who may only want to invest a small amount, such as $25.[783]

Several commenters supported requiring an intermediary to confirm investment limits compliance using a centralized database, should one become established.[784] A number of these commenters suggested the database be created and managed by the Commission with mandatory intermediary participation[785] to allow intermediaries to check an investor's total year to date

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[779] *See* Commonwealth of Massachusetts Letter.

[780] *See* AFR Letter.

[781] *See, e.g.*, Arctic Island Letter 6; ASSOB Letter; CFA Institute Letter; Greenfield Letter; Heritage Letter; Joinvestor Letter; Patel Letter; Public Startup Letter 3; RocketHub Letter.

[782] *See* Heritage Letter.

[783] *See* Arctic Island Letter 6.

[784] *See, e.g.*, BetterInvesting Letter; Arctic Island Letter 6; Consumer Federation Letter; Finkelstein Letter; IAC Recommendation; Merkley Letter; Verinvest Letter. *See also* CFA Institute Letter (suggesting that "the Commission require such intermediaries to cross check each investor's information against other files on record with the Commission to ensure compliance with the law's limitations").

[785] *See, e.g.*, Arctic Island Letter 6; Consumer Federation Letter; Finkelstein Letter. *See also* CFA Institute Letter.

purchases across all platforms.[786] One commenter stated that the statute "contemplates" the development of a central data repository and suggested that it could be established at the relevant national securities association.[787] Another commenter suggested, in connection with its support for the use of a centralized database, imposing a three-to-five year time limit, after which intermediaries would no longer be permitted to rely on investor representations about their investments on other platforms.[788] One commenter suggested the Commission incentivize the private creation of a centralized database.[789] Another opposed the Commission imposing any obligation on intermediaries until after such a centralized database is established.[790] Another commenter, supporting the creation of a single, centralized database, warned that "competing databases" would be incomplete.[791]

Others commenters expressed concern that the proposed rule included no mechanism to prevent investors from registering with multiple platforms and investing far in excess of the statutory limits.[792] Commenters who addressed the issue supported requiring intermediaries to request information about any other intermediary accounts prior to accepting an investment

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786 *See* Finkelstein Letter.

787 *See* Merkley Letter (noting that the proposal "does not establish such a repository or set forth any path towards its establishment and thus fails to implement the plain meaning of the statutory language" and suggesting that "[t]esting, supervisory oversight, and other mechanisms to ensure investors are protected . . . be more fully considered").

788 *See* Consumer Federation Letter.

789 *See* IAC Recommendation (suggesting the Commission create such an incentive by monitoring the effectiveness of the proposed reasonable reliance approach and to end that approach if a cost-effective and suitable cross-portal monitoring system is developed); *see also* BetterInvesting Letter.

790 *See* Wefunder Letter.

791 *See* CFIRA Letter 12.

792 *See, e.g.*, Finkelstein Letter; Vann Letter (stating that intermediaries should be required to "make it clear that the aggregate limits apply across all such platforms, not just their own").

commitment.[793] One of these commenters suggested requiring intermediaries to add a text box to their site that requires the investor to input the total dollar amount invested on other platforms.[794] The other commenter stated that an intermediary should only be required to request additional information if there are doubts about the investor's self-certification.[795]

(c) Final Rules

After considering the comments, we are adopting Rule 303(b)(1) as proposed. As a threshold matter, we note that a number of commenters supported the proposed approach for establishing compliance with investment limits. Although we appreciate some of the additional suggestions provided by commenters, as outlined above, we believe the approach in Rule 303(b)(1) for establishing compliance with investment limits is an appropriate means of implementing the provisions of Section 4A(a)(8), which is designed to help ensure that an investor has not made purchases, in the aggregate from all issuers, that exceed those limits during a 12-month period. We note, however, that intermediaries can, in their discretion, take additional measures for evaluating investors' compliance with investment limits, including those suggested by commenters, such as: using a centralized data repository, to the extent that one is created; requiring verification of income or net worth electronically by uploading financial documents; or creating a tool for investors to use, such as a questionnaire, to assemble the underlying data.

While several commenters opposed permitting an intermediary to rely on the representations of an investor about investment limits and some suggested requiring intermediaries to take certain affirmative steps to verify compliance, we believe that it would be

793 *See, e.g.*, ASSOB Letter; Wefunder Letter.

794 *See* Wefunder Letter.

795 *See* ASSOB Letter.

difficult for intermediaries to monitor or independently verify whether each investor remains within his or her investment limits where the investor may be participating in offerings on multiple platforms. We note, however, that reliance on investor representations must be reasonable. At a minimum, it would not be reasonable, and therefore would be a violation of the rule and potentially subject to an enforcement action by the Commission, for an intermediary to ignore investments made by an investor in other offerings on the intermediary's platform, to not obtain information and take into account investments made by an investor in other offerings (made in reliance on Section 4(a)(6)) on platforms that are controlled by or under common control with the intermediary, or to ignore other information or facts about an investor within its possession.

Under the final rules, an intermediary will be permitted to reasonably rely on a centralized data repository of investor information, should one be created in the future. We are not mandating the creation of such a database at this time, in part to help to minimize the obstacles that intermediaries may face in getting this newly formed marketplace up and running.[796] We note, in response to one commenter,[797] that it is the Commission's normal practice to review the effectiveness of all of its rules, particularly in light of market developments, and consider changes as the Commission deems appropriate. Commission staff expects to review the need for a

[796] We do not believe that the statute requires the establishment of a centralized database or repository of investor information as one commenter suggested. *See* Merkley Letter. Instead, the statute calls for intermediaries to "make such efforts as the Commission determines appropriate, by rule" to ensure that no investor exceeds the investment limits set forth in Section 4(a)(6).

[797] *See* IAC Recommendation; *see also* BetterInvesting Letter.

centralized database during the study of the federal crowdfunding exemption that it plans to undertake no later than three years following the effective date of Regulation Crowdfunding.[798]

(2) Acknowledgment of Risk

(a) Proposed Rule

Securities Act Section 4A(a)(4) requires an intermediary to ensure that each investor: (1) reviews educational materials; (2) positively affirms that the investor understands that he or she is risking the loss of the entire investment and that the investor could bear such a loss; and (3) answer questions demonstrating an understanding of the level of risk generally applicable to investments in startups, emerging businesses and small issuers, the risk of illiquidity and such other matters as the Commission determines appropriate. As discussed above, Rule 302(b) of Regulation Crowdfunding requires an intermediary to provide to investors certain educational materials in connection with the opening of an account. In addition, proposed Rule 303(b)(2) of Regulation Crowdfunding would require an intermediary, each time before accepting an investment commitment, to obtain from the investor a representation that the investor has reviewed the intermediary's educational materials, understands that the entire amount of his or her investment may be lost and is in a financial condition to bear the loss of the investment.[799] The proposed rule would also require that an intermediary obtain from the investor answers to questions demonstrating the investor's understanding that there are restrictions on the investor's ability to cancel an investment commitment and obtain a return of his or her investment, that it

[798] *See* Section II. Further, we anticipate that, because of the electronic nature of crowdfunding, many of the books and records maintained by intermediaries will be in electronic format. We expect this will enable the Commission to analyze data across the crowdfunding industry as part of its ongoing oversight. We note that Commission staff also expects to review the books and records practices of intermediaries as part of its planned three-year review.

[799] *See* Section II.C.4.b. (discussing Rule 302(b)(2) of Regulation Crowdfunding).

may be difficult for the investor to resell the securities, and that the investor should not invest any funds in a crowdfunding offering unless he or she can afford to lose the entire amount of his or her investment.

(b) Comments on the Proposed Rule

Several commenters supported the requirement that intermediaries obtain investor acknowledgments.[800] Some of these commenters, however, opposed requiring investors to re-acknowledge or to re-certify for each investment commitment.[801]

One commenter stated that investors should be required to complete and sign "subscription forms" that set forth, in addition to what the proposed rules would require, additional information concerning the investor's level of investment experience, the identity of any person from whom the investor acquired any information about the investment and the percentage of the investor's liquid net worth represented by the proposed investment.[802]

One commenter supported the Commission providing recommended forms of questions and representations, noting that "any material examples provided by the Commission will be helpful to both the investor and the intermediary."[803] However, another commenter stated that it would be opposed to the Commission providing recommended forms of questions as a "starting point" because such recommended forms could be seen as a safe harbor and constrain

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[800] *See, e.g.*, Arctic Island Letter 6; CFA Institute Letter; Greenfield Letter; Joinvestor Letter; RocketHub Letter; STA Letter; Wefunder Letter.

[801] *See* Wefunder Letter; RocketHub Letter (suggesting that once an account has been created on an intermediary platform, an investor should be able to invest in multiple offerings on the same intermediary platform without having to re-certify and review the educational materials).

[802] *See* Greenfield Letter. *See also* STA Letter (stating that investors should be required to acknowledge that they are aware that "they may need to be diligent in notifying the issuer, or its designee, of any changes that would affect their ability to receive communications from the issuer"). We note, however, that issuers are not obligated to contact investors directly.

[803] *See* Joinvestor Letter.

effectiveness.[804] In contrast, a different commenter stated that Commission-provided questions and representations should serve as a safe harbor so there is an incentive for issuers to use them.[805]

(c) Final Rules

After considering the comments, we are adopting Rule 302(b)(2) as proposed. As noted in the Proposing Release, this rule is intended to help ensure that investors engaging in transactions made in reliance on Section 4(a)(6) are fully informed and reminded of the risks associated with their particular investment before making any investment commitment. While an intermediary cannot ensure that all investors understand the risks involved, the rule requires intermediaries to confirm that an investor: (1) has reviewed the intermediary's educational materials delivered pursuant to Rule 302(b); (2) understands that the entire amount of his or her investment may be lost, and is in a financial condition to bear the loss of the investment; and (3) has completed a questionnaire demonstrating an understanding of the risks of any potential investment and other required statutory elements. In addition, the questionnaire required under the rule may help to address, at least in part, the concerns expressed by some commenters that Section 4A(a)(4) requires more than a mere self-certification.[806] We note, however, that the plain language of Section 4A(a)(4)(B) seemingly requires only that the investor positively affirms his or her understanding of the risk of loss.

Our final rule does not provide a model form of acknowledgment or questionnaire. Rather, the rule permits an intermediary to develop the representation and questionnaire in any format that is reasonably designed to demonstrate the investor's receipt of the information and

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804 *See* Wefunder Letter.

805 *See* Public Startup Letter 3.

806 *See, e.g.*, Accredify Letter; Commonwealth of Massachusetts Letter; Farnkoff Letter; Saunders Letter; Verinvest Letter.

compliance with the other requirements under the final rules. As with the educational material requirements, we continue to believe that rather than providing sample content or a model form of acknowledgment or questionnaire, intermediaries should be provided with sufficient flexibility to choose both the content, within the requirements of Rule 302(b), and the format used to present the required materials. Likewise, we also believe that an intermediary's familiarity with its business and likely investor base make it best able to determine the format in which to present the required materials. We note that any format used must be reasonably designed to demonstrate receipt and understanding of the information. There are many ways, especially on a web-based system, to convey information to, and obtain effective acknowledgment from, investors. As explained in the Proposing Release, the requirements of the rule would not be satisfied if, for example, an intermediary were to pre-select answers for an investor.

Further, an intermediary in its discretion may require additional information, such as information concerning the investor's level of investment experience, the identity of any person from whom the investor acquired any information about the investment and the percentage of the investor's liquid net worth represented by the proposed investment, or impose additional requirements on prospective investors, such as imposing express acknowledgments of the investor's responsibilities with respect to compliance.

Finally, although several commenters suggested that once an account has been created on an intermediary's platform, an investor should be able to invest in multiple offerings on the same intermediary platform without having to re-certify and review the educational material, we continue to believe that, in order to realize the statute's investor protection goals, it is prudent to require an intermediary to obtain an investor representation and completed questionnaire each time an investor seeks to make an investment commitment. Accordingly, under Rule 303(b), an

intermediary will be required to obtain these items each time an investor seeks to make an investment commitment.

c. Communication Channels

(1) Proposed Rule

Proposed Rule 303(c) of Regulation Crowdfunding would require an intermediary to provide, on its platform, channels through which investors can communicate with one another and with representatives of the issuer about offerings made available on the intermediary's platform. An intermediary that is a funding portal would be prohibited from participating in communications in these channels.[807] Proposed Rule 303(c) also would require the intermediary to: (1) make the communications channels publicly available; (2) permit only those persons who have opened accounts to post comments; and (3) require any person posting a comment in the communication channels to disclose whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or is otherwise compensated, whether in the past or prospectively, to promote the issuer's offering.

(2) Comments on the Proposed Rule

We received comments both supporting[808] and opposing the proposed rules on communications channels.[809] Several commenters agreed that posting in communication channels should be limited to registered investors on an intermediary's platform.[810]

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807 *See* Rule 303(c)(1) (an intermediary that is a funding portal cannot "participate in these communications, other than to establish guidelines for communication and remove abusive or potentially fraudulent communications"). *See also* Exchange Act Section 3(a)(80) (defining the term "funding portal" as any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to Securities Act Section 4(a)(6), that does not, among other things, "offer investment advice or recommendations").

808 *See, e.g.*, PeoplePowerFund Letter; RocketHub Letter; Vann Letter (stating that intermediaries should be allowed to decide who may post on the channels).

Some commenters stated there should be more privacy or control in the manner in which comments are posted to the communications channels, such as submitting comments to intermediaries to review prior to posting or restricting the publicly viewable comments.[811] One commenter stated that he interprets the proposed rule to permit issuers to post videos and other promotional content (similar to marketing content used on non-securities-based crowdfunding sites like Kickstarter), and that he supported this approach as it would permit the issuer to "communicate freely and creatively . . . while giving the crowd a forum to ask questions or offer criticism."[812] Another commenter encouraged the Commission "to provide an investor 'hotline', where investors can report concerns relating to crowdfunding communications or transactions, and that intermediaries be required to provide notice on their platforms of how to access this hotline."[813]

Several commenters generally supported the disclosure requirement on communications by issuers or intermediaries and agreed that these communications should be made transparent to investors.[814]

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809 *See, e.g.*, Cromwell Letter (claiming that "[a]s [a] venture investor, you cannot judge the abilities of the management team over the Internet. Real venture capitalists do not make their investments over the Internet -- they spend hours and hours interviewing the founders / management team, in person. Small investors cannot successfully invest over the Internet, either."); Public Startup Letter 3; Moskowitz Letter (stating that the proposed rules do not prevent an accredited investor from, for example, posting a solicitation within the communication channels for more securities than he or she could purchase in the offering within his or her investment limits).

810 *See, e.g.*, PeoplePowerFund Letter; RocketHub Letter; Wefunder Letter.

811 *See, e.g.*, ASSOB Letter (stating that "random unmoderated comments" in communication channels should not be permitted, because it would allow for unacceptable solicitations or claims of return on investment); RocketHub Letter (expressing concern that certain confidential information may be disclosed between registered investors and the issuer, which would not be suitable for a public forum).

812 *See* Odhner Letter.

813 *See* CFA Institute Letter.

814 *See, e.g.*, CFA Institute Letter; RocketHub Letter (suggesting that intermediaries should be able to assist posters in disclosing their relationship to issuer).

One commenter generally supported the proposed rule requiring each promotional communication to be accompanied by disclosure of the receipt of past or prospective compensation.[815] Another commenter suggested that the proposed rules should be amended to require that intermediaries prominently post the online identities of the issuer's paid promoters in the communication channels.[816] One commenter, however, stated that the Commission should not mandate the exact methods by which an intermediary achieves compliance with the requirement for promoters to disclose their relationship with an issuer.[817]

In response to our request for comments, several commenters supported requiring intermediaries to keep the communication channels available to investors post-offering.[818] Another commenter, however, stated that the communication channels should be closed after stock certificates are issued and received by investors.[819] This commenter further noted that the continued maintenance of a communication channel after the end of a campaign would be an unnecessary cost. The same commenter suggested that the issuer's website is a better place for communication between investors and issuers.[820]

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815 *See* CFA Institute Letter.

816 *See* MCS Letter.

817 *See* Wefunder Letter (suggesting that the disclosures at the account opening stage are better devoted to the discussion of the risk of startup investing).

818 *See, e.g.*, PeoplePowerFund Letter (suggesting that the posting forum should be live and accessible to all website members not less than 30 days after the issue has been completed); RocketHub Letter; StartupValley Letter (suggesting that intermediaries should open a private channel of communication between investors and issuers for the post offering period and not use the same public channel that was used for the pre-offering and funding periods).

819 *See* RFPIA Letter.

820 *Id. See also* CfPA Letter (stating that ongoing communication between issuers and investors should be an obligation of issuers alone).

(3) Final Rule

After considering the comments, we are adopting Rule 303(c) as proposed. We considered commenters' suggestions that the issuer's website is a better place for communication between investors and issuers and that ongoing communication between issuers and investors should be an obligation of issuers alone. We believe, however, that communication channels on the intermediary's platform will provide a centralized and transparent means for members of the public that have opened an account with an intermediary to share their views about investment opportunities and to communicate with representatives of the issuer to better assess the issuer and investment opportunity.[821] While the JOBS Act does not impose this requirement, we believe it is consistent with the legislative intent that such a mechanism be in place for offerings made in reliance on Section 4(a)(6).[822] Also, though communications among investors may occur outside of the intermediary's platform, communications by an investor with a crowdfunding issuer or its representatives about the terms of the offering are required to occur through these channels[823] on the single platform through which the offering is conducted.[824] This requirement is expected to provide transparency and accountability, and thereby further the protection of investors.

Although one commenter stated that it interpreted the proposed rule to permit issuers to post videos and other promotional content, aside from Rule 303(c)(4) and its requirements for promotional activity, Rule 303(c) itself does not address the content or form used by issuers when

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821 *See also* discussion in Section II.B.5.

822 *See* 158 CONG. REC. S2231 (daily ed. Mar. 29, 2012) (statement of Sen. Scott Brown) ("In addition to facilitating communication between issuers and investors, intermediaries should allow fellow investors to endorse or provide feedback about issuers and offerings, provided that these investors are not employees of the intermediary. Investors' credentials should be included with their comments to aid the collective wisdom of the crowd.").

823 *See* Rule 204 of Regulation Crowdfunding and discussion in Section II.B.4.

824 *See* Rule 100(a)(3) of Regulation Crowdfunding and discussion in Section II.A.3.

communicating with investors through the channels provided on an intermediary's platform. Rather, Rule 204 of Regulation Crowdfunding sets forth the advertising requirements for issuers and, as explained above, Rule 204 allows an issuer to communicate with investors about the terms of the offering through communication channels provided by the intermediary on the intermediary's platform, so long as the issuer identifies itself as the issuer in all communications.[825]

We are requiring intermediaries to make the communications on the channels publicly available for viewing. We believe that this requirement is consistent with the concept of crowdfunding, as it provides for transparent crowd discussions about a potential investment opportunity. We also are requiring in Rule 303(c)(3) that intermediaries limit the posting in communication channels to those individuals who have opened an account with the intermediary on its platform. As stated in the Proposing Release, while we recognize that this requirement could narrow the range of views represented by excluding posts by anyone who has not opened an account with the intermediary, we believe that it will help to establish accountability for comments made in the communication channels. We continue to believe that, without this measure, there would be greater risk of the communications including unfounded, potentially abusive or biased statements intended to promote or discredit the issuer and improperly influence the investment decisions of members of the crowd.

With respect to one commenter's suggestion that the Commission provide an investor "hotline" where investors can report concerns relating to crowdfunding communications or transactions, we note that the Commission has an existing "Tips, Complaints and Referrals Portal"

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[825] *See* Section II.B.4 (discussing Rule 204).

available on its website,[826] where the public may provide the Commission with information about potential fraud or wrongdoing involving alleged violations of the securities laws.

We are mindful of the cost associated with the communications channel, and, therefore, we are not requiring that intermediaries keep the communication channels available to investors post-offering, as suggested by some commenters.[827] However, an intermediary in its discretion can choose to maintain the communication channels post-offering.[828]

Consistent with the prohibition on a funding portal offering investment advice or recommendations,[829] the rule as adopted will prohibit an intermediary that is a funding portal from participating in any communications in these channels, apart from establishing guidelines for communication and removing abusive or potentially fraudulent communications. A funding portal can, for example, establish guidelines pertaining to the length or size of individual postings in the communication channels and can remove postings that include offensive or incendiary language. Also, although we understand the reasons for commenters' suggestions that there should be more privacy or control in the manner in which comments are posted, we believe that aside from intermediaries removing abusive or potentially fraudulent communications, investor protection is better served by providing the opportunity for uncensored and transparent crowd discussions about a potential investment opportunity.

826 *See* Enforcement Tips and Complaints, *available at* https://www.sec.gov/complaint/tipscomplaint.shtml.

827 *See, e.g.,* PeoplePowerFund Letter; RocketHub Letter; StartupValley Letter.

828 It is important to note that an intermediary would still have to maintain records of such communications to satisfy the books and records requirements of the crowdfunding rules. *See* Rule 404(a)(3).

829 *See* Rule 300(c)(2)(i). Exchange Act Section 3(a)(80) defines the term "funding portal" as any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to Securities Act Section 4(a)(6), that does not, among other things, "offer investment advice or recommendations."

Finally, under the rule as adopted an intermediary must require any person posting on the communication channel to clearly and prominently disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or is otherwise compensated, whether in the past or prospectively, to promote the issuer's offering. This disclosure will apply to officers, directors and other representatives of the issuer, and also will be required of an intermediary that is a broker and its associated persons. We continue to believe that intermediaries, as the hosts of the communication channels, are well placed to take measures to ensure that promoters clearly identify themselves in their communication channels, in accordance with Securities Act Section 4A(b)(3).

d. Notice of Investment Commitment

(1) Proposed Rule

Proposed Rule 303(d) of Regulation Crowdfunding would require an intermediary, upon receipt of an investment commitment from an investor, to promptly give or send to the investor a notification disclosing: (1) the dollar amount of the investment commitment; (2) the price of the securities, if known; (3) the name of the issuer; and (4) the date and time by which the investor may cancel the investment commitment. Pursuant to proposed Rule 302(a)(2) of Regulation Crowdfunding, this notification would be provided by e-mail or other electronic media, and would be documented in accordance with applicable recordkeeping rules.[830]

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[830] *See* Section II.C.4 (discussing Rule 100(a)(3)) and Section II.D.5 (discussing the recordkeeping rules applicable to funding portals). *See also* note 1114 (discussing the recordkeeping rules applicable to brokers and intermediaries).

(2) Comments on the Proposed Rule

Commenters generally supported the requirement that intermediaries send these notifications to investors.[831] One of these commenters stated that, in its view, the notice should be submitted twice: first, when an investor has made a commitment, and again when the cancellation period is over.[832] One commenter stated that, in its view, investors also should be notified of whether a campaign has been successful or not, both when the campaign is near completion and when the campaign has been closed.[833] However, one commenter opposed all notice requirements.[834]

(3) Final Rules

After considering the comments, we are adopting Rule 303(d) as proposed. As stated in the Proposing Release, the notification is intended, among other things, to provide the investor with a written record of the basic terms of the transaction, as well as a reminder of his or her ability to cancel the investment commitment. We believe that the adopted notification requirements will be useful to investors and provide transparency. We also believe that requiring that this notification be sent once—promptly upon receipt of an investment commitment from an investor—rather than multiple times as commenters suggested—will help to minimize the costs associated with providing additional notification, while still providing the investor with, among other things, an important reminder about the ability to cancel the investment commitment. Although an intermediary can decide, in its discretion, to provide additional notifications to its customers as a

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831 *See, e.g.,* CFA Institute Letter; Joinvestor Letter; RocketHub Letter.

832 *See* RocketHub Letter.

833 *See* Joinvestor Letter.

834 *See* Public Startup Letter 3.

business decision, we believe at this time that adopting additional notification requirements could hamper flexibility in the evolving crowdfunding market and potentially impair the development of best practices that are tailored to this unique form of raising capital.

e. Maintenance and Transmission of Funds

(1) Proposed Rule

Securities Act Section 4A(a)(7) requires that an intermediary "ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount, . . . as the Commission shall, by rule, determine appropriate." Proposed Rule 303(e)(1) of Regulation Crowdfunding would implement this provision and address the maintenance and protection of investor funds, pending completion of a transaction made in reliance on Section 4(a)(6), by requiring an intermediary that is a registered broker to comply with established requirements in Exchange Act Rule 15c2-4[835] for the maintenance and transmission of investor funds.

Proposed Rule 303(e)(2) would establish separate requirements for an intermediary that is a funding portal. Because a funding portal cannot receive any funds, it would be required to direct investors to transmit money or other consideration directly to a "qualified third party" that has agreed in writing to hold the funds for the benefit of the investors and the issuer and to promptly transmit or return the funds to the persons entitled to such funds. Proposed Rule 303(e)(2) would define "qualified third party" to mean a bank[836] that has agreed in writing to either: (i) hold the funds in escrow for the persons who have the beneficial interests in the funds and to transmit or return the funds directly to the persons entitled to them when the appropriate event or contingency

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835 17 CFR 240.15c2-4.

836 *See* Exchange Act Section 3(a)(6) [15 U.S.C. 78c(a)(6)] (defining "bank").

has occurred; or (ii) establish a bank account (or accounts) for the exclusive benefit of investors and the issuer.

Proposed Rule 303(e)(3) would require an intermediary that is a funding portal to promptly direct transmission of funds from the qualified third party to the issuer when the aggregate amount of investment commitments from all investors is equal to or greater than the target amount of the offering and the cancellation period for each investor has expired, provided that in no event may the funding portal direct this transmission of funds earlier than 21 days after the date on which the intermediary makes publicly available on its platform the information required to be provided by the issuer under Rules 201 and 203(a) of proposed Regulation Crowdfunding.

(2) Comments on the Proposed Rule

Several commenters generally supported the proposed fund maintenance and transmission requirements.[837] One commenter suggested that intermediaries be allowed to reject an investor's investment commitment if that investor does not have a correlating balance in an account with the intermediary.[838] Another commenter suggested that the Commission require that such accounts be interest bearing and that either (1) the investors' funds be returned to them with their pro rata portion of the interest in the event the offering is canceled, or (2) the funds and the accrued interest be dispersed to the issuer upon the offering's successful closing.[839] Another commenter suggested that qualified third parties should be registered and verified for "reputations [of]

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837 *See, e.g.,* Arctic Island Letter 6; ASTTC Letter; CSTTC Letter; Greenfield Letter (suggesting that the issuer should be required to certify in writing under penalty of perjury to the escrow bank that the offering has been completed pursuant to the terms in the offering statement and that there have been no material changes of circumstances that would render the representations in the offering statement false or misleading); Joinvestor Letter; STA Letter.

838 *See* Zhang Letter.

839 *See* MCS Letter.

integrity"; complaints against those entities should be made public; and "drawdown" schedules should be submitted at the onset of projects and subsequently control issuer access to "project funds."[840]

In the Proposing Release, we requested comment on various alternatives to the proposed rules. As to whether the proposed rules should prohibit any variations of a contingency offering, such as minimum-maximum, offerings, one commenter stated that the target amount of a crowdfunding campaign "should represent the minimum to avoid investor confusion" and that "oversubscription should be allowed."[841] This commenter noted that these conditions would allow companies to "choose to set their own minimum and maximum range."[842] Another commenter suggested that we permit contingency offers based on a maximum amount of funds being raised or other benchmarks if the maximum is not met or, alternatively, permit "all-or-none" offerings.[843]

As to whether other types of custody arrangements should be permitted, one commenter requested clarification that a carrying broker would not be deemed to accept any part of the sale price of any security for purposes of Exchange Act Rule 15c2-4 under specific circumstances.[844]

As to whether there should be a fixed deadline for transmission of funds (such as three business days), one commenter stated that "fixed deadlines should be set to protect investor and

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840 *See* Otherworld Letter.

841 *See* Joinvestor Letter.

842 *Id.*

843 *See* PeoplePowerFund Letter (suggesting also that any oversubscribed issues be allocated on a "first come first served" basis in connection with "all-or-none" offerings).

844 *See* FOLIOfn Letter. Although this commenter stated its belief that the proposed procedure is consistent with Rule 15c2-4 on the basis that the carrying broker would not be "accept[ing] any part of the sale price" until closing, at which time funds would be promptly transferred to the issuer, it stated that additional clarity would be helpful to ensure that the Proposing Release does not introduce confusion if read by some as containing an implication to the contrary.

issuer interests." This commenter suggested that "one week (7 days) should be sufficient to disburse collected funds."[845] Another commenter suggested a three-day deadline.[846]

As to whether SRO and staff guidance on Exchange Act Rule 15c2-4 should be expressly incorporated into the rules, one commenter suggested that there was no need for incorporation of prior guidance about Rule 15c2-4 into the proposed rules.[847]

As to whether the definition of "qualified third party" should be expanded to include entities other than a bank, one commenter stated that the Commission should "consider [permitting] non-bank custodians, such as internet services that specialize in escrow and payment transfer."[848] Another commenter suggested that "qualified third parties" should include credit unions, savings and loans and other institutions that offer similar protections to banks.[849] Similarly, another commenter suggested that credit unions should be included.[850] One commenter suggested that banks should not be a qualified third party.[851] One commenter suggested that the definition of "qualified third party" be expanded to include certain broker-dealers that "hold funds and securities on behalf of customer accounts pursuant to [Exchange Act] Rule 15c3-3 and

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845 *See* Joinvestor Letter.

846 *See* Public Startup Letter 3.

847 *See* Arctic Island Letter 6.

848 *See* Joinvestor Letter.

849 *See* Growthfountain Letter.

850 *See* Vann Letter.

851 *See* Public Startup Letter 3 (claiming that "[b]anks are unable to serve as the 'qualified third party'" and that no entities other than registered broker-dealers should serve this function in connection with Regulation Crowdfunding sales.). *But see* Computershare Letter (supporting the "inclusion of a requirement that Funding Portals use a qualified third party, which is a bank, to hold investor funds as escrow agent and transmit the funds to the issuer once the offering requirements are met"); ASTTC Letter (stating that it "strongly supports the Proposed Rule's requirement that Funding Portals be required to utilize qualified escrow agents to hold the investor assets prior to transmittal to issuers and that "[q]ualified escrow agents are generally regulated banks"); STA Letter (stating that "[it] is pleased that the Proposed Rules contain a requirement that Funding Portals transmit investor assets to qualified escrow agents, which are banks, prior to their release to the issuer.").

maintain net capital pursuant to [Exchange Act] Rule 15c3-1(a)(2)(i)".[852] The commenter also suggested that funding portals and other brokers should be able to utilize these brokers "to the identical degree they would be able to utilize banks under Rule 15c2-4."[853]

Commenters generally agreed with our proposed approach not to require funding portals to maintain net capital, noting among other things that imposing "net capital requirements would increase the cost of starting a new funding portal and reduce the potential number of intermediaries, while providing little additional protection to investors and issuers."[854]

As to whether certain methods of payment for the purchase of securities should either be required or prohibited, one commenter suggested that the types of payment methods not be limited in any way.[855] However, some commenters stated, generally, that credit cards should be prohibited as a form of payment for securities in connection with crowdfunding.[856]

(3) Final Rule

After considering the comments, we are adopting Rule 303(e) substantially as proposed, but with certain revisions in response to comments. Rule 303(e)(1), as adopted, requires an

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852 *See* FOLIOfn Letter. *See also* Arctic Island Letter 8 (suggesting that the rules permit a $250,000 net capital broker-dealer to act as trustee for an omnibus escrow account at an FDIC insured bank); Ex 24 Letter.

853 *See* FOLIOfn Letter (stating also its belief that the brokers "should be distinguished from other broker-dealers in the context of Regulation Crowdfunding and not be subject to the requirements of SEC Rule 15c2-4(b)").

854 *See* Tiny Cat Letter (stating that "[f]unding portals are already prohibited from handling funds and securities, and are also subject to a fidelity bond in the proposed regulations"). *See also* Joinvestor Letter (suggesting that since funding portals will not be monetary custodians, there should be no net capital requirement instituted); Vann Letter (stating that a "capital requirement would unnecessarily restrict competition").

855 *See* Public Startup Letter 3.

856 *See, e.g.,* Arctic Island Letter 6 (suggesting that, given the chargeback periods for credit cards, broker-dealers should only be permitted to accept credit card payments from investors if the broker-dealer "directly and unconditionally guarantees the amounts obtained thereby to both the issuer and the escrow agent"); Consumer Federation Letter (suggesting that allowing payment via credit card increases the risk that investors will make crowdfunding investments that they cannot afford); Joinvestor Letter; RocketHub Letter (stating that "[p]ermitting debt-based payment vehicles, such as credit cards, which have their own rescission policies, (i.e., charge backs) is problematic").

intermediary that is a registered broker-dealer to comply with established requirements in Exchange Act Rule 15c2-4 for the maintenance and transmission of investor funds. Rule 15c2-4 requires, in relevant part, that in connection with a contingency offering of a security, any money or other consideration received by a broker-dealer participating in the distribution must be promptly deposited in a separate bank account, as agent or trustee for the persons who have the beneficial interest therein, until the appropriate event or contingency has occurred, and thereafter promptly transmitted or returned to the persons entitled thereto;[857] or alternatively, that all such funds must be promptly transmitted to a bank that has agreed in writing to hold such funds in escrow for the persons who have the beneficial interests therein and to transmit or return such funds directly to the persons entitled thereto when the appropriate event or contingency has occurred.[858] When the Commission adopted Rule 15c2-4, the Commission explained that the rule was designed to prevent fraud by a broker-dealer "either upon the person on whose behalf the distribution is being made or upon the customer to whom the payment is to be returned if the distribution is not completed."[859] As such, consistent with Securities Act Section 4A(a)(7), the intermediary may transmit the proceeds to the issuer only if the target offering amount is met or exceeded.

Rule 303(e)(2) as adopted establishes separate requirements for an intermediary that is a funding portal (as compared to an intermediary that is a broker-dealer) because a funding portal

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857 *See* Exchange Act Rule 15c2-4(b)(1). We note, however, that any broker-dealer seeking to hold such investor funds in a separate bank account as agent or trustee for the persons who have a beneficial interest therein are still subject to net capital requirements pursuant to Exchange Act Rule 15c3-1.

858 *See* Exchange Act Rule 15c2-4(b)(2).

859 *Adoption of Rule 15c2-4 under the Securities Exchange Act of 1934*, Release No. 34-6737 (Feb. 21, 1962) [27 F.R. 2089 (Mar. 3, 1962)].

cannot, by statute, hold, manage, possess, or otherwise handle investor funds or securities.[860] Therefore, Rule 303(e)(2) requires a funding portal to direct investors to transmit money or other consideration directly to a qualified third party that has agreed in writing[861] to hold the funds for the benefit of the investors and the issuer and to promptly transmit or return the funds to the persons entitled to such funds.[862]

We are revising the definition of a "qualified third party" to include for purposes of the final rule: a registered broker or dealer that carries customer or broker or dealer accounts and holds funds or securities for those persons,[863] a bank, or a credit union insured by the National Credit Union Administration ("NCUA").[864] We had proposed to define "qualified third party" to mean a bank[865] because investors, as well as intermediaries and issuers, would then be afforded the protections of existing regulations that apply to banks, in particular those pertaining to the

860 *See* Exchange Act Section 3(a)(80)(D).

861 This written agreement is required to be maintained by the funding portal pursuant to proposed Rule 404 of Regulation Crowdfunding. *See* Section II.D.5.

862 In the crowdfunding context, we expect that the intermediary will make the determination as to whether the contingency (*i.e.*, the target offering amount) has been met. *See* Securities Act Section 4A(a)(7) (requiring that an intermediary "ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount, . . . as the Commission shall, by rule, determine appropriate.").

863 Broker-dealers that may serve as qualified third parties under Rule 303(e) include only those broker-dealers that are required to maintain minimum net capital of $250,000 or a higher minimum amount depending on their status under Appendix E of Rule 15c3-1 under the Exchange Act. *See* Exchange Act Rules 15c3-1(a)(2)(i) and 15c3-1(a)(7)(i).

864 The NCUA was established by the Federal Credit Union Act of 1934. *See* Federal Credit Union Act of 1934, as amended, 12 U.S.C. 1752 *et seq.* The NCUA administers the National Credit Union Share Insurance Fund ("NCUSIF"), which is backed by the full faith and credit of the U.S. government. NCUSIF protection covers the deposits in federal credit unions, as well as a majority of state-chartered credit unions. *See* NCUA Share Insurance Fund Information, Reports, and Statements, Frequently Asked Questions, NATIONAL CREDIT UNION ADMINISTRATION, http://www.ncua.gov/DataApps/Pages/SI-FAQs.aspx.

865 *See* Proposing Release, at 182-83 [78 FR 66427, at 66473]. *See also* Exchange Act Section 3(a)(6) [15 U.S.C. 78c(a)(6)] (defining "bank").

safeguarding of customer funds.[866] However, after considering the comments, we agree with those commenters who suggested that the definition of "qualified third party" should be expanded to include entities other than a bank and should include, as one commenter suggested, credit unions provided that these entities offer similar protections to banks.[867] We also made a corresponding change to the language of the rule text to indicate that a qualified third party arrangement may involve either a bank or credit union account (or accounts) established for the exclusive benefit of investors and the issuer.

After considering the comments, we further believe that the definition of "qualified third party" should be expanded to include certain types of registered broker-dealers. We are expanding the definition to include registered broker-dealers that carry customer or broker or dealer accounts and holds funds or securities for those persons. We believe such brokers-dealers are appropriate entities to serve as qualified third parties as they are subject to various regulatory obligations, which are designed to provide enhanced protection of investor funds through the imposition of capital and other requirements.[868] We note that we are not amending the requirements of Rule 15c2-4 through this release and not distinguishing broker-dealers that participate in offerings made in reliance on Securities Act Section 4(a)(6), either as a qualified

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866 For example, bank deposit accounts at FDIC-insured banks are protected by FDIC deposit insurance. *See* Federal Deposit Insurance Corp., Deposit Insurance FAQs, *available at* http://www.fdic.gov/deposit/deposits/faq.html.

867 We do not believe that the definition of qualified third party should be extended to include Internet service providers that specialize in escrow and payment transfer, as suggested by one commenter, because we do not believe that such entities are governed by a regulatory scheme designed to provide similar protections as the other entities that we are defining as qualified third parties under Rule 303(e). We note that another commenter suggested the addition of savings and loan associations. We believe that certain savings and loan associations are covered by the definition of "bank" under Exchange Act Section 3(a)(6), and as such, are qualified third parties under Rule 303(e). We note that the Federal Deposit Insurance Corp. extended its authority to cover savings and loan associations in 1989. *See* Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) (creating the Savings Association Insurance Fund (SAIF)).

868 *See, e.g.,* Exchange Act Rule 15c3-1 and Rule 15c2-4.

third party or an intermediary, from broker-dealers in any other contingency offerings. As such, broker-dealers participating in offerings made in reliance on Section 4(a)(6), either as an intermediary or as a qualified third party, are still subject to Rule 15c2-4.[869] Further, we believe that existing Commission and staff guidance on Rule 15c2-4 is extensive and clear and does not warrant incorporation into the final rule or clarification.

The statute does not limit or require a particular payment mechanism, and we are not imposing such a restriction because we believe that the rules should provide reasonable flexibility regarding the payment mechanisms intermediaries employ. We believe that restrictions on particular payment mechanisms would not serve to significantly increase investor protection, particularly in light of the established investment limits. We note, however that an intermediary can, in its discretion, decline to accept certain payment methods, such as credit cards, or accept them only in certain circumstances.[870]

We also are not adopting additional requirements that would, for example, (1) prohibit variations of a contingency offering, such as minimum-maximum offerings; (2) establish a fixed deadline for transmission of funds as compared to the proposed requirement to transmit funds "promptly"; or (3) require funding portals to maintain a certain amount of net capital. We believe that additional restrictions, such as prohibiting variations of a contingency offering or establishing

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869 Under existing Rule 15c2-4, the qualified third party broker-dealer will be required to promptly deposit the funds in a separate bank account, as agent or trustee for the persons who have the beneficial interest therein, until the appropriate event or contingency has occurred, and thereafter promptly transmit or return the funds to the persons entitled thereto. *See* Rule 15c2-4(b)(1).

870 We note, for example, that an intermediary can, in its discretion, decline to accept credit cards given that, as at least one commenter suggested, an investor's use of his or her right to dispute credit card charges can inhibit the ability of an issuer to meet its target or to provide accurate disclosures to investors and the Commission regarding the progress it has made toward, and whether it has, reached the target offering amount. This potential impact will affect offerings conducted through brokers and funding portals alike. We also note that pursuant to Exchange Act Section 3(a)(80)(D) (15 U.S.C. 78c(a)(80)(D)), a funding portal is statutorily prohibited from extending credit or margin to customers.

a fixed deadline for the transmission of funds could hamper flexibility in the nascent crowdfunding market and prohibit the development of best practices specifically tailored to this unique form of capital raising. Finally, we are not requiring in the final rule net capital standards for funding portals. As noted above, funding portals are prohibited from handling, managing or possessing investor funds or securities.[871] We continue to believe that the requirements relating, in particular, to transmission of proceeds under the final rules will help ensure that investor funds are protected, without requiring funding portals to maintain net capital.

f. Confirmation of Transactions

(1) Proposed Rule

As proposed, Rule 303(f)(1) of Regulation Crowdfunding would require that an intermediary, at or before the completion of a transaction made pursuant to Section 4(a)(6), give or send to each investor a notification disclosing: (1) the date of the transaction; (2) the type of security that the investor is purchasing; (3) the identity, price and number of securities purchased by the investor, as well as the number of securities sold by the issuer in the transaction and the price(s) at which the securities were sold; (4) certain specified terms of the security, if it is a debt or callable security; and (5) the source and amount of any remuneration received or to be received by the intermediary in connection with the transaction, whether from the issuer or from other persons. This notification would be required to be provided by e-mail or other electronic media,[872] and to be documented in accordance with applicable recordkeeping rules.[873] Pursuant to

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871 *See* Exchange Act Section 3(a)(80)(D) [15 U.S.C. 78c(a)(80)(D)] and discussion in Section II.C.1.

872 *See* proposed Rule 302(a)(2) (requiring an intermediary to provide all information electronically). *See also* Section II.C.4.a (discussing electronic delivery requirements).

873 Intermediaries that are brokers are subject to the recordkeeping requirements of Exchange Act Rules 17a-3 and 17a-4, and intermediaries that are funding portals are subject to recordkeeping requirements under Rule

proposed Rule 303(f)(2), an intermediary that gives or sends to each investor the notification described above would be exempt from the requirements of Exchange Act Rule 10b-10[874] for the subject transaction.

(2) Comments on the Proposed Rule

Commenters generally supported the proposed confirmation requirements.[875] One commenter, however, stated its view that permitting intermediaries to satisfy the delivery requirement for transaction confirmations through delivery of a message that contains a notice that the information is available on the intermediary's website would not be sufficient.[876]

(3) Final Rule

After considering the comments, we are adopting Rule 303(f), as proposed, but with one clarifying change. As proposed, Rule 303(f)(1)(vi) would have required an intermediary to give or send to each investor a notification disclosing: "[t]he source and amount of any remuneration received or to be received by the intermediary in connection with the transaction, including the amount and form of any remuneration that is received, or will be received, by the intermediary from persons other than the issuer. We are revising Rule 303(f)(1)(vi) to require disclosure as well of the form of any remuneration received or to be received by the intermediary in connection with the transaction, including any remuneration received or to be received by the intermediary from persons other than the issuer. This edit is intended to clarify the rule by placing "source, form and amount" together, rather than having "form" listed out separately as proposed.

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404 of Regulation Crowdfunding. *See* note 1114 (discussing the recordkeeping rules applicable to brokers and intermediaries). *See also* Section II.D.5.

[874] *See* note 882 (discussing Exchange Act Rule 10b-10 (17 CFR 240.10b-10) generally).

[875] *See, e.g.,* CFA Institute Letter; Joinvestor Letter.

[876] *See* Consumer Federation Letter (stating that "[w]hile most if not all intermediaries would be likely to deliver the actual confirmation to investors, the rule would not guarantee this").

As explained in the Proposing Release, we believe that transaction confirmations serve an important and basic investor protection function by, among other things, conveying information and providing a reference document that allows investors to verify the terms of their transactions, acting as a safeguard against fraud and providing investors a means by which to evaluate the costs of their transactions.[877] Each of the required items of information is intended to assist investors in memorializing and assessing their transactions. Furthermore, the requirement that an intermediary disclose to an investor the source, form and amount of any remuneration received or to be received is designed to help to highlight potential conflicts of interest if, for example, an intermediary has a financial interest in an issuer using its services.[878]

As for the concern raised by one commenter about the delivery requirements for transaction confirmations,[879] we note, as we did in the Proposing Release, that the confirmation is required to be provided by e-mail or other electronic media, consistent with the Commission's long-standing policies on the use of electronic media for delivery purposes.[880] This is also consistent with the requirement for an intermediary to provide all information electronically. We believe that this delivery requirement is appropriate for crowdfunding transactions and satisfies our obligation that requirements under Securities Act Section 4A(a)(12) be for the protection of

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[877] *See* Proposing Release at 78 FR 66475. *See also Confirmation of Transactions*, Release No. 34-34962 (Nov. 10, 1994) [59 FR 59612, 59613 (Nov. 17, 1994)].

[878] Although Securities Act Section 4A(a)(11) requires an intermediary to prohibit its directors, officers or partners (or any person occupying a similar status or performing a similar function) from having any financial interest in an issuer using its services, the final rules do not include a complete prohibition on the intermediary, itself, having a financial interest in an issuer using its services. The intermediary may have a financial interest in an issuer using its services, subject to certain limitations. *See* Rule 300(b). *See also* Section II.C.2.b.

[879] *See* Consumer Federation Letter.

[880] *See* Proposing Release, at 189 [78 FR 66427, at 66475]. *See also Use of Electronic Media,* note 714 at 25853 (discussing the "access equals delivery" concept and citing *Use of Electronic Media for Delivery Purposes*, Release No. 34-36345 (Oct. 6, 1995) [60 FR 53548, 53454 (Oct. 13, 1995)])).

investors and in the public interest. As to the same commenter's view that the rule would not guarantee delivery of a confirmation to investors,[881] although we acknowledge that statutes and rules cannot guarantee compliance, there is a robust regulatory scheme in place that is designed to promote compliance and that is coupled with supervision and enforcement by both the Commission and the registered national securities association.

In addition, under Rule 303(f)(2) as adopted, an intermediary that gives or sends to each investor the notification described above is exempt from the requirements of Exchange Act Rule 10b-10 for the subject transaction.[882] The confirmation terms under Rule 303(f)(2) are similar to, but not as extensive as, those broker-dealers are subject to under Rule 10b-10. We believe that this difference is appropriate given the more limited scope of an intermediary's role in crowdfunding transactions. Rule 10b–10, for example, requires disclosure about such matters as payment for order flow, riskless principal transactions, payment of odd-lot differentials and asset-backed securities. These items generally would not be relevant to crowdfunding securities transactions or an intermediary's participation in such transactions, and their inclusion in a

[881] *See* Consumer Federation Letter.

[882] Exchange Act Rule 10b-10 (17 CFR 240.10b-10) generally requires a broker-dealer effecting a customer transaction in securities (other than U.S. savings bonds or municipal securities) to provide a notification to its customer, at or before completion of a securities transaction, that discloses certain information specific to the transaction. Specifically, Rule 10b-10 requires the disclosure of the date, time, identity, prices and number of securities bought or sold; the capacity in which the broker-dealer acted (*e.g.*, as agent or principal); yields on debt securities; and under specified circumstances, the amount of remuneration the broker-dealer will receive from the customer and any other parties. With regard to the specified circumstances mentioned above, the remuneration disclosures of Rule 10b-10 generally are required, but certain exclusions apply. For example, the remuneration disclosures are generally required where a broker or dealer is acting as agent for a customer or some other person. In the case where remuneration is received or to be received by the broker from such customer in connection with the transaction, the disclosures are not required where the remuneration paid by such customer is determined pursuant to written agreement with such customer, otherwise than on a transaction basis. 17 CFR 240.10b-10(a)(2)(i)(B). In contrast, the remuneration disclosure requirements of Rule 303(f)(2)(vi) are required across all crowdfunding transactions where remunerations are received or are to be received. Given the limits on the dollar amount of securities that can be offered, as well as the limits on individual investment amounts, in transactions relying on Section 4(a)(6), we do not expect investors to negotiate individualized compensation agreements.

crowdfunding securities confirmation may be confusing to investors. Therefore, we believe that if an intermediary satisfies the notification requirements of the final rules, the intermediary will have provided investors with sufficient relevant information about the crowdfunding security, and so should not be required to meet the additional requirements of Rule 10b–10.

6. Completion of Offerings, Cancellations and Reconfirmations

a. Proposed Rule

Under Securities Act Section 4A(a)(7), an intermediary is required to allow investors to cancel their commitments to invest as the Commission shall, by rule, determine appropriate. Securities Act Section 4A(b)(1)(G) requires an issuer, prior to sale, to provide investors "a reasonable opportunity to rescind the commitment to purchase the securities." We proposed, therefore, in Rule 304(a) of Regulation Crowdfunding, to give investors an unconditional right to cancel an investment commitment for any reason until 48 hours prior to the deadline identified in the issuer's offering materials. Under this approach, an investor could reconsider his or her investment decision with the benefit of the views of the crowd and other information, until the final 48 hours of the offering. Thereafter, an investor would not be able to cancel any investment commitments made within the final 48 hours of the offering (except in the event of a material change to the offering, as discussed below).[883]

We also proposed in Rule 304(b) that if an issuer reached the target offering amount prior to the deadline identified in its offering materials, it could close the offering once the target offering amount was reached, provided that: (1) the offering had been open for a minimum of 21 days; (2) the intermediary provided notice about the new offering deadline at least five business days prior to the new offering deadline; (3) investors would be given the opportunity to reconsider

[883] *See* proposed Rule 304(c).

their investment decision and to cancel their investment commitment until 48 hours prior to the new offering deadline; and (4) at the time of the new offering deadline, the issuer continued to meet or exceed the target offering amount.

In addition, we proposed in Rule 304(c) that if there was a material change[884] to the terms of an offering or to the information provided by the issuer about the offering, the intermediary would be required to give or send to any investors who have made investment commitments notice of the material change, stating that the investor's investment commitment will be cancelled unless the investor reconfirms his or her commitment within five business days of receipt of the notice.[885] As proposed, if the investor failed to reconfirm his or her investment within those five business days, the intermediary would be required, within five business days thereafter, to: (1) provide or send the investor a notification disclosing that the investment commitment was cancelled, the reason for the cancellation and the refund amount that the investor should expect to receive; and (2) direct the refund of investor funds.[886] This notification, like other notifications from an intermediary, would be required to be provided by e-mail or other electronic media, and to be documented in accordance with applicable recordkeeping rules.[887]

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[884] In the Proposing Release, we noted that in those instances where an issuer had previously disclosed in its offering materials only the method for determining the price of the securities offered and not the final price of those securities, setting of the final price would be considered a material change. We also noted that if the change involved closing the offering once the target offering amount is reached, which would be prior to the deadline identified in the offering materials, then the procedures required under proposed Rule 304(b), and not those in Rule 304(c), would apply.

[885] The proposed rules also required that an issuer extend an offering to allow for a five business day period in instances where material changes to the offering or to the information provided by the issuer occurred within five business days of the maximum number of days that an offering was to remain open. *See* proposed Rule 304(c)(2) of Regulation Crowdfunding. *See also* Rule 302(a)(2) (requiring that notification be provided by email or through other electronic media).

[886] *See* proposed Rule 304(c)(1) of Regulation Crowdfunding.

[887] Intermediaries that are brokers would be subject to the recordkeeping requirements of Exchange Act Rules 17a-3 and 17a-4, and intermediaries that are funding portals would be subject to recordkeeping requirements under proposed Rule 404 of Regulation Crowdfunding. *See* note 1114 (discussing the recordkeeping rules

Finally, we proposed in Rule 304(d) that if an issuer did not complete an offering, for example, because the target was not reached or the issuer decided to terminate the offering, the intermediary would be required, within five business days, to: (1) give or send to each investor who had made an investment commitment a notification disclosing the cancellation of the offering, the reason for the cancelation, and the refund amount that the investor should expect to receive; (2) direct the refund of investor funds; and (3) prevent investors from making investment commitments with respect to that offering on its platform. This notification, like other notifications from an intermediary, would be required to be provided by e-mail or other electronic media, and to be documented in accordance with applicable recordkeeping rules.[888]

b. Comments on the Proposed Rule

One commenter supported the unconditional right of investors to cancel an investment commitment for any reason until 48 hours prior to the close of an offering.[889] Other commenters, however, expressed concern over the potential for misconduct regarding cancellations,[890] such as scenarios where investors commit and then withdraw at the last minute.[891]

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applicable to brokers and intermediaries). *See also* Section II.D.5; Section II.C.4. (discussing an intermediary's electronic delivery requirements and Rule 302(a)(2)).

888 *See* note 1114 (discussing the recordkeeping rules applicable to brokers and intermediaries).

889 *See* CFA Institute Letter.

890 *See, e.g.*, Joinvestor Letter (suggesting the lock-in-date should be fourteen days prior to the closing date to prevent any misconduct surrounding the approach of a target, or the limit of oversubscription, near to the close of the round); Consumer Federation Letter; RocketHub Letter.

891 *See, e.g.*, RocketHub Letter (recommending a 24-hour cancellation period in order to protect investors from "'pump & rescind' schemes" and minimize an issuer's exposure to the risk of "'short fall' situations"); Consumer Federation Letter (noting the risk that "individuals associated with the issuer will commit money to the offering early in the process in order to stimulate interest and create a sense of urgency about investing, only to withdraw at the last minute"). The same commenter suggested that potential gamesmanship by investors associated with the issuer has the potential to discredit crowdfunding and recommended that the Commission consider more meaningful restrictions on issuer participation.

One commenter stated that the rule on early closure of an offering should be more narrowly defined.[892] This commenter requested that the Commission clarify whether, under such circumstances, an offering should be closed from accepting more funds or keep accepting commitments until the end of the five business day period, even if this puts an offering over set limits.[893]

Some commenters supported the proposal that existing disclosure materials can be modified in the event of a material change, with the original offering remaining open,[894] while one commenter also suggested that no changes should be allowed within 21 days of the close date.[895] Several commenters generally agreed that an investor should have to reconfirm the commitment to invest when a material change occurs.[896] One commenter stated that many investors would prefer not to have to re-confirm their investments and recommended allowing investors to decide how to handle material changes.[897] Another commenter opposed any reconfirmation requirement because it believed there should be a presumption that any changes made would be in the best interest of the issuer and all of its stakeholders.[898]

Some commenters supported the proposed five-day reconfirmation period for investors.[899] Some commenters, however, stated that five business days is not enough time for an investor to

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892 *See* RFPIA Letter (stating that "[i]f the issuer reaches the target offering amount prior to the deadline the current proposed regulation require[s] a funding portal to give a 5 day notice to investors of the new closing date. Since funding portals have no crystal balls, this process needs to be more narrowly defined").

893 *Id.*

894 *See, e.g.,* Arctic Island Letter 6; Joinvestor Letter; Wales Capital Letter 2.

895 *See* Joinvestor Letter.

896 *See, e.g.,* CFA Institute Letter; Wales Capital 2 Letter.

897 *See* Wefunder Letter.

898 *See* Public Startup Letter 3.

899 *See, e.g.,* CFA Institute Letter; Wales Capital 2 Letter.

decide whether to reconfirm an investment commitment after a material change is made by the issuer.[900] One commenter suggested a shorter reconfirmation time period.[901] Another commenter recommended that the Commission clarify when the five-day reconfirmation period begins.[902] One commenter suggested material revisions made to the offering should restart the 21-day minimum period for the campaign, though generally agreed that a five-business day notification is sufficient in the event that an offering is cancelled.[903]

c. **Final Rules**

We are adopting Rule 304 as proposed, with a technical change to correct a cross-cite in the rule text. We believe that the final rule appropriately takes into consideration the needs of investors to be able to consider material changes to the terms of the offering and new views expressed by the crowd, while allowing issuers to have certainty about their ability to close an offering at the end of the offering period. We have considered the comments outlined above about concerns with cancellation generally and those suggesting other types of cancellation or lock-in periods. However, we continue to believe that allowing investors to cancel any investment commitments for any reason until 48 hours prior to the deadline identified in the issuer's offering materials is an appropriate cancellation period because it is consistent with the requirement of Section 4A(b)(1)(G) that investors have a "reasonable opportunity" to rescind investment commitments, while also providing issuers with certainty within a reasonable amount of time

[900] *See, e.g.,* Arctic Island Letter 6 (advocating that the time period be "indefinite" so as to give investors more time to consider the changes and to give issuers more time to answer questions of individual investors and provide clarifications or make subsequent changes as needed); CfPA Letter (recommending that any change in offering documents on a website after initial posting restart the 21-day period (or at least half of that) during which offerings cannot close and prospective or pledged investors can reconsider and rescind their commitments).

[901] *See* RFPIA Letter (suggesting eliminating the requirement or reducing it to 72 hours).

[902] *See* ODS Letter.

[903] *See* Wales Capital Letter 2.

about whether they have indeed received investment commitments. Although we acknowledge commenters' concerns about potential misconduct in connection with cancellations of investment commitments, we note that issuers and investors, including investors associated with the issuer, are subject to the antifraud provisions of the securities laws. We also note that, as we discussed above, an intermediary is required to promptly remove an offering from its platform if it becomes aware of information that causes it to believe that the issuer or the offering presents the potential for fraud or otherwise raises concerns about investor protection.[904]

In regards to one commenter's request for clarification as to whether an intermediary may continue to receive investment commitments during the five business day period prior to an early closure of an offering (even if the commitment may be oversubscribed), we note that intermediaries are permitted to continue to receive investment commitments during that time period, provided that the intermediary informs investors about the continuation of such acceptance in accordance with Rule 304(b).[905]

In addition, we believe that when material changes arise during the course of an offering, an investor who had made a prior investment commitment should have a reasonable period during which to review the new information and to decide whether to invest by reconfirming the investment commitment. Despite some commenters' concerns outlined above, we continue to believe that a five business day period is appropriate because it reasonably reflects the need to allow an investor sufficient time to consider material changes to the terms of the offering while

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904 *See* Section II.C.3.

905 However, the issuer will still have to comply with the rules regarding oversubscriptions. *See* Section II.B.6.a. This same commenter expressed uncertainty about how an issuer will communicate early closure to a funding portal so that the funding portal can provide appropriate notice to investors about the new offering deadline. The final rules do not prescribe the mechanics for how funding portals must communicate with issuers as we believe the better course is to provide for flexibility in this regard so that intermediaries and issuers can arrive at efficient working arrangements.

giving issuers certainty about their ability to close an offering. For the same reasons noted above, we also believe that five business days is a sufficient amount of time for intermediaries to notify investors about offerings that are not completed or terminated. Finally, we believe that requiring an investor to reconfirm his or her investment commitment within five business days of receipt of the notice of a material change is sufficiently clear as to when the reconfirmation period begins and provides additional investor protection and is therefore an appropriate requirement for the final rule.

7. Payments to Third Parties

a. Proposed Rule

Securities Act Section 4A(a)(10) provides that an intermediary in a transaction made in reliance on Section 4(a)(6) shall not compensate "promoters, finders, or lead generators for providing the broker or funding portal with the personal identifying information of any potential investor."

We proposed in Rule 305(a) of Regulation Crowdfunding to prohibit an intermediary from compensating any person for providing it with the "personally identifiable information"[906] of any investor. As explained in the Proposing Release, we believe that any person compensated for providing the personally identifiable information of investors would be acting as a promoter, finder or lead generator within the meaning of Securities Act Section 4A(a)(10).

[906] As proposed, the term "personally identifiable information" would mean any information that can be used to distinguish or trace an individual's identity, either alone or when combined with other personal or identifying information that is linked or linkable to a specific individual. *See* proposed Rule 305(c) of Regulation Crowdfunding. As explained in the Proposing Release, personally identifiable information could include any information that can be used to identify an individual, such as name, social security number, date or place of birth, mother's maiden name or biometric records, as well as any other information that is linked directly to an individual, such as financial, employment, educational or medical information.

Proposed Rule 305(b), however, would permit an intermediary to compensate a person for directing issuers or investors to the intermediary's platform if: (1) the person does not provide the intermediary with the personally identifiable information of any investor, and (2) the compensation, unless it is paid to a registered broker or dealer, is not based, directly or indirectly, on the purchase or sale of a security offered in reliance on Securities Act Section 4(a)(6) on or through the intermediary's platform.[907]

b. Comments on the Proposed Rule

Some commenters generally supported the portion of the proposed rule that allows intermediaries to compensate third parties for directing investors to the platform.[908] Some of these comments also agreed that intermediaries should be permitted to compensate third parties for general business advertising including, for example, web search engine direction or other standard Internet marketing techniques.[909] In response to our request for comment as to whether disclosures should be required when an intermediary compensates third parties for directing investors to its platform, one commenter suggested the Commission should not require disclosure of "standard Internet marketing [practices]" that "inform investors of companies they may be interested in."[910] Another commenter stated that compensation should only be allowed under limited circumstances, albeit without providing examples of those limited circumstances.[911] We

[907] We note that the receipt of direct or indirect transaction-based compensation would strongly indicate that the recipient is acting as a broker. As such, the party receiving the compensation in the scenario described needs to consider whether it would be required to register as a broker.

[908] *See, e.g.,* RoC Letter; RocketHub Letter; Wefunder Letter.

[909] *See, e.g.,* RocketHub Letter; Wefunder Letter. *See also* ABA Letter (discussing the practice of so-called "passive bulletin boards").

[910] Wefunder Letter.

[911] *See* Joinvestor Letter ("We believe such compensation should be allowed under extremely limited circumstances, as promotion will be a central issue to these campaigns.").

did not receive comments related to the definition of the term "personally identifiable information" as proposed in Rule 305(c).

c. **Final Rules**

We are adopting Rule 305 with modifications. Rule 305(a), like the proposed rule, states that an intermediary may not compensate any person for providing the intermediary with the personally identifiable information of any investor in securities offered and sold in reliance on Section 4(a)(6) of the Securities Act. However, we are not including in the final rule what was proposed in paragraph (b), which stated that an intermediary may compensate a person for directing issuers to the intermediary's platform, provided that unless the compensation is made to a registered broker or dealer, the compensation is not based, directly or indirectly, on the purchase or sale of a security offered in reliance on Section 4(a)(6) of the Securities Act on or through the intermediary's platform. Upon further consideration, we believe this provision would be duplicative of Rule 402(b)(6), which addresses referral payments that funding portals are permitted to pay to third parties.[912] In addition, registered broker-dealers are already subject to limitations on the types of compensation that they may pay to third parties, and as we explained in the Proposing Release, are subject to an established regulatory and oversight regime that provides important safeguards for investors.

We agree with those commenters who believe intermediaries should be permitted to compensate third parties for general business advertising including, for example, web search engine direction or other standard Internet marketing techniques so long as that compensation is not based, directly or indirectly, on the purchase or sale of a security offered in reliance on

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912 *See* Section II.D.3.

Securities Act Section 4(a)(6).[913] We believe permitting compensation for these types of general business advertising does not raise the same privacy concerns as those implicated by the provision of personally identifiable information and is generally consistent with the statutory scheme for crowdfunding promotional activities. Therefore, under the rules, an intermediary may pay a person a flat fixed fee[914] to direct persons to the intermediary's platform through, for example, hyperlinks or search term results or make payments to a person to advertise its existence.[915] The intermediary, however, cannot pay to receive personally identifiable information in under any circumstances pursuant to the prohibition in Rule 305(a).

Finally, we are adopting as proposed the definition of personally identifiable information, which will be renumbered as Rule 305(b).

D. Additional Funding Portal Requirements

1. Registration Requirement

a. Generally

(1) Proposed Rules

Securities Act Section 4A(a)(1) requires that an intermediary facilitating a transaction made in reliance on Securities Act Section 4(a)(6) register with the Commission as a broker or a funding portal. The statute does not, however, prescribe the manner in which a funding portal

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913 *See, e.g.,* 158 Cong. Rec. S5474-03 (daily ed. July 26, 2012) (statement of Sen. Jeff Merkley) ("[T]he limitation on off-platform advertising is intended to prohibit issuers—including officers, directors, and 20 percent shareholders—from promoting or paying promoters to express opinions outside the platform that would go beyond pointing the public to the funding portal.").

914 A flat fixed fee is one that is not based on the success of the offering, and so would not be transaction-based compensation. We note that the receipt of direct or indirect transaction-based compensation would strongly indicate that the recipient is acting as a broker. As such, the party receiving this kind of compensation needs to consider whether it would be required to register as a broker.

915 *See also* Rule 402 of Regulation Crowdfunding and discussion in Section II.D.3 (discussing advertising and marketing activities in which a funding portal may engage under the Regulation's safe harbor).

would register with the Commission.[916] Securities Act Section 4A(a)(12) requires intermediaries to comply with requirements as the Commission may, by rule, prescribe for the protection of investors and in the public interest. Exchange Act Section 3(h)(1)(C) also permits the Commission to impose, as part of its authority to exempt funding portals from broker registration, "such other requirements under [the Exchange Act] as the Commission determines appropriate."

We proposed to establish a streamlined registration process under which a funding portal would register with the Commission by filing a form with information consistent with, but less extensive than, the information required for broker-dealers on the Uniform Application for Broker-Dealer Registration ("Form BD").[917] Under proposed Rule 400(a), a funding portal would register by completing a Form Funding Portal, which would include information concerning the funding portal's principal place of business, its legal status and its disciplinary history, if any; business activities, including the types of compensation the funding portal would receive; control affiliates of the funding portal and disclosure of their disciplinary history, if any; FINRA membership or membership with any other registered national securities association; and the funding portal's website address(es) or other means of access.[918] Proposed Rule 400(a) also would require a funding portal to become a member of FINRA or another applicable national securities association registered under Exchange Act Section 15A. As proposed in Rule 400(a), the funding portal's registration would become effective the later of: (1) 30 calendar days after the

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916 *Compare* Exchange Act Section 15(b) [15 U.S.C. 78*o*(b)] (prescribing the manner of registration of broker-dealers).

917 Brokers currently register with the Commission using Form BD. Information on that form regarding the broker's credentials, including current registrations or licenses and employment and disciplinary history, is publicly available on FINRA's BrokerCheck.

918 We discuss in Section II.D.1.b the information required to be included in Form Funding Portal.

date that the registration is received by the Commission; or (2) the date the funding portal is approved for membership in FINRA or any other registered national securities association.

Proposed Rule 400(b) would require a funding portal to file an amendment to Form Funding Portal within 30 days of any of the information previously submitted on the form becoming inaccurate for any reason.

In addition, proposed Rule 400(c)(1) would permit a funding portal that succeeds to and continues the business of a registered funding portal to also succeed to the registration of the predecessor on Form Funding Portal. As proposed in Rule 400(c)(1), the registration would remain effective as the registration of the successor if the successor, within 30 days after such succession, files a registration on Form Funding Portal and the predecessor files a withdrawal on Form Funding Portal.[919] Proposed Rule 400(c)(1), therefore, would not apply where the predecessor funding portal intends to continue to engage in funding portal activities.

In certain circumstances, proposed Rule 400(c)(2) would allow the successor to file an amendment to the predecessor's Form Funding Portal rather than requiring the successor and predecessor, respectively, to follow the registration filing and withdrawal process under Rule 400(c)(1) described above. Specifically, proposed Rule 400(c)(2) provides that, if the succession is based solely on a change of the predecessor's date or state of incorporation, form of organization or composition of a partnership, the successor may, within 30 days after the succession, amend the notice registration of the predecessor on Form Funding Portal to reflect these changes. Successions by amendment would be limited to those successions that resulted

919 Under the proposed rules, the registration of the predecessor funding portal would be deemed withdrawn 45 days after the notice registration on Form Funding Portal was filed by the successor. *See* proposed Rule 400(c)(1). A similar process exists for registered broker-dealers under Exchange Act Rule 15b1-3 (17 CFR 240.15b1-3).

from a formal change in the structure or legal status of the funding portal but did not result in a change in control.

The instructions to the proposed Form Funding Portal would limit the term "successor" to an entity that assumed or acquired substantially all of the assets and liabilities of the predecessor funding portal's business.

We also proposed in Rule 400(d) to require a funding portal to promptly file a withdrawal of registration on Form Funding Portal upon ceasing to operate as a funding portal. The withdrawal would be effective on the later of 30 days after receipt by the Commission, after the funding portal was no longer operational, or within a longer period of time consented to by the funding portal or that the Commission, by order, determined as necessary or appropriate in the public interest or for the protection of investors.[920]

Proposed Rule 400(e) would provide that each application for registration, amendment thereto, successor registration or withdrawal would be considered filed when a complete Form Funding Portal was submitted with the Commission or its designee. Proposed Rule 400(e) also would require duplicate originals of the application to be filed with surveillance personnel designated by the registered national securities association of which the funding portal is a member.

[920] A similar process exists for registered broker-dealers under Exchange Act Section 15(b)(5) (15 U.S.C. 78*o*(b)(5)) and Rule 15b6-1 (17 CFR 240.15b6-1) thereunder.

(2) Comments on the Proposed Rule

We received some comments generally supporting the proposed registration method,[921] while one commenter generally opposed the proposed registration method, stating the Commission is requiring too stringent a registration process and financial overhead for funding portals.[922] One commenter encouraged the Commission to require broker-dealers to register on the same form as funding portals.[923]

In the Proposing Release, we requested comments on whether we should impose other restrictions or prohibitions on affiliations of the funding portal, such as affiliation with a registered broker-dealer or registered transfer agent. Some commenters opposed the imposition of other restrictions or prohibitions on affiliations of the funding portal.[924] One of these commenters stated that affiliations and partnerships with brokers or transfer agents should be optional.[925]

(3) Final Rules

We are adopting Rule 400(a) – (e) generally as proposed with one change. We are deleting from Rule 400(e) as proposed the language stating that Form Funding Portal may be filed with a Commission designee, as we have determined not to designate this function. Rather, these filings will be made through the EDGAR system as explained in more detail below.

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921 *See, e.g.*, Joinvestor Letter; DreamFunded Letter (favoring the proposed rules which provide a "high barrier to entry" to funding portals, as it will "stop anyone from potentially creating a funding portal over a weekend").

922 *See* PeoplePowerFund Letter (suggesting that the Commission should consider, "a simple registration detailing the owners and operators of a web portal, the legal domicile and registration contact information etc. and the portals [sic] commitment to adherence of the rules of the [C]ommission").

923 *See* RocketHub Letter. The commenter also stated that it has "a serious concern with [broker-dealers] having an unfair advantage in the market, by already being regulated and registered with the Commission as well as FINRA. Therefore, they may be able to service the market well ahead of [funding] [p]ortals."

924 *See, e.g.*, Joinvestor Letter; Tiny Cat Letter.

925 *See* Tiny Cat Letter.

Rule 400 establishes a streamlined registration process for a funding portal to register with the Commission. We have considered the general comment suggesting that the registration requirement for funding portals is too stringent and creates financial overhead. We believe, however, that the rules as adopted provide a reasonable approach to funding portal registration – they are based on broker-dealer registration requirements, which we believe have been effective in providing investor protection and allowing the Commission to perform its oversight function. At the same time, the registration requirement takes into account the more limited activities of funding portals as compared to broker-dealers. As such, the registration requirements we are imposing on funding portals are generally consistent with those imposed on broker-dealers, while not as extensive in every aspect. As we note in Section III.B.5, we have considered the costs of funding portal registration and believe that the anticipated costs to funding portals are justified in light of the expected benefits investors will receive from utilizing funding portals that are subject to registration requirements, which include public disclosure of registration information on Form Funding Portal in EDGAR, as described in more detail in Section II.D.1.b below. We believe that having such a registration system will promote investor confidence in this new and emerging market, while providing us and FINRA (and any other applicable national securities association registered pursuant to Exchange Act Section 15A) with information integral to effective oversight.

Finally, consistent with the proposal, we are not imposing additional restrictions or prohibitions on affiliations of the funding portal in the final rules. We note, however, that Form Funding Portal, which will be publicly available, requires a funding portal to disclose information about its control relationships and the disciplinary history of associated persons.[926]

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[926] *See* Item 4 - Control Relationship of Form Funding Portal and Item 5 – Disclosure Information of Form Funding Portal. "Control" is defined for the purposes of Form Funding Portal as "[t]he power, directly or

b. **Form Funding Portal**

(1) **Proposed Rules**

As noted above, proposed Rule 400(a) requires a funding portal seeking to register with the Commission, through an initial application, to file a completed Form Funding Portal with the Commission. As proposed, Rule 400(b) – (d) would have also required funding portals to use proposed Form Funding Portal to amend any part of the funding portal's most recent Form Funding Portal, including certain successor registrations, or to withdraw from registration as a funding portal with the Commission.[927] We proposed to make a blank Form Funding Portal available through the Commission's website or such other electronic database, as determined by the Commission in the future.

As proposed, Form Funding Portal appropriately considered the need to provide efficiency in completing the form while requesting sufficient information from funding portals to allow for effective regulatory oversight. The proposed form would have consisted of eight sections, including items related to: identifying information, form of organization, successions, control persons, disclosure information, non-securities related business, escrow, compensation arrangements, and withdrawal. These items would require an applicant to provide certain basic identifying and contact information concerning its business; list its direct owners and executives;

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indirectly, to direct the management or policies of the *funding portal*, whether through contract, or otherwise. A *person* is presumed to *control* a *funding portal* if that *person*: (1) is a director, general partner or officer exercising executive responsibility (or has a similar status or functions); (2) directly or indirectly has the right to vote 25 percent or more of a class of a voting security or has the power to sell or direct the sale of 25 percent or more of a class of voting securities of the *funding portal*; or (3) in the case of a partnership, has contributed, or has a right to receive, 25 percent or more of the capital of the *funding portal*." *See* Instructions to Form Funding Portal.

[927] As noted in Section II.D.1.a., a successor funding portal may amend the registration of its predecessor on Form Funding Portal, within 30 days after succession, if the succession is based solely on a change of the predecessor's date of incorporation, state of incorporation, form of organization, or composition of a partnership. Otherwise, a successor must file a registration statement on Form Funding portal within 30 days after succession and a predecessor must file a withdrawal on Form Funding Portal. *See* Rule 400(c).

identify persons that directly or indirectly control the funding portal, control the management or policies of the funding portal and persons the funding portal controls; and supply information about its litigation and disciplinary history and the litigation and disciplinary history of its associated persons.[928] Under proposed Form Funding Portal, a funding portal would be able to operate multiple website addresses under a single funding portal registration, provided the funding portal disclosed on Form Funding Portal all the websites and names under which it did business.[929] In addition, the proposed form would have required an applicant to describe any non-securities related business activities and supply information about its escrow arrangements, compensation arrangements with issuers and fidelity bond.

Upon a filing to withdraw from registration, a funding portal would be required to provide certain books and records information. In addition, as discussed in detail in Section II.D.1.d. below, applicants that are incorporated in or organized under the laws of a jurisdiction outside of the United States or its territories, or whose principal place of business is not in the United States or its territories, would have been required to complete Schedule C to Form Funding Portal, which would require information about the applicant's arrangements to have an agent for service of process in the United States, as well as a certification and an opinion of counsel addressing the ability of the applicant to provide the Commission and the national securities association of which it is a member with prompt access to its books and records and to submit to onsite inspection and examination by the Commission and the national securities association.

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[928] This information would be used to determine whether to approve an application for registration, to decide whether to revoke registration, to place limitations on the applicant's activities as a funding portal and to identify potential problem areas on which to focus during examinations. If an applicant or its associated person has a disciplinary history, then the applicant could be required to complete the appropriate Disclosure Reporting Page ("DRP"), either Criminal, Regulatory, Civil Judicial, Bankruptcy, Bond or Judgment on proposed Form Funding Portal.

[929] *See* proposed Form Funding Portal, Item 1; 17 CFR 249.2000.

We also proposed that a person duly authorized to bind the funding portal be required to sign Form Funding Portal in order to execute the documents.[930] As proposed, the funding portal also would have been required to consent to service of process to its contact person on the form.[931]

Finally, we proposed to make all current Forms Funding Portal, including amendments and registration withdrawal requests, immediately accessible and searchable by the public, with the exception of certain personally identifiable information or other information with significant potential for misuse (including the contact employee's direct phone number and e-mail address and any IRS Employer Identification Number, social security number, date of birth, or any other similar information).[932]

(2) Comments on Proposed Rules

We received one comment in support of using EDGAR for all funding portal filing and registration requirements.[933] Some commenters also generally supported allowing a funding portal to file one registration application to operate multiple websites.[934] One commenter, however, expressed concern about allowing funding portals to file one registration form for

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930 *See* execution statement of proposed Form Funding Portal. We proposed requiring a person executing Form Funding Portal and Schedule C (if applicable) to represent that the person has executed the form on behalf of, and is duly authorized to bind, the funding portal; the information and statements contained in the form and other information filed are current, true and complete; and if the person is filing an amendment, to the extent that any information previously submitted is not amended, such information is currently accurate and complete.

931 *See* execution statement of proposed Form Funding Portal. Specifically, we proposed requiring the funding portal to consent that service of any civil action brought by, or notice of any proceeding before, the Commission or any national securities association of which it is a member, in connection with the funding portal's investment-related business, may be given by registered or certified mail to the funding portal's contact person at the main address, or mailing address, on the form.

932 *See* proposed Instructions to Form Funding Portal.

933 *See* Public Startup Letter 3.

934 *See, e.g.*, Joinvestor Letter; Tiny Cat Letter (stating that requiring new applications for each website would be unnecessary as it "would not provide any new information for either the commission or the public" so long as the expansion involves no material changes to information in the initial application).

multiple websites. This commenter suggested the Commission "clearly address Portals that register with the Commission, and then subsequently license out or sell their registration."[935] The same commenter stated that "[s]ome entrepreneurs have indicated that they intend to operate a 'parent' funding [p]ortal, which allows other sites to operate under its umbrella, (leveraging the parent's systems, architecture, design, infrastructure, etc.)."[936]

(3) **Final Rules**

We are adopting Form Funding Portal generally as proposed,[937] with the following changes:

- The final rules amend Regulation S-T to permit a funding portal to file PDF exhibits and attachments to Form Funding Portal on EDGAR as "official filings."[938]
- The following has been added to the title of the form: "Application or Amendment to Application for Registration or Withdrawal from Registration as Funding Portal" to clarify that the form will be used for all funding portal registration applications, amendments and withdrawals;
- Amendments to Form Funding Portal will require a narrative explaining the amendment, which we believe will clarify to investors and potential investors the particular information being amended by the funding portal in its filing;

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935 RocketHub Letter.

936 *Id.*

937 We also made minor non-substantive technical changes and changes to increase the clarity of the information being requested in the form.

938 *See* Rule 101(a)(1)(xviii) of Regulation S-T. As we noted in Section II.B.3, Regulation S-T generally allows PDF documents to be filed only as unofficial copies. *See* Rule 104 of Regulation S-T. However, Rule 101 provides for certain exceptions to this restriction. The PDF documents must be in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T.

- Form Funding Portal will not require information about fidelity bonds since we are not adopting the fidelity bond requirement in the proposed rules;[939]
- Item 1 also will require information about website URL changes on the most recent Form Funding Portal, title of the contact employee and the month the applicant funding portal's fiscal year ends;
- The title of Item 4 is changed from "Control Persons," as proposed, to "Control Relationships," as adopted, to clarify that Item 4 may capture information not being captured in Schedules A and B;
- The language in Item 5 "to determine whether to approve an application for registration" has been deleted;[940]
- Item 7, as adopted, references "qualified third party arrangements" rather than "escrow arrangements," as proposed, to indicate that, in addition to holding the funds in escrow, a qualified third party may also hold investor funds in an account for the benefit of investors and the issuer;[941]
- "G – Other (general partner, trustee, or elected member)" has been added as an ownership code in Schedule A;
- Schedules A and B have been changed from the proposal to clarify that the Schedules are collecting information about whether direct owners and executive officers are "control" persons;

939 *See* Section II.D.1.c.

940 We note, however, that failure to answer a question in Item 5 will result in an incomplete application for registration.

941 *See* Section II.C.5.e.

- The language to Schedule C of Form Funding Portal has been changed to track more closely the requirements of Rule 400(f) for nonresident funding portals and to add an execution section for these entities; and
- Withdrawal information for funding portals proposed to be collected under Item 8 will instead be collected in a new "Schedule D".[942]

We continue to believe that the information required by Form Funding Portal is important for our oversight of funding portals and to allow us to assess a funding portal's application for registration and perform examinations of funding portals. We also note that the information required by the Form will be available to investors and potential investors and will provide transparency regarding intermediaries. Although we generally modeled Form Funding Portal on Form BD, we have tailored the questions to the activities of funding portals. For example, Form Funding Portal, in contrast to Form BD, does not include any questions about holding customer funds and securities because funding portals are statutorily prohibited from holding or maintaining customer funds or securities. We also included questions in Form Funding Portal to address specific restrictions that are imposed upon funding portals but not upon broker-dealers. For example, Form Funding Portal requires specific information about a funding portal's qualified

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942 There have been no substantive changes to the withdrawal information to be collected on Schedule D. The instructions to Form Funding Portal have been modified from the proposal to (1) include IRS Tax Identification Number and the contact employee's fax number as information that will be redacted on Form Funding Portal by the Commission and, therefore, not disseminated to the public by the form; and (2) inform funding portals that they should manually redact certain personally identifiable information or other information with significant potential for misuse (including the contact employee's direct phone number, fax number and e-mail address and any IRS Employer Identification Number, IRS Tax Identification Number, social security number, or any other similar information) from any PDF attachments they file as part of their Form Funding Portal submission due to privacy concerns. The instructions have also been modified to amend the definition of SRO to delete the reference to Section 3 of the Exchange Act and clarify that the phrase "any national securities association registered with the Commission" in the definition encompasses any national securities association registered under Section 15A of the Exchange Act, in order to alleviate any confusion by funding portals when completing the form.

third party arrangements because a funding portal is prohibited from holding and maintaining customer funds.

In developing these requirements, we have taken into account that funding portals are limited purpose brokers that are conditionally exempt from registration as broker-dealers, and accordingly have sought to require appropriate information from these entities, while, at the same time, not making the process of completing and filing the required form inappropriately burdensome for funding portals.

As noted above, we proposed to make a blank Form Funding Portal available through our website or another electronic database. At the time of the Proposing Release, we had not yet determined the appropriate database through which to access and electronically file Form Funding Portal. We requested comments in the Proposing Release on the type of web-based registration that funding portals should use for accessing and filing Form Funding Portal, and as noted above, received one comment in support of using EDGAR for funding portal filing and registration requirements.[943] We have determined to require funding portals to access and file Form Funding Portal through the Commission's EDGAR system. Before a funding portal will be able to access EDGAR and electronically file Form Funding Portal, it will have to obtain EDGAR access codes and a central index key ("CIK") by creating and submitting a Form ID with the Commission for authorization to access EDGAR. The applicant will be required to fill out general user information fields on Form ID, including filer type name, address, phone number, e-mail address, organization name and employer identification number and file a signed, notarized version of the document. To facilitate this process, we are amending Form ID to add "Funding Portal" as a filer type and are also revising the instructions to the form to include the definition of "funding portal"

[943] *See* Public Startup Letter 3.

(as defined by Rule 300(c)(2)). Once the application has been accepted by the Commission, the funding portal will receive an e-mail with a CIK, which it can use (along with a passphrase that it has previously created) to generate EDGAR access codes, and access the system and Form Funding Portal.

As proposed, a funding portal will be required to check a box indicating the purpose for which the funding portal was filing the form:

- to register as a funding portal with the Commission, through an initial application;
- to amend any part of the funding portal's most recent Form Funding Portal, including a successor registration; or
- to withdraw from registration as a funding portal with the Commission.

The funding portal will receive an SEC file number after it files its Form Funding Portal initial application, and thereafter must provide us that file number when submitting an amendment or withdrawal from registration on Form Funding Portal. We will use this number to cross-reference amendments and withdrawals to the original registration.

When a funding portal's registration becomes effective, the information on Form Funding Portal will be made available to the public through EDGAR, with the exception of certain personally identifiable information or other information with significant potential for misuse (including the contact employee's direct phone number, fax number and e-mail address and any IRS Employer Identification Number, IRS Tax Identification Number, social security number, date of birth or any other similar information). In addition to current versions of Form Funding Portal, investors and potential investors also will be able to access historical versions of a funding portal's filings on EDGAR. We believe that making these documents publicly available and

searchable will provide the public with information about the registration process and the funding portal industry, thereby increasing transparency into this developing market.

The final rule permits a funding portal to operate multiple website addresses under a single funding portal registration. As we noted in the Proposing Release, we believe that allowing a funding portal to utilize more than one website address, if it chooses to do so, may allow the portal to minimize its regulatory costs while having the flexibility to customize each website to fit its specific needs, such as appealing to certain industries or investors. We have considered one commenter's concern about funding portals licensing or selling their registrations, and note that registrations are not transferrable among entities; rather, each funding portal is required to register with the Commission, pursuant to Rule 400(a). As explained above, an entity may succeed to and continue the business of a registered funding portal, but the successor must file a registration on Form Funding Portal within 30 days after any succession resulting in a change of control.[944]

c. Fidelity Bond

(1) Proposed Rule

Proposed Rule 400(f) would have required that funding portals, as a condition of registration, have in place, and thereafter maintain for the duration of such registration, a fidelity bond that: (1) has a minimum coverage of $100,000; (2) covers any associated person of the funding portal unless otherwise excepted in the rules set forth by FINRA or any other registered national securities association of which it is a member; and (3) meets any other applicable requirements set forth by FINRA or any other registered national securities association of which it is a member. While fidelity bond coverage was not mandated by statute, the proposed requirement was intended to help insure against the loss of investor funds that might occur if a

[944] *See* Section II.D.1.a.

funding portal were to violate the express prohibition set forth in Exchange Act Section 3(a)(80) on holding, managing, possessing or otherwise handling investor funds or securities.

(2) Comments on Proposed Rule

We received comments both in support of,[945] and opposition to,[946] the proposed requirement for funding portals to maintain fidelity bonds. One commenter stated its view that a fidelity bond may be necessary as a preventative measure to protect the interests of investors and issuers.[947] Another commenter noted that although fidelity bond coverage may be "indirect" to customers, they are protected under such coverage because the insured entity may recover its losses due to theft or embezzlement by its employees and meet the obligations of its customers.[948] The same commenter, however, suggested that the Commission may find a surety bond more appropriate in the crowdfunding context than a fidelity bond because investors would be able to make a direct claim under it for losses due to a funding portal's violation of the rules, and the insurer would be able to seek indemnity for that amount from the funding portal.[949] One commenter stated that it is not appropriate to require that the fidelity bond cover associated persons, and that the requirement is a "hangover from a non-transparent financial services sector," unlike the transparent crowdfunding model.[950] Another commenter noted that a fidelity bond would protect a funding portal from employee theft or embezzlement, and suggested that there is a low risk of this occurring since a funding portal not does hold cash or customer funds.[951] The

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945 *See, e.g.*, Joinvestor Letter; Public Startup 3 Letter; RocketHub Letter; SFAA Letter.

946 *See, e.g.*, ASSOB Letter; Heritage Letter; PeoplePowerFund Letter; RoC Letter.

947 *See* Joinvestor Letter.

948 *See* SFAA Letter.

949 *See id.*

950 *See* ASSOB Letter.

951 *See* Heritage Letter

commenter further stated that "[o]btaining a bond is simply one more expense that the portal must incur and it is necessary to control compliance costs if crowdfunding is to be a success."[952]

(3) Final Rules

After taking into account the comments and upon further consideration, we have determined not to adopt a fidelity bond requirement for funding portals. We have been persuaded by the comments that such a requirement may not be appropriate. We believe that the statutory protections and prohibitions set forth in Exchange Act Section 3(a)(80) on holding, managing, possessing or otherwise handling investor funds or securities provide substantial protections to investors. We recognize, as some commenters observed, that there may be potential risks to investors if a funding portal were to violate the prohibitions in Regulation Crowdfunding, including the potential loss of investor funds. As we discussed in the Proposing Release, funding portals will not be members of the Securities Investor Protection Corporation ("SIPC") and their customers, therefore, will not receive SIPC protection.[953] Furthermore, consistent with the proposed rules, the final rules also do not subject funding portals to minimum net capital requirements. Despite these vulnerabilities, we note that the potential burden associated with the requirement of a fidelity bond (or any bond) may not be justified by the benefits that could be derived from requiring that a funding portal obtain such a bond. In particular, we are concerned that a fidelity bond requirement could create a potential barrier to entry for some funding portals that could be detrimental to our mission of capital formation, as well as the feasibility of crowdfunding. At the same time, we are mindful of the potentially limited benefits of requiring such bonds to be obtained by funding portals, when taking into account the statutory restrictions

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[952] *Id.*

[953] *See* Proposing Release at 78 FR at 66482. Membership in SIPC applies only to persons registered as brokers or dealers under Section 15(b) of the Exchange Act. *See* 15 U.S.C. 78ccc(a)(2).

on funding portals' permissible activities. Instead, we believe at this time that the prohibition on a funding portal from handling customer funds and securities as well as the general anti-fraud provisions of our statutes and rules provide significant investor protections that do not need to be supplemented by a fidelity bond requirement. This decision is consistent with our approach generally to the regulation of funding portals in which we have sought to structure rules tailored to the business of funding portals that address the risks posed by such activities while considering the impact that our rules may have on this emerging market.

d. Requirements for Nonresident Funding Portals

(1) Proposed Rules

Under proposed Rule 400(g), registration pursuant to Rule 400 of Regulation Crowdfunding by a "nonresident funding portal"[954] would be first conditioned upon there being an information sharing arrangement in place between the Commission and the competent regulator in the jurisdiction under the laws of which the nonresident funding portal is organized or where it has its principal place of business that is applicable to the nonresident funding portal. The proposed rule would further require a nonresident funding portal registered or applying for registration to: (1) obtain a written consent and power of attorney appointing an agent for service of process in the United States (other than the Commission or a Commission member, official or employee), upon whom may be served any process, pleadings, or other papers in any action;[955] (2) furnish the Commission with the name and address of its agent for services of process on Schedule C of Form

[954] *See* proposed Rule 400(g)(1) of Regulation Crowdfunding (defining "nonresident funding portal" as "a funding portal incorporated in or organized under the laws of any jurisdiction outside of the United States or its territories, or having its principal place of business in any place not in the United States or its territories").

[955] *See* proposed Rule 400(g)(2)(i) of Regulation Crowdfunding.

Funding Portal;[956] and (3) certify on Schedule C of Form Funding Portal and provide an opinion of counsel that it can, as a matter of law, provide the Commission and any national securities association of which it is a member with prompt access to its books and records and can, as a matter of law, submit to onsite inspection and examination by the Commission and such national securities association.[957]

Proposed Rule 400(g)(2)(iv) would require a registered nonresident funding portal to promptly appoint a successor agent if it discharges its identified agent for service of process or if its agent for service of process is unwilling or unable to accept service on its behalf. In addition, proposed Rule 400(g)(2)(iii) would require a registered funding portal to promptly amend Schedule C to its Form Funding Portal if its agent, or the agent's name or address, changes. Finally, proposed Rule 400(g)(2)(v) would require the registered nonresident funding portal to maintain, as part of its books and records, the agreement with the agent for service of process for at least three years after termination of the agreement.

In addition, we proposed in Rule 400(g)(3)(ii) to require a registered nonresident funding portal to re-certify, on Schedule C to Form Funding Portal, within 90 days after any changes in the legal or regulatory framework that would affect: (1) its ability to provide (or the manner in which it provides) the Commission, or the national securities association of which it is a member, with prompt access to its books and records; or (2) the ability of the Commission or the national securities association to inspect and examine the nonresident funding portal. The re-certification would be accompanied by a revised opinion of counsel describing how, as a matter of law, the

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956 *See* proposed Rule 400(g)(2)(ii) of Regulation Crowdfunding.

957 *See* proposed Rule 400(g)(3)(i) of Regulation Crowdfunding. Exchange Act Section 3(h)(1)(C) permits us to impose, as part of our authority to exempt funding portals from broker registration, "such other requirements under [the Exchange Act] as the Commission determines appropriate."

entity can continue to meet its obligations to provide the Commission and the national securities association with prompt access to its books and records and to be subject to inspection and examination.[958]

(2) Comments on the Proposed Rule

One commenter stated its view that the definition of a nonresident funding portal will create a competitive advantage for foreign intermediary platforms.[959] Another commenter stated its view that nonresident funding portals should be subject to the same rules as domestic funding portals.[960]

In the Proposing Release, we requested comments about other actions or requirements that could address our concern that the Commission and the applicable national securities association be able to have direct access to books and records and be able to adequately examine and inspect a nonresident funding portal, if it would be impossible or impractical for such funding portal to obtain the required opinion of counsel. In response, a commenter suggested an arrangement between a nonresident funding portal and a domestic funding portal in which the nonresident funding portal would be required to make and keep current books and records, but the domestic

958 *See* proposed Rule 400(g)(3)(ii) of Regulation Crowdfunding.

959 *See* Public Startup Letter 3 (stating its view that the definition of nonresident funding portal is "flawed" because it believes these foreign entities could choose to act as intermediaries for U.S. issuers and U.S. investors in crowdfunding transactions without relying on Section 4(a)(6) and, therefore, gain a competitive advantage by not having to comply with the requirements of the rules under Regulation Crowdfunding in the same manner as domestic funding portals). *But see* Joinvestor Letter (stating its belief that "nonresident funding portal is properly defined").

960 *See* Wales Capital Letter 3. The commenter also recommended using the term "'foreign' funding portal" to be consistent with the treatment of corporations incorporated in another jurisdiction under various state laws. According to the commenter, a foreign corporation must file a notice of doing business in any state or nation in which it does substantial regular business, and must name an "'agent for acceptance of service'" in that nation (or the Secretary of State as agent) to allow people doing business with a foreign corporation to be able bring legal actions locally.

funding portal would have the ability to obtain and be responsible for the accuracy of such books and records.[961]

One commenter suggested that nonresident funding portals be required to clearly indicate on their websites that they are organized and operating outside of the U.S. and indicate whether a U.S. or non-U.S. bank will be used to process investors' funds.[962] One commenter suggested that a nonresident funding portal should be required to appoint a U.S. agent for all potential proceedings,[963] while another commenter suggested that a nonresident funding portal should be required to have a resident legal representative to handle any matters between issuers or investors and the portal.[964]

(3) Final Rules

We are adopting Rule 400(g) as proposed with certain minor changes, and renumbering it as Rule 400(f) due to the elimination of the fidelity bond requirement proposed as subparagraph (f).[965] We are changing the language of the rule as adopted applicable to a nonresident funding portal to:

- Add the term "registered" to any references to national securities association in the Rule to be more consistent with the terminology in the Exchange Act; and
- Require the nonresident funding portal also to certify that it "will" provide the Commission and any national securities association of which it "becomes" (rather

961 *Id.*

962 *See* Zhang Letter.

963 Wales Capital Letter 3.

964 *See* Joinvestor Letter.

965 We also added "*Inspections and Examinations*" to the heading of Rule 400(f)(3); this modification does not change the requirements from those proposed. In addition, we changed a cross-cite in the rule text to reflect the renumbering.

than "is") a member with prompt access to the books and records and "will" submit to onsite inspection and examination by the Commission and such national securities association.[966]

As we noted in the Proposing Release, the rule aims to help ensure that we and any applicable registered national securities association can access the books and records of, conduct examinations and inspections of, and enforce U.S. laws and regulations with respect to, funding portals that are not based in the United States, or that are subject to laws other than those of the United States. We believe that these rules will further our goal of promoting the ability of the Commission and any applicable national securities association to conduct effective regulatory oversight of funding portals.

We have considered the comments and believe that the final rule appropriately takes into consideration the need to provide more choices for U.S. issuers seeking to use intermediaries or access investors outside of the United States, while meeting the challenges associated with supervising, examining, and enforcing rules regarding activities of intermediaries based outside the United States. For example, as we noted in the Proposing Release, the requirement for an information sharing arrangement is designed to provide us with greater assurance that we will be able to obtain information about a nonresident funding portal necessary for our oversight of the funding portal. The ability to obtain information and secure the cooperation of the home country regulator according to established practices and protocols is expected to help to address the increased challenges that may arise from oversight of entities located outside of the United States.

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[966] The language in the proposed rule required a certification that the funding portal "can" meet such obligations but did not require a certification that it "will" meet them.

We note that nonresident funding portals are subject to the same registration requirements as other funding portals under Rule 400.[967]

We have also considered the comment submitted in response to our question about the use of books and records arrangements in situations where it would be impossible or impractical for a nonresident funding portal to obtain the required opinion of counsel.[968] We have determined not to adopt an alternative to the opinion of counsel requirement for nonresident funding portals in Regulation Crowdfunding. The opinion of counsel requirement is consistent with our approach to other nonresident registered entities and we believe it is an appropriate mechanism to use here, as well.[969] As we stated in the Proposing Release, we believe that the certification and supporting opinion of counsel requirements are important to confirm that each nonresident funding portal is in a position to provide the Commission and FINRA (or the applicable national securities association registered under Exchange Act Section 15A) with information that is necessary for us and the national securities association to effectively fulfill regulatory oversight responsibilities.[970] We do not believe that the books and records arrangement suggested by the commenter would provide assurance that we or FINRA would be able to consistently obtain such information, which could hinder our ability to fulfill our regulatory oversight responsibilities.

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[967] We have considered the commenter's view that there would be a potential competitive advantage for foreign intermediaries choosing to operate outside of the Section 4(a)(6) exemption. *See* Public Startup Letter 3. However, we note that any entities (foreign or domestic) intermediating offerings of securities between U.S. issuers and investors generally will be broker-dealers, either required to register under the Exchange Act or to be exempt from registration. *See* 15 U.S.C. 78o(a). We also note that the offer and sale of securities in the United States or to U.S. persons must be registered unless an exemption is available.

[968] *See* Wales Capital Letter 3.

[969] We note that the opinion of counsel requirement is generally consistent with the requirement for nonresident security-based swap dealers and major security-based swap participants, as well as those for nonresident municipal advisors. *See* Exchange Act Rule 15Fb2-4 and Rule 15Ba1-6.

[970] *See* Exchange Act Section 3(h)(1)(A). Failure to make this certification or re-certification or to provide an opinion of counsel or revised opinion of counsel will result in an incomplete application for registration.

We have also considered the comment suggesting that a nonresident funding portal be required to clearly indicate on its website that it is organized and operating outside of the United States and whether it will use a U.S. or non-U.S. bank to process investors' funds.[971] However, in light of the other disclosure requirements we are adopting, we are not persuaded that such a requirement is necessary. We note that the information required to be filed on Form Funding Portal (and that will be publicly disclosed) will include information about the qualified third party for the maintenance and transmission of investors' funds under Rule 303(e), including the name and address of the qualified third party.[972] In addition, a nonresident funding portal will be required to publicly disclose information on Schedule C to Form Funding Portal. Since Schedule C is required to be completed by nonresident funding portals only, investors will be able to discern easily whether or not the entity is a nonresident funding portal and, among other things, has certified (and provided an attached opinion of counsel indicating) that it is able to provide the Commission and any national securities association prompt access to its books and records and will submit to onsite inspection and examination by the same.

Finally, we have considered the comments suggesting that a nonresident funding portal should be required to have a U.S. agent for potential proceedings,[973] or a resident legal representative to handle any matters between issuers or investors, and the portal.[974] We note that, as discussed above, we are requiring funding portals to execute a written consent and power of attorney appointing an agent in the United States. The agent will be the representative of the funding portal for service of any process, pleadings or other papers in any action to enforce the

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[971] *See* Zhang Letter.

[972] *See* Form Funding Portal, Item 7 - Qualified Third Party Arrangements; Compensation Arrangements.

[973] *See* Wales Capital Letter 3.

[974] *See* Joinvestor Letter.

Exchange Act, Securities Act or any rule or regulation promulgated thereunder. As we noted above, we have limited the types of actions for which a nonresident funding portal will be required to have an agent for service of process, pleadings, or other papers in order to remain generally consistent with recent requirements that we have imposed on other types of nonresident entities. The funding portal will be required to disclose the name and address of its U.S. agent in Schedule C to its Form Funding Portal, and amend the Schedule promptly upon any change to the agent, agent's name or agent's address. We are not, however, requiring that nonresident funding portals have a resident legal representative to handle any matters between the portal and issuers or investors, which is consistent with our approach to other nonresident registered entities.[975]

2. Exemption from Broker-Dealer Registration

a. Proposed Rule

Exchange Act Section 3(h)(1), which was added by Section 304(a) of the JOBS Act, directs the Commission by rule to exempt, conditionally or unconditionally, a registered funding portal from the requirement to register as a broker or dealer under Exchange Act Section 15(a), provided that the funding portal: (1) remains subject to the examination, enforcement and other rulemaking authority of the Commission; (2) is a member of a registered national securities association; and (3) is subject to other requirements that the Commission determines appropriate.

As explained earlier, the role contemplated by Title III of the JOBS Act for an entity acting as an intermediary in a crowdfunding transaction would bring that entity within the

[975] For example, we note that requiring a U.S. agent for service of process but not requiring a U.S. legal representative to handle any matters between a funding portal and issuers or investors is generally consistent with the requirements for nonresident security-based swap dealers and major security-based swap participants, as well as those for nonresident municipal advisors. *See* Exchange Act Rule 15Fb2-4 and Rule 15Ba1-6.

definition of "broker" under Exchange Act Section 3(a)(4).[976] A funding portal would be "effecting transactions in securities for the account of others" by, among other things, ensuring that investors comply with the conditions of Securities Act Section 4A(a)(4) and (8), making the securities available for purchase through the funding portal, and ensuring the proper transfer of funds and securities as required by Securities Act Section 4A(a)(7).[977] In addition, a funding portal's receipt of compensation linked to the successful completion of the offering also would be indicative of acting as a broker in connection with these transactions. Thus, absent an exemption or exception, a funding portal would be required to register as a broker under the Exchange Act.

We proposed Rule 401(a) to provide an exemption for registered funding portals from the broker registration requirements of Exchange Act Section 15(a)(1) in connection with its activities as a funding portal. Consistent with the JOBS Act, the funding portal would remain subject to the full range of our examination and enforcement authority, even though it is not registered as a broker.[978] In this regard, proposed Rule 403 would require that a funding portal permit the examination and inspection of all of its business and business operations that related to its

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976 *See* Exchange Act Section 3(a)(4)(A) [15 U.S.C. 78c(a)(4)(A)] (defining "broker" as "any person engaged in the business of effecting transactions in securities for the account of others"). An entity acting as an intermediary in the offer and sale of securities pursuant to Section 4(a)(6), as contemplated in Title III of the JOBS Act, would not come within the meaning of "dealer," which is defined in Exchange Act Section 3(a)(5)(A) (15 U.S.C. 78c(a)(4)(A)), because it would not be engaging in the business of buying and selling securities for its own account. *See also* Exchange Act Section 15(a) [15 U.S.C. 15*o*(a)].

977 At the same time, there are statutory restrictions on the scope of services that a funding portal could provide. *See* Section II.C.1 (discussing Exchange Act Section 3(a)(80)).

978 *See* Exchange Act Section 3(h)(1)(C). *See also* Securities Act Section 20 [15 U.S.C. 77t] and Exchange Act Sections 21 and 21C [15 U.S.C. 78u and 78u-3]. In addition, we highlighted in the Proposing Release that Exchange Act Sections 15(b)(4) and 15(b)(6) (15 U.S.C. 78*o*(b)(4) and 78*o*(b)(6)) apply to brokers (including funding portals) regardless of whether or not they are registered with the Commission as brokers. Exchange Act Section 15(b)(4) authorizes the Commission to bring administrative proceedings against a broker when the broker violates the federal securities laws (and for other misconduct) and provides for the imposition of sanctions, up to and including the revocation of a broker's registration. Exchange Act Section 15(b)(6) provides similar enforcement authority against the persons associated with a broker, including barring persons from associating with any Commission registrant.

activities as a funding portal, such as its premises, systems, platforms and records, by representatives of the Commission and of the national securities association of which it is a member.[979] Proposed Rule 404 also would impose certain recordkeeping requirements on funding portals.[980]

We had further proposed in Rule 401(b) that, notwithstanding the exemption from broker registration, for purposes of Chapter X of Title 31 of the Code of Federal Regulations, a funding portal would be a broker or dealer "required to be registered" with the Commission under the Exchange Act, thereby requiring funding portals to comply with Chapter X, including certain anti-money laundering ("AML") provisions thereunder.[981]

b. Comments on the Proposed Rule

Commenters generally agreed with the funding portal exemption from registration as a broker-dealer.[982] One commenter stated that funding portals that provide no advice, make no warranties as to the suitability of an investment and do not handle share transfers or money, should not be required to register as a broker-dealer and requiring them to do so would provide no benefit to the public.[983]

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979 *See* Section II.D.4.

980 *See* Section II.D.5.

981 *See* 31 CFR 1010.100(h) and 1023.100(b) (defining broker or dealer for purposes of the applicability of AML requirements). *See* Currency and Foreign Transactions Reporting Act of 1970 (commonly referred to as the Bank Secrecy Act ("BSA")) [12. U.S.C. 1829b, 12 U.S.C. 1951-1959, 31 U.S.C. 5311-5330].

982 *See, e.g.,* Heritage Letter; Joinvestor Letter; PeoplePowerFund Letter; RocketHub Letter.

983 *See, e.g.,* PeoplePowerFund Letter (stating that requiring funding portals "to register as broker dealers thus crushing the very idea of crowd sourced funding as a people driven force for the good of the 'everyman'").

One commenter stated that the exemption from broker-dealer registration actually precludes funding portals from becoming members of FINRA,[984] and asserted that funding portals should not have to comply with the same requirements as broker-dealers for purposes of Chapter X of Title 31 of the CFR.[985] Another commenter, however, stated that it "supports the Commission's interpretation of the exemption, and believes that AML compliance is necessary."[986]

c. Final Rules

We are adopting, as proposed, paragraph (a) under Rule 401, but renumbering it as Rule 401 as we not adopting proposed Rule 401(b). We note, however, that the exemption from broker registration is applicable only to funding portals that are registered under Rule 400. Therefore, a funding portal that ceases to be registered under Rule 400 will no longer be exempt from broker registration under Rule 401. In response to the comment that this exemption precludes funding portals from becoming members of FINRA, as we noted above, because a funding portal will be engaged in the business of effecting securities transactions for the accounts of others through crowdfunding, it will be a "broker" within the meaning of Section 3(a)(4) of the Exchange Act. We also note that Exchange Act Section 3(h)(2) states that for purposes of sections 15(b)(8) and 15A, the term "broker or dealer" includes a funding portal and the term "registered broker or dealer" includes a registered funding portal. Therefore, funding portals are explicitly permitted by statute to become members of FINRA.

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984 *See* Vann Letter (reasoning that, because a funding portal is "not registered as a 'broker dealer,'" and because "the Securities Exchange Act of 1934 states 'A registered securities association shall deny membership to any person who is not a registered broker or dealer,'" then funding portals cannot become members of FINRA).

985 *Id.* (arguing that such requirements would be "overly burdensome" because funding portals "do not, by law, handle any money").

986 *See* RocketHub Letter.

We are not, however, adopting proposed Rule 401(b). As described in more detail in Section II.D.4.b. below, we have determined that the imposition of AML requirements on funding portals should be addressed outside of the rules that we are adopting in this release.

3. Safe Harbor for Certain Activities

Under Exchange Act Section 3(a)(80), which was added by Section 304(b) of the JOBS Act, a funding portal is defined as an intermediary that does not: (i) offer investment advice or make recommendations; (ii) solicit purchases, sales or offers to buy the securities offered or displayed on its platform or portal; (iii) compensate employees, agents or other persons for such solicitation or based on the sale of securities displayed or referenced on its platform or portal; (iv) hold, manage, possess or otherwise handle investor funds or securities; or (v) engage in such other activities as the Commission, by rule, determines appropriate. As noted in the Proposing Release, commenters have raised questions about the scope of permissible activities for funding portals consistent with these prohibitions.[987] To provide regulatory clarity, we proposed Rule 402, which would provide a non-exclusive conditional safe harbor for funding portals under which certain limited activities would be deemed consistent with the statutory prohibitions on funding portals. The permissible activities in the proposed safe harbor involved: (i) limiting offerings on the platform; (ii) highlighting and displaying offerings on the platform; (iii) providing communication channels; (iv) providing search functions; (v) advising issuers; (vi) compensating others for referring persons to the funding portal; (vii) paying or offering to pay compensation to registered brokers or dealers; (viii) receiving compensation from a registered broker or dealer; (ix) advertising the funding portal and offering; (x) denying access to, or cancelling, offerings due to fraud or investor protection concerns; (xi) accepting investment commitments on behalf of the

[987] *See* Proposing Release 78 FR 66484-66485.

issuer; (xii) directing the transmission of investor funds; and (xiii) directing a qualified third party's transmission of investor funds.

Proposed Rule 402(a) also stated that no presumption shall arise that a funding portal has violated the prohibitions under Section 3(a)(80) of the Exchange Act or Regulation Crowdfunding by reason of the funding portal or its associated persons engaging in activities in connection with the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act that do not meet the conditions specified in the safe harbor, and that the antifraud provisions and all other applicable provisions of the federal securities laws continue to apply to the activities described in the safe harbor.

Commenters strongly supported the idea of a safe harbor for funding portals,[988] but they also suggested additional examples for the safe harbor. We are adopting the safe harbor in Rule 402 with certain changes as discussed further below. Each activity of the safe harbor is addressed below.

a. Limiting Offerings

(1) Proposed Rule

Proposed Rule 402(b)(1) would permit a funding portal to apply objective criteria to limit the securities offered in reliance on Section 4(a)(6) of the Securities Act through the funding portal's platform where: (i) the criteria are reasonably designed to result in a broad selection of issuers offering securities through the funding portal's platform, are applied consistently to all potential issuers and offerings and are clearly displayed on the funding portal's platform; and (ii) the criteria could include, among other things, the type of securities being offered (for example,

[988] *See, e.g.,* CFIRA Letter 1; Joinvestor Letter; Merkley Letter (stating that the proposed safe harbor "strikes the right balance"). *But see* Public Startup 3 Letter (stating that the safe harbor should cover any activity by a funding portal not directly related to the sale of securities for the account of others).

common stock, preferred stock or debt securities), the geographic location of the issuer and the industry or business segment of the issuer, *provided* that a funding portal may not deny access to an issuer based on the advisability of investing in the issuer or its offering, except to the extent described in proposed Rule 402(b)(10) for fraud and investor protection concerns.

(2) Comments on Proposed Rule

We received a significant number of comments on the ability of a funding portal to limit the offerings on its platform. Many of these comments suggested a broader standard than the standard that we proposed. Several commenters expressed concern that the proposed safe harbor placed funding portals at a competitive disadvantage to registered brokers because it did not provide funding portals with the flexibility to limit the offerings on their platforms,[989] even if they have legitimate concerns about offerings aside from fraud or investor protection.[990] For example, commenters suggested that a funding portal should be permitted to reject offerings based on whatever factors the portal deems appropriate without automatically triggering regulation as a broker-dealer,[991] especially if it deems the offering to have tangible shortcomings that could be detrimental to investors or overly risky.[992]

Commenters asserted that a funding portal's ability to limit the offerings on its platform is important for investor protection. They stated that funding portals should be permitted to screen

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989 *See, e.g.*, EMKF Letter; SBA Office of Advocacy Letter.

990 *See, e.g.*, ABA Letter; CfPA Letter; CrowdCheck 2 Letter; Graves Letter; Seyfarth Letter (stating that "even with a lower liability threshold, curation is an essential tool for investor protection").

991 *See, e.g.*, IAC Recommendation (suggesting that "[o]ne of the most cost-effective ways to reduce the risk of serious compliance violations is to give crowdfunding intermediaries a free hand to reject any offering they believe could pose an undue compliance or fraud risk"); *see also* CFIRA Letter 12 (agreeing with IAC's suggestion "that all intermediaries . . . should have greater latitude in their ability to curate offerings. . . . All intermediaries (including non-BD portals) should be allowed to use their discretion as to whether or not any particular offering is suitable for their service"). *See also* BetterInvesting Letter.

992 *See* Graves Letter.

out clearly unprepared or ill-conceived offerings,[993] and should be permitted to limit offerings on their platforms to issuers that are "crowdfund-ready."[994] Commenters drew a distinction between the permissibility of applying internal screening standards to limited offerings on the platform versus the prohibition on providing investment advice or recommendations.[995] Some commenters suggested that having a disclaimer that "curation" (or limiting offerings on a platform) does not constitute a recommendation on the advisability of any investment displayed on the platform;[996] or that the funding portal does not advertise or make statements that the offerings listed on its platform are safer or better investments than those listed on other platforms,[997] would mitigate regulatory concerns. Some commenters also suggested that the criteria used to limit offerings should be clearly displayed on a funding portal's platform.[998]

In addition, some commenters pointed to a tension in the statute under which a funding portal is potentially subject to liability for material misstatements and omissions in the issuer's offering materials but, at the same time, may be limited in its ability to deny access to its platform.[999] These commenters argued that it was not equitable for a funding portal to have such liability if it cannot determine whether and under what circumstances to permit an issuer or offering access to its platform.

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993 *See* EMKF Letter.

994 *See* SBEC Letter.

995 *See, e.g.,* Angel 1 Letter ("Forcing portals to become the equivalent of common carriers that have to take every offering, no matter how foolish, will make crowdfunding more likely to fail."); Consumer Federation Letter; Saunders Letter.

996 *See, e.g.,* EarlyShares Letter; EMKF Letter; SBA Office of Advocacy Letter.

997 *See* Milken Institute Letter.

998 *See, e.g.,* ABA Letter; CFIRA Letter 1.

999 *See, e.g.,* CrowdCheck 2 Letter; Milken Institute Letter; RocketHub Letter.

(3) Final Rules

In view of the comments, and upon further consideration, we are modifying Rule 402(b)(1) to expressly provide that a funding portal may, consistent with the prohibitions under Exchange Act Section 3(a)(80) (including the prohibition against offering investment advice or recommendations in Section 3(a)(80)(A)), determine whether and under what terms to allow an issuer to offer and sell securities in reliance on Securities Act Section 4(a)(6) through its platform.[1000]

We agree with commenters that the ability of a funding portal to determine which issuers may use its platform is important for the protection of investors, as well as to the viability of the funding portal industry, and thus the crowdfunding market. We acknowledge the concerns raised by commenters that the proposed rules could otherwise have unduly restricted a funding portal's ability to limit offerings conducted on its platform, and we are modifying the safe harbor contained in Rule 402(b)(1) to address these concerns. Specifically, we are revising Rule 402(b)(1) to read that a funding portal may "[d]etermine whether and under what terms to allow an issuer to offer and sell securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through its platform, provided that the funding portal otherwise complies with Regulation Crowdfunding (§§ 227.100 *et seq.*)." The new language is designed to make it clear that a funding portal may exercise its discretion, subject to the prohibition in the statute on providing investment advice or recommendations, to limit the offerings and issuers that it allows

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1000 *See also* Rule 402(b) (limiting permissible activities to those consistent with the prohibitions under Exchange Act Section 3(a)(80)). The discretion a funding portal has to limit offerings on its platform is in addition to the requirement under Rule 301 to deny access, and cancel offerings, based on fraud and investor protection concerns.

on its platform under the safe harbor, as long as it complies with all other provisions of Regulation Crowdfunding.

In making this change, we recognize that the activities in which a funding portal may engage are, by definition, far more limited than the activities in which a registered broker-dealer may engage. At the same time, we believe that the JOBS Act established an important role for intermediaries, both broker-dealers and funding portals, to play in crowdfunding offerings. While we are providing funding portals with broad discretion to determine whether and under what circumstances to allow an issuer to offer and sell securities through its platform in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), a funding portal must comply with all applicable provisions of Regulation Crowdfunding, including the prohibition on providing investment advice or recommendations. In this regard and as more fully discussed below, among other things, a funding portal cannot advertise, make statements or otherwise represent that the offerings listed on its platform are safer or better investments than those listed on other platforms. Given this statutory restriction, we are not, as some commenters suggested, requiring a funding portal to provide a disclaimer stating that limiting the offerings on its platform does not constitute investment advice or a recommendation, nor are we requiring that its criteria for limiting offerings on its platform be publicly displayed. We do not believe that requiring a funding portal to display its criteria for limiting offerings on its platform will add significant investor protection. While a funding portal may decide to make such criteria public, we caution that a funding portal must avoid any appearance that it is giving investment advice or recommendations or that the funding portal believes its offerings are investment worthy.

b. Highlighting Issuers and Offerings

(1) Proposed Rule

Proposed Rule 402(b)(2) would permit a funding portal to apply objective criteria to highlight offerings on the funding portal's platform where: (i) the criteria are reasonably designed to highlight a broad selection of issuers offering securities through the funding portal's platform, are applied consistently to all issuers and offerings and are clearly displayed on the funding portal's platform; (ii) the criteria may include, among other things, the type of securities being offered (for example, common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the number or amount of investment commitments made, progress in meeting the issuer's target offering amount or, if applicable, the maximum offering amount; and the minimum or maximum investment amount; *provided* that a funding portal may not highlight an issuer or offering based on the advisability of investing in the issuer or its offering; and (iii) the funding portal does not receive special or additional compensations for highlighting one or more issuers or offerings on its platform.

(2) Comments on Proposed Rule

Several commenters suggested additional criteria for the safe harbor, including for example: (i) how long the issuer has been operational or profitable;[1001] (ii) historical and projected revenue and earnings before interest, taxes, depreciation and amortization (EBITDA);[1002] (iii) the size of the issuer's management team;[1003] (iv) relevant experience and length of experience of the issuer's management;[1004] (v) the type of corporate structure of the issuer;[1005] (vi) the stage and

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1001 *See, e.g.*, CFIRA Letter 1; CFIRA Letter 2.

1002 *Id.*

1003 *Id.*

1004 *See, e.g.*, CFIRA Letter 2.

operating history of the issuer;[1006] (vii) valuation methodology;[1007] (viii) results of securities and background checks;[1008] (ix) "trending";[1009] and (x) most money raised, soonest offering to close, most money invested, least money invested, or on a purely random basis (so long as none of the bases are value-driven – that is, which investment is a safer or better investment).[1010] Another commenter questioned whether, under the safe harbor, funding portals would be permitted to highlight offerings based on their discretion or the use of metrics, such as topic, media coverage, or momentum.[1011] However, another commenter suggested that a funding portal should not have discretion regarding which objective criteria it can use to highlight issuers or offerings because it may result in the portal implicitly recommending securities.[1012] This commenter suggested that the Commission should create a specific list of acceptable objective criteria that a funding portal may apply.[1013]

1005 *See* RocketHub Letter.

1006 *Id.*

1007 *Id.*

1008 *Id.*

1009 *See* Seyfarth Letter.

1010 *See* ASSOB Letter.

1011 *See* RocketHub Letter.

1012 *See* Commonwealth of Massachusetts Letter; *c.f.* ABA Letter (requesting Commission guidance that a portal engaging in activities covered by the safe harbor will not trigger the application of the Investment Advisers Act).

1013 *See* Commonwealth of Massachusetts Letter. *See also* ABA Letter (requesting explicit Commission guidance as to permissible criteria).

Several commenters stated that the criteria used to highlight offerings should be clearly displayed on the platform.[1014] However, one commenter stated that algorithms should not be required to be disclosed on the platform.[1015]

Several commenters suggested that the safe harbor should include the ability of a funding portal to provide mechanisms by which investors can rate an issuer or an offering, which then could be highlighted on the platform.[1016] However, one of these commenters stated that any such rating must be mathematical rather than value-driven or it would amount to "enticement."[1017]

(3) Final Rules

After considering the comments, we are adopting Rule 402(b)(2) as proposed. Specifically, Rule 402(b)(2) allows a funding portal to highlight particular issuers or offerings of securities made in reliance on Section 4(a)(6) on its platform based on objective criteria where the criteria are reasonably designed to highlight a broad selection of issuers offering securities through the funding portal's platform, are applied consistently to all issuers and offerings and are clearly displayed on the funding portal's platform. Consistent with the proposal, the final rule specifies in subparagraph (b)(2)(ii) that objective criteria may include, for example: the type of securities being offered (*e.g.*, common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the number or amount of investment commitments made; the progress in meeting the target offering amount or, if applicable, the maximum offering amount; and the minimum or maximum investment amount.

1014 *See, e.g.*, ABA Letter; CFIRA Letter 1.

1015 *See* Joinvestor Letter.

1016 *See, e.g.*, ASSOB Letter; CFIRA Letter 1; Joinvestor Letter.

1017 *See* ASSOB Letter.

It is important to note that the criteria must be reasonably designed to highlight a broad selection of issuers and offerings, so as not to recommend or implicitly endorse one issuer or offering over another, and must be applied consistently to all potential issuers and offerings.[1018] This highlighting of issuers or offerings that have been admitted to a funding portal's platform can, depending on relevant facts and circumstances, involve providing investment advice that violates the prohibition on a funding portal providing such advice. To that end, the rule provides a safe harbor only when a funding portal is using objective criteria and such criteria are clearly displayed on its platform to inform investors why certain issuers or offerings are being highlighted.[1019] To reiterate, a funding portal may not highlight an issuer or offering based on the advisability of investing in the issuer or offering or give the impression that the funding portal is providing an implicit (or explicit) recommendation on whether to invest in the issuer or offering.

To help prevent conflicts of interest and incentives for funding portals to favor certain issuers over others, the final rule also prohibits a funding portal from receiving any special or additional compensation for highlighting (or offering to highlight) one or more issuers or offerings on its platform.[1020]

Although some commenters suggested that we include additional criteria in subparagraph (b)(2)(ii), we emphasize that the rule does not establish an exclusive list. The listed criteria are intended as examples, and the safe harbor is non-exclusive. Crowdfunding is a new and evolving market, and we believe that providing principles in the safe harbor by which a funding portal can highlight offerings on its platform will provide it with the flexibility to adapt to the crowdfunding

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[1018] *See* Rule 402(b)(2) and (b)(2)(i).

[1019] *Id.*

[1020] *See* Rule 402(b)(2)(iii) of Regulation Crowdfunding. This rule prohibits paid placements of the kind suggested by one commenter. *See* Earlyshares Letter.

market as it develops while maintaining investor protection. In this regard, the examples listed in Rule 402(b)(2)(ii) are intended to provide guidance to funding portals as they develop their platform and related tools.

Although we are not including additional criteria in Rule 402(b)(2)(ii) at this time, we note that certain of the suggested highlighting criteria are covered by the criteria listed in the rule, such as the issuer's industry; the type of securities being offered; and the geographic location of the issuer's business. Others, while not listed in the final rule, we believe are based on objective criteria, such as the amount of money being raised or size of the offering; soonest offering to close; most or least money invested; how long the issuer has been operational or profitable; the size of the management team of the issuer; the stage and operating history of the issuer; valuation methodology; "trending"; earnings before interest, taxes, depreciation and amortization (EBITDA); and highlighting on a purely random basis. However, we caution that a funding portal must be cognizant not to present highlighted issuers in a manner that, directly or implicitly, results in the provision of investment advice or recommendations.[1021]

c. Providing Search Functions

(1) Proposed Rule

Proposed Rule 402(b)(3) would permit a funding portal to provide search functions or other tools that investors can use to search, sort, or categorize the offerings available through the funding portal's platform according to objective criteria where: (i) the objective criteria may include, among other things, the type of securities being offered (for example, common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business

[1021] For example, a funding portal may provide the EBITDA of an issuer but it cannot insinuate or state on its platform that the EBITDA corresponds to the advisability of investing in an issuer.

segment of the issuer; the number or amount of investment commitments made, progress in meeting the issuer's target offering amount or, if applicable, the maximum offering amount; and the minimum or maximum investment amount; and (ii) the objective criteria may not include, among other things, the advisability of investing in the issuer or its offering, or an assessment of any characteristic of the issuer, its business plan, its key management or risks associated with an investment.

(2) Comments on Proposed Rule

Several commenters suggested that the safe harbor be broadened to include additional criteria.[1022] One commenter suggested that funding portals should be permitted to sort offerings based on an algorithmic score that takes into account any objective numerical data that is reasonably likely to correlate to successful investments, such as numeric ratings by accredited and unaccredited investors, number of investment commitments weighted by investor portfolio valuation, and number of page views.[1023] Another commenter stated that the use of the word "assessment" in the proposed safe harbor[1024] is inappropriately vague when applied to technology, as it could effectively prohibit the use of any computational sorting algorithm using objective searching and sorting criteria. This commenter suggested that the word "assessment" be substituted with the word "opinion," and also that the term "objective criteria" be removed so that the safe harbor would prohibit the use of *subjective* criteria – such as the advisability of investing or an opinion of any characteristic of the issuer, its business plan, its key management or risks

1022 *See, e.g.*, EMKF Letter; EquityNet Letter.

1023 *See* EMKF Letter.

1024 Rule 402(b)(3)(ii) states in part that the "objective criteria may not include . . . an assessment of any characteristic of the issuer, its business plan, its key management or risks . . . ."

associated with an investment – "generated exclusively by the portal," excepting instances of peer review and feedback generated by users.[1025]

(3) **Final Rules**

After considering comments, we are adopting Rule 402(b)(3) substantially as proposed. The final rule permits a funding portal to provide search functions or other tools on its platform that users could use to search, sort or categorize available offerings according to objective criteria.[1026] The final rule also permits search functions that, for example, will allow an investor to sort through offerings based on a combination of different criteria, such as by the percentage of the target offering amount that has been met, geographic proximity to the investor and number of days remaining before the closing date of an offering.[1027] However, the final rule makes clear that the search criteria may not include the advisability of investing in the issuer or its offering, or an assessment of any characteristic of the issuer, its business plan, its management or risks associated with an investment. In this regard, we are making minor changes from proposed Rule 402(b)(3)(i) and (ii) by deleting the word "objective" in the final rules because the term is redundant to the requirement in Rule 402(b)(3) that the criteria be "objective." Further, we are persuaded by one commenter's observation that the use of the word objective in the subparts could be

[1025] *See* EquityNet Letter (noting that "[a]llowing investors the ability to sort through each other's comments or opinions becomes an integral part of any site where commenting is allowed on products" and that "[b]ecause sorting comments would require a technological assessment of subjective data, we believe an explicit carve out in the safe harbor provisions is necessary").

[1026] *See* Rule 402(b)(3) Regulation Crowdfunding. *See also* 158 CONG. REC. 2231 (daily ed. Mar. 29, 2012) (statement of Sen. Scott Brown) ("Funding portals should be allowed to organize and sort information based on certain criteria. This will make it easier for individuals to find the types of companies in which they can potentially invest. This type of capability – commonly referred to as curation – should not constitute investment advice.").

[1027] *See* Rule 402(b)(3) of Regulation Crowdfunding. Rule 402(b)(3)(i) provides examples of search criteria that are consistent with those listed in the Rule 402(b)(2)(ii) safe harbor for highlighting issuers and offerings.

misleading.[1028] The new sentence structure also makes Rule 402(b)(3) consistent with Rule 402(b)(2), which we believe provides additional clarity and consistency for funding portals when complying with the rules.

Rule 402(b)(3) does not preclude the use of computational sorting algorithms using objective searching and sorting criteria.[1029] However, a funding portal must take care not to indicate that the platform's search results or tools, directly or indirectly, correlate to successful investments. Likewise, we believe that the more particular, biased or weighted a funding portal's algorithm or assessment is, the less likely the criteria as a whole will be objective. However, this does not preclude a funding portal from permitting investors with access to its communication channels from rating issuers or offerings (*e.g.*, a star rating) on its platform or searching such ratings, as long as a funding portal (including its associated persons, such as its employees) does not participate in the rating process.[1030]

d. Providing Communication Channels

(1) Proposed Rule

Proposed Rule 402(b)(4) would address the terms under which a funding portal could provide communication channels by which investors can communicate with one another and with representatives of the issuer through the funding portal's platform about offerings conducted through the platform, as required by Rule 303(c). Under the terms of Rule 402(b)(4) as proposed,

1028 *See* EquityNet Letter. However, we do not agree with the commenter's assertion that using the word "assessment" in Rule 402(b)(3) equates to a prohibition on the use of computational sorting algorithms using objective searching and sorting criteria because, in this context, assessment is used to refer to subjective criteria.

1029 In response to one commenter's suggestion that a funding portal should be permitted to use algorithmic scores, the final rule does not preclude the use of algorithms as long as the criteria used by the algorithm are objective. *See* EMKF Letter. Thus, a "score" based on an algorithm may be used as long as it does not involve subjective criteria.

1030 *See* Rule 402(b)(4)(i).

the safe harbor would apply so long as the funding portal (and its associated persons): (i) does not participate in these communications, other than to establish guidelines for communication and remove abusive or potentially fraudulent communications; (ii) permits public access to view the discussions made in the communication channels; (iii) restricts posting of comments in the communication channels to those persons who have opened an account on its platform; and (iv) requires that any person posting a comment in the communication channels clearly disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or is otherwise compensated, whether in the past or prospectively, to promote an issuer's offering.

(2) Comments on Proposed Rule

Several commenters supported permitting a funding portal to provide communication channels on its platform through which investors can make comments, rate issuers and provide other feedback, and through which issuers can respond to investor comments.[1031] One of these commenters stated that these capabilities could enable a funding portal to share with investors information related to issuers, capital raised by an issuer, crowd investing, or the crowd-based rating of specific issuers.[1032] Another commenter suggested that funding portals allow investors to assign a quantifiable indicator to each other's comments, so that users can search out the best and worst of the comments and issuers have a chance to respond to investor comments in an open

[1031] *See, e.g.,* CFIRA Letter 1; EquityNet Letter; Milken Institute Letter.

[1032] *See* Milken Institute Letter.

forum.[1033] One commenter recommended that permission to rate issuers or offerings should only be given to investors who actually invested in or committed to invest in the offering.[1034]

(3) Final Rules

We are adopting, as proposed, Rule 402(b)(4) to address the terms under which a funding portal can provide communication channels by which investors can communicate with one another and with representatives of the issuer through the funding portal's platform about offerings conducted through the platform, as required by Rule 303(c).[1035] The safe harbor specifies that a funding portal (including its associated persons, such as its employees) may not participate in these communications, other than to establish guidelines about communication and to remove abusive or potentially fraudulent communications. Under Rule 402(b)(4), a funding portal must make communication channels available to the general public and restrict the posting of comments on those channels to those who have accounts on the funding portal's platform. In addition, the funding portal must require each person posting comments to disclose clearly with each posting in the channel whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or is otherwise compensated or will receive any compensation for promoting an issuer.[1036]

We agree with commenters that investors should be permitted to communicate with one other, and with representatives of the issuer, over communication channels on the platform

1033 *See* EquityNet Letter.

1034 *See* CFIRA Letter 1.

1035 *See* Section II.C.5.b(3) for a discussion of Rule 303(c).

1036 *See* Rule 402(b)(4)(iv).

provided by the funding portal.[1037] The communication channel is meant to strengthen and foster the ability of the crowd to communicate. We believe that the capabilities within the communication channel will develop and evolve over time. For example, as noted above, a communication channel may permit investors to rate or comment on an issuer or offering, or to assign quantifiable indicators to one other's comments. Also, a funding portal must make communication channels available for viewing by the general public, and permit anyone who has opened an account on its platform to post comments on the channel.[1038] As we stated in the Proposing Release, requiring investors to have accounts with the funding portal before posting a comment should provide a measure of control over these communications that could aid in promoting accountability for comments made and help ensure that interested persons, such as those associated with the issuer or receiving compensation to promote the issuer, are properly identified.

We reiterate that while a funding portal must provide for a communication channel and may develop certain features or tools as a part of that channel (such as a crowd-based rating system), a funding portal (including its associated persons, such as its employees) may not engage or participate in such communications.[1039] In addition, a funding portal should consider whether the tools or features of the communication channels it develops and the guidelines it establishes for the channel would constitute the funding portal providing impermissible investment advice or recommendations. For example, the funding portal may not establish a guideline that permits a person to rate an offering only if the person provides a positive rating, or otherwise incentivizes

1037 As discussed in Section II.C.5, an issuer, its agents and promoters must identify themselves in all communications through the communication channel.

1038 *See* Rule 402(b)(4)(i) and (ii).

1039 *See* Rule 402(b)(4)(i). *See also* Rule 303(c).

persons to give positive ratings. However, contrary to what one commenter suggested, we do not believe a funding portal may limit the rating capability to those account holders who have made investment commitments to the relevant offering.[1040] We believe that limiting ratings capability to persons that invest in an offering is likely to skew the ratings, and therefore, we would view such a limitation as inappropriate. Further, such a limitation could prevent persons with relevant and important information about the investment from contributing their views to the crowd.

e. Advising Issuers

(1) Proposed Rule

Proposed Rule 402(b)(5) would permit a funding portal to advise an issuer about the structure or content of the issuer's offering, including assisting the issuer in preparing offering documentation.

(2) Final Rules

We did not receive any comments that specifically addressed the ability of a funding portal to advise issuers and are adopting Rule 402(b)(5) as proposed. The rule permits a funding portal to advise an issuer about the structure or content of the issuer's offering, including preparing offering documentation. We believe funding portals will be in a position to provide experience and assistance to issuers relatively efficiently, and should be able to leverage their expertise to increase the viability of crowdfunding.

We believe that funding portals, as well as broker-dealers, should be permitted to provide certain services to issuers to facilitate the offer and sale of securities in reliance on Section 4(a)(6). Without these services, crowdfunding as a method to raise capital might not be viable. Rule 404(b)(5) permits funding portals to advise an issuer about the structure and content of the issuer's

[1040] *See* CFIRA Letter 1.

offering in a number of ways. A funding portal can, for example, provide pre-drafted templates or forms for an issuer to use in its offering that will help it comply with its proposed disclosure obligations. Other examples of permissible assistance can include advice about the types of securities the issuer can offer, the terms of those securities and the procedures and regulations associated with crowdfunding.

f. Paying for Referrals

(1) Proposed Rule

Proposed Rule 402(b)(6) would permit a funding portal to compensate a third party for referring a person to the funding portal, so long as the third party does not provide the funding portal with personally identifiable information of any investor and the compensation, other than that paid to a registered broker or dealer, is not based, directly or indirectly, on the purchase or sale of a security in reliance on Section 4(a)(6) of the Securities Act offered on or through the funding portal's platform.

(2) Comment on Proposed Rule

One commenter requested clarification as to: (i) whether and when compensation paid to a non-broker-dealer will be deemed improperly based on the purchase or sale of a security; (ii) whether a funding portal may pay a registered broker-dealer a referral fee without a formal agreement; and (iii) whether a funding portal may charge issuers fees based on the success of the offering.[1041]

(3) Final Rules

We are adopting Rule 402(b)(6) as proposed. Rule 402(b)(6) permits a funding portal to compensate a third party for referring a person to the funding portal if the third party does not

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[1041] *See* ABA Letter.

provide the funding portal with personally identifiable information about any investor and the compensation, other than that paid to a registered broker or dealer, is not based, directly or indirectly, on the purchase or sale of a security in reliance on Section 4(a)(6) of the Securities Act offered on or through the funding portal's platform. We believe the safe harbor in this regard addresses the prohibition in Rule 305 against an intermediary compensating any person for providing the intermediary with the personally identifiable information of any investor in securities offered and sold in reliance on Section 4(a)(6). We also believe that Rule 402(b)(6)'s prohibition on funding portals paying transaction-based compensation to third parties, other than that paid to a registered broker or dealer, will help to minimize the incentive for high-pressure sales tactics and other abusive practices in this area. One commenter requested additional guidance as to what types of compensation would equate to compensation based on the offer or sale of a security.[1042] The Commission and courts have interpreted the definition of transaction-based compensation broadly,[1043] and whether compensation is transaction-based is a facts and circumstances determination. Thus, we do not believe that additional guidance is necessary or appropriate in this context.

In response to a commenter's inquiry, a funding portal may not pay a registered broker-dealer a referral fee without a written agreement under the safe harbor. Such an arrangement would be covered by Rule 402(b)(7), which is discussed below.

[1042] *Id.*

[1043] *See, e.g.*, Applicability of Broker-Dealer Registration to Banks, Exchange Act Rel. No. 20,357 at n.14 (Nov. 8, 1983).

g. Compensation Arrangements with Registered Broker-Dealers

(1) Proposed Rule

Proposed Rule 402(b)(7) would permit a funding portal to pay or offer to pay any compensation to a registered broker or dealer for services in connection with the offer or sale of securities by the funding portal in reliance on Section 4(a)(6) of the Act, provided that: (i) such services are provided pursuant to a written agreement between the funding portal and the registered broker or dealer; (ii) such services and compensation are permitted under Regulation Crowdfunding and are not otherwise prohibited under Rule 305; and (iii) such compensation complies with and is not prohibited by the rules of any registered national securities association of which the funding portal is required to be a member.

Proposed Rule 402(b)(8) would permit a funding portal to receive any compensation from a registered broker or dealer for services provided by the funding portal in connection with the offer or sale of securities by the funding portal in reliance on Section 4(a)(6) of the Act, provided that: (i) such services are provided pursuant to a written agreement between the funding portal and the registered broker or dealer; (ii) such compensation is permitted under Regulation Crowdfunding; and (iii) such compensation complies with and is not prohibited by the rules of any registered national securities association of which the funding portal is required to be a member.

(2) Comments on Proposed Rule

Several commenters expressed concerns about the permitted relationships between funding portals and broker-dealers.[1044] One of these commenters stated that the proposed safe harbor is "overly broad" and creates "unmanageable conflicts between funding portals and broker dealers,"

[1044] *See, e.g.*, Commonwealth of Massachusetts Letter; RocketHub Letter.

and suggested the Commission prevent these conflicts by prohibiting funding portals from paying broker-dealers any type of compensation in connection with the offer or sale of securities under the crowdfunding exemption.[1045] Another of these commenters suggested that the Commission require relationships between funding portals and brokers to be arms-length and, if they are not, require that the funding portal activity be operated by the broker-dealer entity.[1046]

(3) **Final Rules**

We are adopting Rule 402(b)(7) generally as proposed, but with minor modifications for clarity and consistency. Rule 402(b)(7) specifies that a funding portal may pay or offer to pay compensation to a registered broker or dealer for services, including for referring a person to the funding portal, in connection with the offer or sale of securities by the funding portal in reliance on Section 4(a)(6) of the Securities Act, provided that (i) such services are provided pursuant to a written agreement between the funding portal and the registered broker or dealer; (ii) such compensation is permitted under Regulation Crowdfunding; and (iii) such compensation complies with the rules of any registered national securities association of which the funding portal is a member. As discussed above, proposed Rule 402(b)(7) did not contain a reference to "referrals," while proposed Rule 402(b)(6) included the language "for referring a person to the funding portal." We have added a reference to "referrals pursuant to [Rule 402](b)(7)" to make clear that all payment arrangements with a broker-dealer, including paying a broker-dealer for referrals as permitted under subparagraph (b)(6), must be in writing.

Proposed Rule 402(b)(7)(ii) had also stated that "such compensation is permitted under this part and is not otherwise prohibited under § 227.305"; and subparagraph (b)(7)(iii) stated

1045 *See* Commonwealth of Massachusetts Letter.

1046 *See* RocketHub Letter (expressing concern over broker-dealers creating entities that would register as funding portals so as to evade FINRA oversight as a broker-dealer).

"such compensation complies with and is not prohibited by the rules of any registered national securities association of which the funding portal is required to be a member." We are deleting the phrases "and is not otherwise prohibited under § 227.305" and "and is not prohibited by" to make the language in Rule 402(b)(7) and Rule 402(b)(8) consistent, and because the phrases are redundant. Also, we are deleting the phrase "required to be a member" and replacing it with "is a member" in recognition of the fact that additional national securities associations may exist in the future and that a funding portal would only have to be a member of one such association.

Consistent with Rule 402(b)(7), a funding portal may, for example, pay a broker-dealer for certain services, such as information technology services, qualified third party services or referral services, pursuant to a written agreement. Each party to this type of arrangement will need to comply with all applicable regulations, including the rules of the registered national securities association of which it is a member.

Similarly, we are adopting Rule 402(b)(8) as proposed with minor modifications. Rule 402(b)(8) permits a funding portal to provide services to, and receive compensation from, a registered broker-dealer in connection with the funding portal's offer or sale of securities in reliance on Section 4(a)(6), provided that: (i) such services are provided pursuant to a written agreement between the funding portal and the registered broker or dealer; (ii) such compensation is permitted under Regulation Crowdfunding; and (iii) such compensation complies with the rules of any registered national securities association of which the funding portal is a member. The proposed rules had stated that "such compensation complies with and is not prohibited by the rules of any registered national securities association of which the funding portal is required to be a member." For the reasons discussed above with regard to Rule 402(b)(7)(ii), we are deleting the

phrase "and is not prohibited" because it is redundant and deleting the phrase "required to be a member" and replacing it with "is a member."

Pursuant to Rule 402(b)(8), a funding portal may receive compensation, including transaction-based compensation, from a broker-dealer for providing referrals to that broker-dealer relating to an offering made pursuant to Section 4(a)(6). It is important to emphasize that the safe harbor does not permit a funding portal to receive transaction-based compensation for referrals of investors in other types of offerings, such as Rule 506 offerings, that are effected by a registered broker-dealer.[1047] Further, these arrangements must be compliant with Rule 305, which prohibits, with certain exceptions, an intermediary from compensating any person for providing the intermediary with the personally identifiable information of any investor.[1048] As we stated in the Proposing Release, the safe harbor is intended to facilitate intermediaries' cooperation with each other and promote the use of the Section 4(a)(6) exemption to raise capital, while maintaining a written record of compensation payments.

We disagree with the commenter who suggested that Rules 402(b)(7) and (8) create an unmanageable conflict between funding portals and broker-dealers.[1049] We believe that any potential conflict of interest between broker-dealers and funding portals as a result of compensation arrangements is mitigated due to the fact that both entities are registered with the Commission and members of FINRA and because permissible activities under Rule 402(b)(7) and (8) are limited by Regulation Crowdfunding. We also are not prohibiting a registered broker-dealer and a registered funding portal from being affiliated, nor are we requiring that any

[1047] Receipt of transaction-based compensation in connection with such referrals can cause a funding portal to be a broker required to register with us under Exchange Act Section 15(a)(1) (15 U.S.C. 78*o*(a)(1)).

[1048] *See* Section II.C.7 (discussing Rule 305).

[1049] *See* Commonwealth of Massachusetts Letter.

crowdfunding operation be performed by the registered broker-dealer in such an affiliation.[1050] Because funding portals and broker-dealers are each registered with the Commission and required to be members of a registered national securities association with the attendant rules and oversight, we believe concerns about conflicts of interests among affiliated funding portals and broker-dealers are sufficiently mitigated by this regulatory framework.

While a commenter questioned whether a funding portal may pay introducing brokers a fee for referring persons to the funding portal without a formal written arrangement,[1051] we emphasize that Rule 402(b)(7) requires all such arrangements to be in writing.

h. Advertising

(1) Proposed Rule

Proposed Rule 402(b)(9) would permit a funding portal to advertise the existence of the funding portal and identify one or more issuers or offerings available on the portal on the basis of objective criteria, as long as: (i) the criteria are reasonably designed to identify a broad selection of issuers offering securities through the funding portal's platform and are applied consistently to all potential issuers and offerings; (ii) the criteria may include, among other things, the type of securities being offered (for example, common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the expressed interest by investors, as measured by number or amount of investment commitments made, progress in meeting the issuer's target offering amount or, if applicable, the maximum offering amount; and the minimum or maximum investment amount; and (iii) the funding portal does not receive special or additional compensation for identifying the issuer or offering in this manner.

1050 *See* RocketHub Letter (expressing concern over broker-dealers creating entities that would register as funding portals, so as to evade FINRA oversight as a broker-dealer).

1051 *See* ABA Letter.

(2) Comments on Proposed Rule

Several commenters supported the proposed safe harbor on funding portal advertising.[1052] However, commenters were divided on whether funding portals should be permitted to advertise current offerings and issuers in their advertisements. One commenter was supportive of allowing funding portals to "advertise more generally, as well as highlight ongoing offerings through various communication channels."[1053] The same commenter stated that a portal's decision to feature or highlight issues available should not be viewed by the Commission as investment advice, a recommendation, or a solicitation.[1054] This commenter nonetheless cautioned that "[p]ortals should be barred from language that implicates the level of risk involved in the investment or the overall quality of the investment opportunity" as well as "from soliciting investments for any specific campaign by providing offering details outside of the Portal itself."[1055] Another commentator expressed opposition to "a limitation on the funding portal to only advertise its past offerings," stating that such a limitation "would be overly restrictive."[1056]

In contrast, one commenter stated that, while funding portals should be allowed to advertise, funding portals should not be able to display specific issuers in their advertising materials.[1057] This commenter stated that "[t]he concern with displaying individual issuers is that investors will interpret this as a recommendation and endorsement of the issuer."[1058] The commenter noted that the prohibition on providing recommendations can be easily circumvented

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1052 *See, e.g.*, CFIRA Letter 1; Commonwealth of Massachusetts Letter; ABA Letter.

1053 *See* RocketHub Letter.

1054 *Id.*

1055 *Id.*

1056 *See* CFIRA Letter 1.

1057 *See* Commonwealth of Massachusetts Letter.

1058 *Id.*

by manipulating otherwise seemingly objective criteria, and that funding portals could advertise offerings based on certain criteria, such as high target offerings, that may generate more money for the funding portal (*i.e.*, a funding portal can mask self-interest by using objective criteria).[1059] This same commenter suggested that the Commission could allow descriptions of the portals themselves and the specific business segments featured on their websites, without mentioning specific issuers currently registered with the portal.[1060]

One commenter suggested the Commission clarify that it would be inappropriate for a funding portal to send out soliciting e-mails recommending investment in particular companies to investors who have signed up with that portal.[1061] Another commenter stated that a funding portal should not be permitted to advertise or otherwise make statements that offerings listed are somehow safer or better than other platforms.[1062]

(3) Final Rules

We are adopting Rule 402(b)(9) as proposed. Rule 402(b)(9) permits a funding portal to advertise its existence and identify one or more issuers or offerings available on the portal on the basis of objective criteria, as long as: (i) the criteria are reasonably designed to identify a broad selection of issuers offering securities through the funding portal's platform and are applied consistently to all potential issuers and offerings; (ii) the criteria may include, among other things, the type of securities being offered (for example, common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the expressed interest by investors, as measured by number or amount of investment commitments

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1059 *Id.*

1060 *Id.*

1061 *See* ABA Letter.

1062 *See* Milken Institute Letter.

made, progress in meeting the issuer's target offering amount or, if applicable, the maximum offering amount; and the minimum or maximum investment amount; and (iii) the funding portal does not receive special or additional compensation for identifying the issuer or offering in this manner. However, a funding portal may not base its decision as to which issuers to include in its advertisements on whether it has a financial interest in the issuer,, and any advertising may not directly or indirectly favor issuers in which the funding portal has invested or will invest.

After considering the comment letters, we believe that the requirements of the safe harbor, including the requirement for objective criteria designed to result in a broad selection of highlighted issuers or offerings, will result in advertisements that are focused on the funding portal itself, as opposed to recommending a particular offering or offerings.[1063] Funding portals continue to be subject to the statutory prohibition on providing investment advice and recommendations.[1064] An advertisement by a funding portal must not be an implicit (or explicit) recommendation as to whether to invest in the issuer or offering or advice on the advisability of investing in the issuer or offering. Therefore, consistent with the views of one commenter, a funding portal may not advertise in such a way that expresses the funding portal's view that, for example, certain offerings on its platform are of a higher quality, safer or more worthy than others, or that otherwise gives a recommendation.[1065]

We recognize that advertisements can take many varied forms, including non-traditional means, such as blogs, e-mails through social media or other methods. We believe that these types of communications, when made by a funding portal to investors can be a permissible means of

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1063 The safe harbor is limited to identifying one or more issuers. More detailed information about an issuer should be provided on the funding portal's platform.

1064 *See* Exchange Act Section 3(a)(80)(A).

1065 *See* Milken Institute Letter.

advertising within the scope of Rule 402(b)(9). We agree, however, with a commenter's statement that it would be inconsistent with the statutory prohibition on providing investment advice or recommendations for a funding portal to send out soliciting e-mails recommending investments in particular companies as part of its advertising.[1066]

i. Deny Access to Platform

(1) Proposed Rule

Proposed Rule 402(b)(10) would permit a funding portal to deny access to its platform to, or cancel an offering of, an issuer that the funding portal believes may present the potential for fraud or otherwise raises investor protection concerns.

(2) Comments on Proposed Rule

Some commenters asserted that the proposed rules are ambiguous, and that the lack of specificity exposes funding portals to potential liability. The commenters were concerned that the perceived lack of specificity may also lead funding portals to unintentionally violate the ban on providing investment advice with their attempts to mitigate liability.[1067]

(3) Final Rules

We are adopting Rule 402(b)(10) substantially as proposed with modifications to make it consistent with Rule 301(c)(2), which requires an intermediary to deny access if it has a reasonable basis for believing that the issuer or the offering presents the potential for fraud or otherwise raises concerns about investor protection.[1068] In satisfying this requirement, an intermediary must deny access if it reasonably believes that it is unable to adequately or effectively assess the risk of fraud of the issuer or its potential offering. In addition, if an

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1066 *See* ABA Letter.

1067 *See, e.g.,* RocketHub Letter and Seyfarth Letter.

1068 *See* Section II.C.3 discussing the change to Rule 301(c) to include a "reasonable basis" standard.

intermediary becomes aware of information after it has granted access that causes it to reasonably believe that the issuer or the offering presents the potential for fraud or otherwise raises concerns about investor protection, the intermediary must promptly remove the offering from its platform, cancel the offering, and return (or, for funding portals, direct the return of) any funds that have been committed by investors in the offering. Rule 402(b)(10) requires a funding portal to deny access to its platform to, or cancel an offering of an issuer, pursuant to Rule 301(c)(2), if the funding portal has a reasonable basis for believing that the issuer or the offering presents the potential for fraud or otherwise raises concerns.

We changed the standard in Rule 402(b)(10) to a "reasonable basis for believing" – rather than "believes" – to conform the safe harbor to the requirements of Rule 301(c)(2) as adopted. Thus, the standard in Rule 402(b)(10) is consistent with the modifications that we made to the standard in Rule 301(c)(2).[1069] We believe this change also should help to address commenters' concerns about the perceived lack of specificity in the proposed safe harbor by providing an objective "reasonable belief" standard for the required determinations. Under this standard a funding portal may not ignore facts about an issuer that indicate fraud or investor protection concerns such that a reasonable person would have denied access to the platform. At the same time, a funding portal can also feel assured in its decision to deny an issuer access or cancel an offering if it has a reasonable basis for such a determination. We also believe that including a "reasonable basis" standard adds objectivity to a funding portal's determinations regarding which issuers must be denied access to (or removed from) its platform, which is expected to help to address concerns regarding the clarity of the standard under the proposed rule.

[1069] *See* Section II.C.3.

j. Accepting Investor Commitments

(1) Proposed Rule

Proposed Rule 402(b)(11) would permit a funding portal to accept, on behalf of an issuer, an investment commitment for securities offered in reliance on Section 4(a)(6) of the Securities Act by that issuer on the funding portal's platform.

(2) Comments on Proposed Rule

One commenter noted that the statute prohibits funding portals from handling investor funds or securities, and that the proposed rule requiring the use of third-party entities would create additional transaction costs for funding portals.[1070] Another commenter stated that the safe harbor for accepting investor commitments should permit a funding portal to assist issuers in handling a direct registration system (DRS) between issuers and investors.[1071]

(3) Final Rules

We are adopting Rule 402(b)(11) as proposed. Rule 402(b)(11) permits a funding portal, on behalf of an issuer, to accept investment commitments from investors for securities offered in reliance on Section 4(a)(6) by that issuer on the funding portal's platform. We are not broadening the safe harbor to permit funding portals to handle customer funds, as suggested by one commenter. Although we recognize that the requirement to use a third party entity to handle customer funds imposes an additional expense on a funding portal, Exchange Act Section 3(a)(80)(D) explicitly prohibits funding portals from handling customer funds and securities. Similarly, we believe it would be inconsistent with the statute for a funding portal to facilitate a

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1070 *See* Stephenson, *et al.*, Letter.

1071 *See* RocketHub (suggesting that a portal should be permitted to provide DRS support to issuers and investors). A DRS allows investors to transfer a security that is registered in the investor's name on the issuer's books, and either the company or its transfer agent holds the security for the investor in book-entry form.

securities registration system for issuers and investors because such activity implicitly requires funding portals to handle customer funds and securities, which is prohibited by the statute. In this regard, we note that the activities that a funding portal is permitted to engage in are limited in scope, and as such are subject to a more limited regulatory scheme as compared to registered broker-dealers.

k. Directing Transmission of Funds

(1) Proposed Rule

Proposed Rule 402(b)(12) would permit a funding portal to direct investors where to transmit funds or remit payment in connection with the purchase of securities offered and sold in reliance on Section 4(a)(6) of the Securities Act.

Proposed Rule 402(b)(13) would permit a funding portal to direct a qualified third party, as required by Rule 303(e), to release proceeds to an issuer upon completion of a crowdfunding offering or to return proceeds to investors in the event an investment commitment or an offering is cancelled.

(2) Final Rules

We did not receive comments on the ability of a funding portal to direct investment funds and are adopting Rules 402(b)(12) and (13) as proposed. Rules 402(b)(12) and (13) provide that a funding portal can fulfill its obligations with respect to the maintenance and transmission of funds and securities, as set forth in Rule 303, without violating the prohibition in Exchange Act Section 3(a)(80)(D). Specifically, a funding portal can direct investors where to transmit funds or remit payment in connection with the purchase of securities offered and sold in reliance on Section

4(a)(6),[1072] and as required by Rule 303(e), a funding portal can direct a qualified third party to release the proceeds of an offering to the issuer upon completion of the offering or to return investor proceeds when an investment commitment or offering is cancelled.[1073]

l. Posting News

In the Proposing Release, we asked whether we should adopt a safe harbor that permits a funding portal to post news, such as market news and news about a particular issuer or industry, on its platform. In response to our request for comment, some commenters stated that the safe harbor should permit funding portals to post third party news related to issuers or offerings on their platform.[1074] One commenter cautioned that objective criteria should be used to ensure, for example, that funding portals are not picking out the most flattering or positive news.[1075] Another commenter suggested that funding portals should be aware of the content of materials posted on their portal and held responsible for inappropriate information that is posted.[1076]

While we believe it is possible for funding portals to post news on their platforms in a manner that would not violate the prohibitions in Exchange Act Section 3(a)(80), we are not including such activities within the safe harbor because we believe the permissibility of posting news should be a facts and circumstances determination. When posting news, funding portals will need to ensure that they do not violate the prohibition on giving investment advice and recommendations. For example, if a funding portal selectively determines which news articles to

[1072] *See* Rule 402(b)(12) of Regulation Crowdfunding.

[1073] *See* Rule 402(b)(13) of Regulation Crowdfunding.

[1074] *See, e.g.,* CFIRA Letter 1; RoC Letter; StartupValley Letter. *But see* Joinvestor Letter; Wefunder Letter.

[1075] *See* CFIRA Letter 1.

[1076] *See* RoC Letter.

post or posts only flattering or positive news, then the funding portal is more likely to be giving impermissible investment advice or recommendations.

m. No Presumption and Anti-Fraud Provisions

(1) Proposed Rule

Proposed Rule 402(a) also stated that no presumption shall arise that a funding portal has violated the prohibitions under Section 3(a)(80) of the Exchange Act or Regulation Crowdfunding by reason of the funding portal or its associated persons engaging in activities in connection with the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act that do not meet the conditions specified in the safe harbor and that the antifraud provisions and all other applicable provisions of the federal securities laws continue to apply to the activities described in the safe harbor.

(2) Final Rules

We did not receive any comments on the proposed "no presumption" and anti-fraud provisions and are adopting Rule 402(a) as proposed. We also reiterate that Rule 402(b) is a non-exclusive safe harbor. Rule 402(a) expressly provides that the failure of a funding portal to meet the conditions of the safe harbor does not give rise to a presumption that the funding portal is in violation of the statutory prohibitions of Exchange Act Section 3(a)(80) or Regulation Crowdfunding.[1077]

Further, the safe harbor under Rule 402 does not prohibit funding portals from engaging third party service providers to assist the funding portal in operating its platform, such as providers of software, website maintenance and development, communication channel

[1077] *See* Rule 402(a) of Regulation Crowdfunding.

applications, recordkeeping systems, and other technology.[1078] However, the funding portal remains responsible for its activities and the operation of its platform and for compliance with Regulation Crowdfunding and other applicable federal securities laws.

4. Compliance

a. Policies and Procedures

(1) Proposed Rule

As proposed, Rule 403(a) would require a funding portal to implement written policies and procedures reasonably designed to achieve compliance with the federal securities laws and the rules and regulations thereunder, relating to its business as a funding portal.[1079]

(2) Comments on the Proposed Rules

One commenter agreed that the Commission should not specify requirements for a funding portal's policies and procedures, while another commenter thought the Commission should provide guidance concerning the policies and procedures.[1080] Another commenter suggested that all changes to a funding portal's policies and procedures should be disclosed within 30 days and publicly announced.[1081] Yet another commenter suggested requiring the SRO to mandate that broker-dealers and funding portals follow the same policies.[1082]

[1078] One commenter asked whether funding portals could engage third party service providers consistent with Regulation Crowdfunding. *See* CFIRA Letter 1.

[1079] As a condition to exempting funding portals from the requirement to register as a broker or a dealer under Exchange Act Section 15(a)(1) (15 U.S.C. 78*o*(a)(1)), Exchange Act Section 3(h)(1)(C) provides that registered funding portals must comply with such other requirements as the Commission determines appropriate.

[1080] *See* ASSOB Letter; Consumer Federation of America ("[The Commission] fails to address at all the areas that should be covered by such policies and procedures, or what a funding portal's responsibilities to monitor compliance would be.").

[1081] *See* Joinvestor Letter.

[1082] *See* Rockethub Letter.

(3) Final Rules

We are adopting Rule 403(a) as proposed. We believe that the requirement to implement written policies and procedures will provide important investor protections as it will necessitate that funding portals remain aware of the various regulatory requirements to which they are subject and take appropriate steps for complying with such requirements. We recognize, however, that funding portals may have various business models and, therefore, consistent with the views of one commenter, we are not imposing specific requirements for a funding portal's policies and procedures, provided the policies and procedures are reasonably designed to achieve compliance with the federal securities laws and the rules relating to their business as funding portals. Rather, we are providing a funding portal with discretion to establish, implement, maintain and enforce its policies and procedures based on its relevant facts and circumstances.

We note, however, that a funding portal may rely on the representations of others when meeting certain requirements under Regulation Crowdfunding, unless the funding portal has reason to question the reliability of those representations. For example, a funding portal may rely on an issuer's representation to establish a reasonable basis for believing that an issuer seeking to offer and sell securities in reliance on Section 4(a)(6) through its platform complies with the requirements in Securities Act Section 4A(b) and the related requirements in Regulation Crowdfunding, unless the funding portal has reason to question the reliability of that representation.[1083] A funding portal may also rely on an investor's representation to establish a reasonable basis for believing that an investor satisfies the investment limits established by Section 4(a)(6)(B), unless the funding portal has reason to question the reliability of that

1083 *See* Rule 301(a).

representation.[1084] We believe that when a funding portal relies on the representations of others to form a reasonable basis, the funding portal should have policies and procedures regarding under what circumstances it can reasonably rely on such representations and when additional investigative steps may be appropriate. We further believe that a funding portal's policies and procedures should cover not only permitted activities, but also address prohibited activities. For example, a funding portal should have policies and procedures on the criteria used to limit, highlight and advertise issuers and offerings.

We note one commenter's suggestion that we require funding portals to update their policies and procedures to reflect changes in applicable rules and regulations within a specified time period after the change occurs. However, as explained in the Proposing Release, we believe that the requirement for reasonably designed policies and procedures includes an ongoing obligation for a funding portal to promptly update its policies and procedures if necessary to reflect changes in applicable rules and regulations, a funding portal's business practices, and/or the marketplace.[1085] Finally, in response to one commenter's suggestion that we require SROs to mandate that broker-dealers and funding portals follow the same policies, as noted above, we believe that funding portals should have flexibility to implement policies and procedures suited to their own facts and circumstances. Moreover, we note that any proposed SRO rules relating to policies and procedures of either broker-dealers or funding portals will be subject to the Exchange Act Section 19(b) SRO rule filing process.[1086]

[1084] *See* Rule 303(b)(1).

[1085] Consistent with our requirements for broker-dealers, we are not requiring that a funding portal's policies and procedures be made public, as suggested by a commenter.

[1086] Pursuant to Exchange Act Section 19(b) and Rule 19b-4, SROs are required to file proposed new rules and rule changes with the Commission.

Commission staff expects to review intermediaries' compliance policies and procedures relating to their activities in connection with the offer or sale of securities in reliance on Section 4(a)(6) during the study of the federal crowdfunding exemption that it plans to undertake no later than three years following the effective date of Regulation Crowdfunding.[1087]

b. Anti-Money Laundering

(1) Proposed Rule

Proposed Rule 403(b) would require that funding portals comply with certain AML provisions,[1088] as set forth in Chapter X of Title 31 of the Code of Federal Regulations. The BSA and its implementing regulations establish the basic framework for AML obligations imposed on financial institutions.[1089] The BSA is intended to facilitate the prevention, detection and prosecution of money laundering, terrorist financing and other financial crimes.

Among other things, the BSA and its implementing regulations require a "broker or dealer in securities" (sometimes referred to in the regulations as a "broker-dealer") to: (1) establish and maintain an effective AML program;[1090] (2) establish and maintain a Customer Identification Program;[1091] (3) monitor for and file reports of suspicious activity (SARs);[1092] and (4) comply with requests for information from the Financial Crimes Enforcement Network ("FinCEN").[1093] For purposes of the BSA obligations, a "broker or dealer in securities" is defined as a "broker or dealer in securities, registered or required to be registered with the Securities and Exchange

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[1087] *See* Section II.

[1088] *See also* Section II.D.2. (discussing proposed Rule 401(b)).

[1089] *See* BSA, note 981; 31 CFR Chapter X.

[1090] *See* 31 U.S.C. 5318(h). *See also* 31 CFR 1023.210; FINRA Rule 3310.

[1091] *See* 31 CFR 1023.220.

[1092] *See* 31 CFR 1023.320. *See also* FINRA Rule 3310.

[1093] *See* 31 CFR 1010.520.

Commission under the Securities Exchange Act of 1934, except persons who register pursuant to [S]ection 15(b)(11) of the Securities Exchange Act of 1934."[1094] As explained above, Exchange Act Section 3(h) expressly directs the Commission, conditionally or unconditionally, to exempt funding portals from the requirement to register as a broker or dealer under Section 15(a). As such, a funding portal is not a broker "registered or required to be registered" if it registers as a funding portal with the Commission. We proposed that, notwithstanding this exemption from broker registration, under Rule 401(b) a funding portal would be "required to be registered" as a broker or dealer with the Commission under the Exchange Act solely for purposes of Chapter X of Title 31 of the Code of Federal Regulations, thus subjecting funding portals to the AML requirements of Chapter X of Title 31.

(2) Comments on the Proposed Rule

A few commenters generally suggested that since funding portals are prohibited from handling customer funds and securities they should not be required to comply with AML provisions.[1095] Some commenters, however, generally supported requiring funding portals to comply with AML provisions.[1096] One commenter, noting that non-U.S. investors may participate in crowdfunding and use U.S.-based funding portals, requested that the Commission provide advice and suggestions on "how to prevent anti-money laundering."[1097]

1094 *See* 31 CFR 1010.100(h). As noted above, certain FinCEN regulations apply to a "broker-dealer," which is defined as a "person registered or required to be registered as a broker or dealer with the Commission under the Securities Exchange Act of 1934 (15 U.S.C. 77a *et seq.*), except persons who register pursuant to 15 U.S.C. 78*o*(b)(11)." 31 CFR 1023.100(b). Such broker-dealers also would meet the definition of "broker or dealers in securities" above.

1095 *See* PeoplePowerFund Letter; Public Startup 3 Letter; RFPIA Letter; Vann Letter.

1096 *See* RocketHub Letter (stating that it "supports the Commissions [sic] interpretation of the exemption, and believes that AML compliance is necessary"); Berlingeri Letter (supporting funding portal "compliance with existing anti-money laundering provisions and the requirement to report suspicious activity").

1097 *See* Zhang Letter.

(3) **Final Rules**

Upon further consideration, we have determined not to adopt proposed Rule 403(b). The BSA requirements play a critical role in detecting, preventing, and reporting money laundering and other illicit financing, such as market manipulation and fraud. However, after careful consideration, we believe that AML obligations for funding portals are better addressed outside of the rules that we are currently adopting in this release, and that it would be more appropriate to work with other regulators to develop consistent and effective AML obligations for funding portals.[1098] We note, however, that broker-dealers continue to have their own AML obligations, as do certain other parties involved in transactions conducted pursuant to Section 4(a)(6), such as a bank acting as a qualified third party to hold investor funds.

c. **Privacy**

(1) **Proposed Rule**

Section 4A(a)(9) of the Securities Act requires intermediaries to take such steps to protect the privacy of information collected from investors as the Commission shall, by rule, determine appropriate. Proposed Rule 403(c) would implement the requirements of Section 4A(a)(9) by subjecting funding portals to the same privacy rules as those applicable to brokers. Proposed Rule 403(c), therefore, would have required funding portals to comply with Regulation S-P (Privacy of

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[1098] FinCEN within the Department of Treasury has primary regulatory responsibility for administering the BSA. We note that FinCEN has included in the Unified Agenda and Regulatory Plan an item that states: "FinCEN...is proposing amendments to the regulatory definitions of 'broker or dealer in securities' under the regulations implementing the Bank Secrecy Act. The proposed changes are intended to expand the current scope of the definitions to include funding portals. In addition, these amendments would require funding portals to implement policies and procedures reasonably designed to achieve compliance with all of the Bank Secrecy Act requirements that are currently applicable to brokers or dealers in securities." *See* Office of Mgmt. & Budget, Exec. Office of the President, Office of Info. & Regulatory Affairs, Amendments of the Definition of Broker or Dealer in Securities, RIN 1506-AB29, *available at* http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201504&RIN=1506-AB29. In addition, the Commission has adopted its own rules that require broker-dealers to comply with certain requirements of the BSA's implementing regulations, such as books and records requirements. *See* Exchange Act Rule 17a-8. *See also* Section II.D.5..

Consumer Financial Information and Safeguarding Personal Information),[1099] Regulation S-AM (Limitations on Affiliate Marketing),[1100] and Regulation S-ID (Identity Theft Red Flags)[1101] (collectively, the "Privacy Rules").[1102]

Regulation S-P governs the treatment of nonpublic personal information by brokers, among others.[1103] It generally requires a broker to provide notice to investors about its privacy policies and practices; describes the conditions under which a broker may disclose nonpublic personal information about investors to nonaffiliated third parties; and provides a method for investors to prevent a broker from disclosing that information to most nonaffiliated third parties by "opting out" of that disclosure, subject to certain exceptions. Regulation S-AM allows a consumer, in certain limited situations, to block affiliates of covered persons (*i.e.*, brokers, dealers, investment companies and both investment advisers and transfer agents registered with the Commission) from soliciting the consumer based on eligibility information (*i.e.*, certain financial information, such as information about the consumer's transactions or experiences with the covered person) received from the covered person.[1104] Regulation S-ID generally requires brokers to develop and implement a written identity theft prevention program that is designed to detect,

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1099 *See Privacy of Consumer Financial Information (Regulation S–P)*, Release No. 34-42974 (June 22, 2000) [65 FR 40334 (June 29, 2000)].

1100 *See Regulation S–AM: Limitations on Affiliate Marketing*, Release No. 34-60423 (Aug. 4, 2011) [74 FR 40398 (Aug. 11, 2009)].

1101 *See Identity Theft Red Flags Rules*, Release No. 34-69359 (Apr. 10, 2013) [78 FR 23637 (Apr. 19, 2013)] (adopted jointly with the Commodity Futures Trading Commission).

1102 *See* 17 CFR 248.

1103 *See* 17 CFR 248 Subpart A.

1104 *See* 17 CFR 248 Subpart B.

prevent and mitigate identity theft in connection with certain existing accounts or the opening of new accounts.[1105]

(2) Comments and Final Rules

We are adopting Rule 403(c) as proposed, but renumbering it as Rule 403(b).[1106] One commenter opposed Proposed Rule 403(c), which would impose the Privacy Rules on funding portals, stating that in its view, funding portals do not raise privacy concerns.[1107] We disagree. We believe that privacy is a concern as it relates to funding portals given that funding portals will collect and maintain sensitive personal information about the investors using their platforms.

d. Inspections and Examinations

(1) Proposed Rule

Exchange Act Section 3(h)(1)(A) specifies that funding portals must remain subject to our examination authority to, among other things, rely on any exemptions from broker-dealer registration that we impose. Under proposed Rule 403(d) of Regulation Crowdfunding, a funding portal would be required to permit the examination and inspection of all of its business and business operations that relate to its activities as a funding portal, such as its premises, systems, platforms and records, by our representatives and by representatives of the registered national securities association of which it is a member.

1105 *See* 17 CFR 248 Subpart C.

1106 The rule is being renumbered to account for the elimination of the proposed AML provision in proposed Rule 403(b), which is discussed in Section II.D.4.b above.

1107 *See* Public Startup Letter 3.

(2) Comment and Final Rules

We are adopting Rule 403(d) as proposed, but renumbering it as 403(c).[1108] One commenter opposed the Commission's proposed inspections and examinations rules as unnecessary.[1109] As a condition to exempting funding portals from the requirement to register as broker-dealers under Exchange Act Section 15(a)(1), Exchange Act Section 3(h)(1)(A) requires that registered funding portals remain subject to, among other things, our examination authority. We believe that inspections and examinations are an important aspect of our oversight function of funding portals as they will assist us in monitoring the activities of funding portals in light of applicable statutory and regulatory requirements. Therefore, we are adopting Rule 403(c) to implement the statute and retain examination authority over funding portals.

5. Records to be Created and Maintained by Funding Portals

a. Proposed Rule

As proposed, Rule 404(a) would require funding portals to make and preserve certain records for five years, with the records retained in a readily accessible place for at least the first two years. The required records would include the following:

- All records relating to investors who purchase or attempt to purchase securities through the funding portal;[1110]

1108 The Rule is being renumbered to account for the elimination of the proposed anti-money laundering provision in proposed Rule 403(b), which is described in more detail in Section II.D.4.b. We are also adding the word "registered" to "national securities association" to be consistent with the rest of the rule text and with Exchange Act Section 3(h)(1)(B).

1109 *See* Public Startup Letter 3.

1110 This would include information relating to educational materials provided to investors, account openings and transactions, including notices of investment commitments and reconfirmations.

- All records relating to issuers that offer and sell, or attempt to offer and sell, securities through the funding portal and to persons having control with respect to those issuers;
- Records of all communications that occur on or through its platform;
- All records related to persons that use communication services provided by a funding portal to promote an issuer's securities or to communicate with potential investors;
- All records demonstrating a funding portal's compliance with requirements of Subparts C (intermediary obligations) and D (additional funding portal requirements);[1111]
- All notices provided by the funding portals to issuers and investors generally through the funding portal's platform or otherwise;[1112]
- All written agreements (or copies thereof) entered into by a funding portal, relating to its business as such;
- All daily, monthly and quarterly summaries of transactions effected through the funding portal;[1113] and

[1111] This requirement alone would not, however, require the creation of any records or proscribe the format or manner of any records. However, without records, it would be difficult for a funding portal to demonstrate compliance with Subparts C and D to examiners.

[1112] These would include, but not be limited to: (1) notices addressing hours of funding portal operations (if any); (2) funding portal malfunctions; (3) changes to funding portal procedures; (4) maintenance of hardware and software; (5) instructions pertaining to access to the funding portal; and (6) denials of, or limitations on, access to the funding portal.

[1113] These would include: (1) issuers for which the target offering amount has been reached and funds distributed; and (2) transaction volume, expressed in number of transactions, number of securities involved in a transaction and total amounts raised by and distributed to issuers, as well as total dollar amounts raised across all issuers, expressed in U.S. dollars.

- A log reflecting the progress of each issuer who offers and sells securities through the funding portal toward meeting the target offering amount.

As proposed, Rule 404(b) would require that a funding portal make and preserve its organizational documents during its operation as a funding portal and also those of any successor funding portal. These would include, but not be limited to: (1) partnership agreements; (2) articles of incorporation or charter; (3) minute books; and (4) stock certificate books (or other similar type documents).

We also proposed in Rule 404(c) that the records required to be maintained and preserved pursuant to Rule 404(a) be produced, reproduced, and maintained in the original, non-alterable format in which they were created or as permitted under Section 17a-4(f) of the Exchange Act. We proposed in Rule 404(d) to allow third parties to prepare or maintain the required records on behalf of the funding portal, provided that there is a written undertaking in place between the funding portal and the third party stating that the required records are the property of the funding portal and will be surrendered promptly, on request by the funding portal, to the Commission or the national securities association of which the funding portal is a member.[1114] The funding portal

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1114 The written undertaking would be required to include the following provision:

> With respect to any books and records maintained or preserved on behalf of [name of funding portal], the undersigned hereby acknowledges that the books and records are the property of [name of funding portal], and hereby undertakes to permit examination of such books and records at any time, or from time to time, during business hours by representatives of the Securities and Exchange Commission, and the national securities association of which the funding portal is a member, and to promptly furnish to the Commission and national securities association of which the funding portal is a member, a true, correct, complete and current hard copy of any, all, or any part of, such books and records.

This provision is consistent with the recordkeeping provisions applicable to brokers under Exchange Act Rules 17a-4(f) (17 CFR 17a-4(f)) and 17a-4(j) (17 CFR 240.17a-4(j)), but has been scaled to be more appropriate for funding portals.

also would have been required to file, with the registered national securities association of which it is a member, this written undertaking, signed by a duly authorized representative of the third party. As proposed, an agreement between a funding portal and a third party would not relieve the funding portal of its responsibility to prepare and maintain records, as required under Rule 404 of Regulation Crowdfunding.

As proposed, Rule 404(e) would require all records of a funding portal to be subject at any time, or from time to time, to such reasonable periodic, special or other examination by our representatives and representatives of the registered national securities association of which the funding portal is a member.

Finally, we proposed in Rule 404(f) that funding portals would be required to comply with the reporting, recordkeeping and record retention requirements of Chapter X of Title 31 of the Code of Federal Regulations. Where Chapter X of Title 31 and proposed rules 404(a) and 404(b) would require the same records or reports to be preserved for different periods of time, we proposed requiring the records or reports to be preserved for the longer period of time.

b. Comments on Proposed Rule

Commenters generally did not object to the proposed recordkeeping requirements. Some commenters suggested that the cost for a funding portal to maintain the proposed books and records would not be significant.[1115] A few commenters suggested that funding portals should maintain required records for a longer period of time. One of these commenters recommended a retention period of 10 years,[1116] while the other suggested that issuer data should be kept

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1115 *See, e.g.*, CFIRA Letter 1, Joinvestor Letter.

1116 *See* Joinvestor Letter.

permanently accessible by the funding portal.[1117] Another commenter suggested that the Commission should require intermediaries, rather than the issuers, to maintain records (or arrange for third-party recordkeeping) of the offering materials used by the issuers, thereby reducing the burden on issuers by no longer requiring them to transcribe offering materials into something that can be filed with EDGAR.[1118]

c. Final Rules

We are adopting Rule 404 as proposed, with a modification to subparagraph (e) to require that books and records subject to review under the subsection be produced promptly to representatives of the Commission and the national securities association of which the funding portal is a member,[1119] and a minor modification to subparagraph (f) related to anti-money laundering related records.[1120] We also made a modification to state that, in addition to being furnished to representatives of the Commission, books and records would have to be furnished to the Commission itself. We are also adding the word "registered" to "national securities association" to be consistent with the rest of the rule text and with Exchange Act Section 3(h)(1)(B).[1121]

We believe that it is important for funding portals to be subject to the recordkeeping requirements in order to create a meaningful record of crowdfunding transactions and

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[1117] Mollick, *et al* Letter. *See also* Public Startup Letter 5 (suggesting that the Commission should improve "forensic record-keeping obligations of a funding portal" by requiring portals to "maintain the URLs and website content in perpetuity for all issuers who use the portal to raise capital from the public.").

[1118] CFIRA Letter 1.

[1119] We are making this change to remain consistent with the prompt production standard that is required for third party recordkeeping undertakings pursuant to Rule 404(d).

[1120] In the Proposing Release and as noted in this section, we have provided examples of the types of information that would be required to be maintained under each of the specified records. The same guidance applies with respect to application of the final rules.

[1121] Conforming changes were made to both Rules 404(d) and (e).

communications. For example, we are requiring records of all notices provided by the funding portals to issuers and investors generally through the funding portal's platform or otherwise. We believe that, in addition to the list of examples provided in the rule, this encompasses any notices relating to the funding portal's business as such, including communications in electronic form sent from an associated person of a funding portal to issuers or investors (including potential investors). Every funding portal is required under Rule 404 to furnish promptly to the Commission and its representatives, and the registered national securities association of which the funding portal is a member, legible, true, complete and current copies of such records of the funding portal that are requested by the representatives of the Commission and the national securities association.[1122]

The requirements will enable regulators to more effectively gather information about the activities in which a funding portal has been engaged, as well as about the other parties involved in crowdfunding (*e.g.,* issuers, promoters, and associated persons), to discern whether the funding portals and the other parties are in compliance with the requirements of Regulation Crowdfunding and any other applicable federal securities laws. We believe the requirements will assist regulators' compliance examinations because, without these records, the Commission and any registered national securities association of which the funding portal is a member may have difficulty examining a funding portal for compliance with the requirements of Regulation

[1122] The Commission generally interprets the term "promptly" or "prompt" to mean making reasonable efforts to produce records that are requested by the staff during an examination without delay. The Commission believes that in many cases a funding portal could, and therefore will be required to, furnish records immediately or within a few hours of a request. The Commission expects that only in unusual circumstances would a funding portal be permitted to delay furnishing records for more than 24 hours. *Accord* Security-Based Swap Data Repository Registration, Duties, and Core Principles, Exchange Act Release No. 74246 (Feb. 11, 2015), 80 FR 14438, 14500 n. 846 (Mar. 19, 2015) (similarly interpreting the term "promptly" in the context of Exchange Act Rule 13n–7(b)(3)); Registration of Municipal Advisors, Exchange Act Release No. 70462 (Sept. 20, 2013), 78 FR 67468, 67578-67579 n. 1347 (Nov. 12, 2013) (similarly interpreting the term "prompt" in the context of Exchange Act Rule 15Ba1-8(d)).

Crowdfunding and the federal securities laws.[1123] Therefore, we believe the record retention requirements should be mandatory rather than voluntary as suggested by one commenter. Although we are not requiring that funding portals utilize the record retention services of broker-dealers, as suggested by one commenter, we note that a funding portal may find it cost-effective or otherwise appropriate to use the recordkeeping services of a third party, and the final rules provide the necessary flexibility to allow funding portals to utilize these options.

While some commenters suggest a longer record retention period, we believe the requirement that funding portals preserve their records for five years, with the records retained in a readily accessible place for at least the first two years, provides sufficient investor protection, while not imposing overly burdensome recordkeeping costs.[1124] We are not adopting, as commenters recommended, a requirement that funding portals be required to keep issuer data permanently accessible or maintain URLs and website content in perpetuity for all issuers, as we believe the permanent storage of such information could be unduly burdensome and is unnecessary.

Because permissible funding portal activity is far more limited than that of broker-dealers and a relatively high proportion of funding portals will be new market entrants that have not been subject to regulation before (rather than broker-dealers switching their business models to become funding portals) and, therefore, may not have formal recordkeeping practices in place, the recordkeeping requirements for funding portals are relatively streamlined compared to those for

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[1123] *See*, *supra*, note 798.

[1124] We note that the record retention period requirement continues for a funding portal after it withdraws its registration. Schedule D of Form Funding Portal requests information about the location(s) of where a funding portal will keep its books and records after withdrawal.

broker-dealers. Funding portals are intended to be subject to less regulation than broker-dealers, and recordkeeping requirements adopted in the final rules are consistent with this intent.

Finally, as described above, we are not adopting the proposed requirement that a funding portal comply with the BSA.[1125] Nevertheless, we are revising the final recordkeeping rule to require a funding portal to maintain books and records related to BSA requirements, should funding portals become subject to the requirements of the BSA.[1126]

Commission staff expects to review the books and records practices of intermediaries during the study of the federal crowdfunding exemption that it plans to undertake no later than three years following the effective date of Regulation Crowdfunding.[1127]

E. Miscellaneous Provisions

1. Insignificant Deviations from Regulation Crowdfunding

a. Proposed Rules

We proposed Rule 502 of Regulation Crowdfunding to provide issuers a safe harbor for insignificant deviations from a term, condition or requirement of Regulation Crowdfunding. As proposed in Rule 502(a), to qualify for the safe harbor, the issuer relying on the exemption would have to show that: (1) the failure to comply with a term, condition or requirement was insignificant with respect to the offering as a whole; and (2) the issuer made a good faith and reasonable attempt to comply with all applicable terms, conditions and requirements of Regulation

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[1125] *See* Section II.D.4.b.

[1126] 15 U.S.C. 5311 *et seq.* To the extent that funding portals become subject to the requirements of the BSA and are required to comply with BSA recordkeeping requirements, we believe that this recordkeeping requirement will be valuable to our regulatory oversight function of funding portals' compliance with such BSA requirements. *See generally Recordkeeping by Brokers and Dealers*, Release No. 34-18321 (Dec. 10, 1981) [46 FR 61454 (Dec. 17, 1981)] (noting the effectiveness of on-site examinations of broker-dealers by the Commission and SROs in enforcing compliance with reporting and recordkeeping requirements when adopting Exchange Act Rule 17a-8). Rule 17a-8 (17 CFR 240.17a-8) requires broker-dealers to comply with the reporting, recordkeeping and record retention rules adopted under the BSA.

[1127] *See* Section II.

Crowdfunding; and (3) the issuer did not know of the failure to comply, where the failure to comply with a term, condition or requirement was the result of the failure of the intermediary to comply with the requirements of Section 4A(a) and the related rules, or such failure by the intermediary occurred solely in offerings other than the issuer's offering. As proposed in Rule 502(b), notwithstanding this safe harbor, any failure to comply with Regulation Crowdfunding would nonetheless be actionable by the Commission.

b. Comments on the Proposed Rules

Commenters were generally in favor of the proposed safe harbor.[1128] However, some commenters representing state securities regulators suggested that the safe harbor is unnecessary, would be detrimental to state enforcement efforts and would be a burden on regulators when issuers assert the safe harbor, whether or not they were operating in good faith.[1129] These commenters also recommended that the proposed safe harbor, if adopted, should not be a defense to an enforcement action by the states.[1130]

c. Final Rules

We are adopting the Rule 502(a) safe harbor as proposed.[1131] The first two prongs of the safe harbor provision in Rule 502(a) are modeled after a similar provision in Rule 508 of Regulation D,[1132] and we believe a similar safe harbor is appropriate for offerings made in reliance on Section 4(a)(6). We believe that provisions for insignificant deviations serve an important function by allowing for certain errors that can occur in the offering process without causing the

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[1128] *See, e.g.*, Arctic Island Letter 7; CFIRA Letter 1; Heritage Letter; Joinvestor Letter; Parsont Letter; Schwartz Letter.

[1129] *See* Commonwealth of Massachusetts Letter; NASAA Letter.

[1130] *Id.*

[1131] *See* Rule 502 of Regulation Crowdfunding.

[1132] 17 CFR 230.508.

issuer to lose the exemption and incur certain consequences, including potential private rights of action for rescission for violations of Section 5 of the Securities Act,[1133] and loss of preemption for state securities law registration requirements. The offering exemption in Section 4(a)(6) was designed to help alleviate the funding gap and the accompanying regulatory challenges faced by startups and small businesses, many of which may not be familiar with the federal securities laws. We continue to believe that issuers should not lose the Section 4(a)(6) exemption because of insignificant deviations from a term, condition or requirement of Regulation Crowdfunding, so long as the issuer, in good faith, attempted to comply with the rules. We note that whether a deviation from the requirements would be significant to the offering as a whole will depend on the facts and circumstances of the offering and the deviation. While such determinations will be based on the particular facts and circumstances, we believe that a deviation from certain fundamental requirements in the rules, such as a failure to adhere to the aggregate offering limit under Rule 100(a)(1), presumptively would not be an insignificant deviation that would allow reliance on this safe harbor.

We are adopting the third prong of the safe harbor in Rule 502(a) because, under the statute, an issuer could lose the exemption and potentially violate Section 5 because of the failure of the intermediary to comply with the requirements of Section 4A(a). We believe that an issuer should not lose the offering exemption due to a failure by the intermediary, which likely will be out of the issuer's control, if the issuer did not know of such failure or such failure related to offerings other than the issuer's offering. Absent this safe harbor, we believe that issuers may be hesitant to participate in offerings in reliance on Section 4(a)(6) due to uncertainty about their

1133 *See* Securities Act Section 12(a)

ability to rely on, and to control their ongoing eligibility for, the exemption, which could undermine the facilitation of capital raising for startups and small businesses.

We believe that the potential harm to investors that might result from the applicability of this safe harbor would be minimal because the deviations must be insignificant to the offering as a whole for the safe harbor to apply. We also believe the safe harbor appropriately protects an issuer who made a diligent attempt to comply with the rules from losing the exemption as a result of insignificant deviations from Regulation Crowdfunding.

We also are adopting Rule 502(b) largely as proposed to set forth clearly that the safe harbor for insignificant deviations in Rule 502(a) does not preclude the Commission from bringing an enforcement action seeking appropriate relief for an issuer's failure to comply with all applicable terms, conditions, and requirements of Regulation Crowdfunding. Despite the suggestion of two commenters,[1134] we are not extending Rule 502(b) to enforcement actions by the states. While we recognize the concerns of certain state securities regulators that the safe harbor could be detrimental to state enforcement efforts, we believe that a state's review as to whether there is an insignificant deviation from our rules would create undue uncertainty for issuers seeking to rely on the Section 4(a)(6) exemption.[1135] We note that, irrespective of the scope of the safe harbor, states retain antifraud authority in all cases.

2. Restrictions on Resales

a. Proposed Rules

Section 4A(e) provides that securities issued in reliance on Section 4(a)(6) may not be transferred by the purchaser for one year after the date of purchase, except when transferred: (1) to

[1134] *See* Commonwealth of Massachusetts Letter; NASAA Letter.

[1135] Securities Act Section 18(b)(4)(C), as amended by the JOBS Act, preempts state securities laws' registration and qualification requirements for offerings made pursuant to Section 4(a)(6). 15 U.S.C. 77r(b)(4)(C).

the issuer of the securities; (2) to an accredited investor; (3) as part of an offering registered with the Commission; or (4) to a family member of the purchaser or the equivalent, or in connection with certain events, including death or divorce of the purchaser, or other similar circumstances, in the discretion of the Commission. Section 4A(e) further provides that the Commission may establish additional limitations on securities issued in reliance on Section 4(a)(6).

Proposed Rule 501 largely tracked the provisions of Section 4A(e). We also proposed definitions of "accredited investor" and a "member of the family of the purchaser or the equivalent." Under the proposed rules, the term "accredited investor" would have the same definition in Rule 501 of Regulation D.[1136]

The statute does not define "member of the family of the purchaser or the equivalent." We proposed to define the phrase to include a "child, stepchild, grandchild, parent, stepparent, grandparent, spouse or spousal equivalent, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of the purchaser, and shall include adoptive relationships." This definition tracks the definition of "immediate family" in Exchange Act Rule 16a-1(e),[1137] but with the addition of "spousal equivalent."

b. Comments on the Proposed Rules

Two commenters supported the proposed restrictions on resales,[1138] while several other commenters opposed any resale restrictions.[1139] Two commenters expressed support for the

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1136 17 CFR 230.501(a).

1137 17 CFR 240.16a-1(e).

1138 *See* Arctic Island Letter 7; Joinvestor Letter.

1139 *See, e.g.*, Amram Letter 2 (stating resale restrictions prevent trading liquidity and impede price discovery); Crowdstockz Letter; Hamman Letter; Kickstarter Coaching Letter; Public Startup Letter 2 (recommending a six-month holding period so long as the issuer is current in its filing requirements, except that purchasers who self-certify that they are low-income investors would not be subject to a holding period); Public Startup Letter 3 (also opposing accredited investors having an advantage over other buyers).

proposal that to sell securities purchased in a transaction made in reliance on Section 4(a)(6) to an accredited investor during the restricted period, the seller of such securities would need to have a reasonable belief that the purchaser is an accredited investor.[1140]

One commenter noted that the investors who are eligible to purchase securities from the initial purchasers in the first year would be able to circumvent the investment limits of the proposed rules by purchasing securities from the initial purchasers in an amount greater than they would be able to purchase through intermediaries.[1141] Another commenter noted that the restrictions on resale appear only to cover the sale by the initial purchaser, thus creating the possibility that securities of a particular issuer could become widely traded within the first year if the initial purchaser sells the securities to an eligible purchaser who then resells them to the public within the first year.[1142]

c. Final Rules

We are adopting the restrictions on resales in Rule 501 as proposed, with certain revisions as described below.[1143] We are concerned that, as noted by several commenters, the restrictions on resales would cover only the sale by the initial purchaser, which creates the possibility that securities of a particular issuer could become widely traded within the first year if the initial purchaser sells the securities to an eligible purchaser who subsequently resells them to the public

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1140 *See* Joinvestor Letter; Public Startup Letter 3.

1141 *See* Moskowitz Letter.

1142 CrowdCheck Letter 3 (recommending several alternatives: (1) designate the securities as "restricted" within the meaning of Rule 144; (2) mirror some or all of the issuer's resale restrictions; (3) impose a one-year obligation on the issuer not to register the transfer of securities by any person, except in the four permitted types of transfers; or (4) remove the words "by the purchaser" from the first sentence of proposed Rule 501(a)).

1143 *See* Rule 501 of Regulation Crowdfunding.

within the first year. Further, the proposed rule could allow, as one commenter noted,[1144] investors to circumvent the investment limits in the first year by purchasing securities from the initial purchasers. In response to these concerns, we have modified Rule 501 from the proposal so that the one-year resale restriction will apply to any purchaser during the one-year period beginning when the securities were first issued, not just the initial purchaser. In addition, we have modified the definition to track more closely the language in Securities Act Rule 501(a) to clarify that the person reselling the securities must have a reasonable belief that the purchaser qualifies as an accredited investor.

As adopted, the rule provides that securities issued in a transaction pursuant to Section 4(a)(6) may not be transferred by any purchaser of such securities during that one-year period unless such securities are transferred: (1) to the issuer of the securities; (2) to an accredited investor; (3) as part of an offering registered with the Commission; or (4) to a member of the family of the purchaser or the equivalent, to a trust controlled by the purchaser, to a trust created for the benefit of a member of the family of the purchaser or the equivalent, or in connection with the death or divorce of the purchaser or other similar circumstance. We recognize that several commenters expressed concerns about the exception for resales to accredited investors and the potential unfair advantage this could provide to such investors. While we appreciate these concerns, we note that this treatment will provide some measure of liquidity for holders of these securities within the first year of the offering without undermining the investor protections otherwise provided by the statute and our rules.

[1144] *See* Moskowitz Letter.

3. Information Available to States

Under Section 4A(d), the Commission shall make available, or shall cause to be made available by the relevant intermediary, the information required under Section 4A(b) and such other information as the Commission, by rule, determines appropriate to the securities commission (or any agency or office performing like functions) of each state and territory of the United States and the District of Columbia. We proposed to require issuers to file on EDGAR the information required by Section 4A(b) and the related rules. Information filed on EDGAR is publicly available and would, therefore, be available to each state, territory and the District of Columbia. As we stated in the Proposing Release, we believe this approach will satisfy the statutory requirement to make the information available to each state and territory of the United States, and the District of Columbia. Commenters who addressed this issue agreed with our proposed approach,[1145] and we are adopting this provision as proposed.

4. Exemption from Section 12(g)

a. Proposed Rule

Section 303 of the JOBS Act amended Exchange Act Section 12(g) to provide that "the Commission shall, by rule, exempt, conditionally or unconditionally, securities acquired pursuant to an offering made under [S]ection 4[(a)](6) of the Securities Act of 1933 from the provisions of this subsection." As amended by the JOBS Act, Section 12(g) requires, among other things, that an issuer with total assets exceeding $10,000,000 and a class of securities held of record by either 2,000 persons, or 500 persons who are not accredited investors, register such class of securities

[1145] *See, e.g.*, CFIRA Letter 9; Public Startup Letter 3.

with the Commission.[1146] Crowdfunding contemplates the issuance of securities to a large number of holders, which could increase the likelihood that Section 4(a)(6) issuers would exceed the thresholds for triggering reporting obligations under Section 12(g). As discussed in the Proposing Release, Section 303 could be read to mean that securities acquired in a crowdfunding transaction would be excluded from the record holder count permanently, regardless of whether the securities continue to be held by a person who purchased in the crowdfunding transaction. An alternative reading could provide that securities acquired in a crowdfunding transaction would be excluded from the record holder count only while held by the original purchaser in the Section 4(a)(6) transaction, as a subsequent purchaser of the securities would not be considered to have "acquired [the securities] pursuant to an offering made under [S]ection 4[(a)](6)."

Consistent with the statute, the Commission's proposed Rule 12g-6 would provide that securities issued pursuant to an offering made under Section 4(a)(6) would be permanently exempted from the record holder count under Section 12(g). An issuer seeking to exclude a person from the record holder count would have the responsibility for demonstrating that the securities held by the person were initially issued in an offering made under Section 4(a)(6).

b. Comments on the Proposed Rules

Commenters generally supported the permanent exemption from the record holder count under Section 12(g).[1147] One commenter recommended that the exemption from the record holder count under Section 12(g) apply to different securities issued in a subsequent restructuring,

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1146 *See* Section 501 of the JOBS Act. In the case of an issuer that is a bank or a bank holding company, Exchange Act Section 12(g)(1)(B) (15 U.S.C. 78*l*(g)(1)(B)) requires, among other things, that the issuer, if it has total assets exceeding $10,000,000 and a class of securities held of record by 2,000 persons, register such class of securities with the Commission. *See* Section 601 of the JOBS Act.

1147 *See, e.g.*, ABA Letter; Arctic Island Letter 7; Craw Letter; Heritage Letter; Joinvestor Letter; PeoplePowerFund Letter; Public Startup Letter 3; Wefunder Letter.

recapitalization or similar transaction that is exempt from, or otherwise not subject to, the registration requirements of Section 5, if the parties to the transaction are affiliates of the original issuer.[1148] A few commenters recommended conditioning the exemption from the record holder count under Section 12(g) on the issuer's asset value,[1149] while a few others opposed such concept.[1150] Another commenter recommended that issuers that fail to comply with Regulation Crowdfunding's ongoing reporting requirements be disqualified from relying on the exemption from the record holder count under Section 12(g),[1151] while two commenters opposed such concept.[1152]

c. Final Rules

In response to comments received, we are adopting Rule 12g-6 with certain modifications.[1153] The rule provides that securities issued pursuant to an offering made under Section 4(a)(6) are exempted from the record holder count under Section 12(g), provided that the issuer is current in its ongoing annual reports required pursuant to Rule 202 of Regulation Crowdfunding, has total assets as of the end of its last fiscal year not in excess of $25 million, and has engaged the services of a transfer agent registered with the Commission pursuant to Section 17A of the Exchange Act.[1154]

1148 *See* Arctic Island Letter 7. *See also* ABA Letter (recommending that the Commission, at a minimum, exempt from the Section 12(g) record holder count securities issued in a statutory merger to change the domicile of the issuer, in reliance on Securities Act Rule 145(a)(2)).

1149 *See, e.g.*, ABA Letter ($25 million); PeoplePowerFund Letter.

1150 *See, e.g.*, Arctic Island Letter 7; Public Startup Letter 3.

1151 *See* Joinvestor Letter.

1152 *See* Arctic Island Letter 7; Public Startup Letter 3.

1153 17 CFR 240.12g-6.

1154 *Id.*

An issuer that exceeds the $25 million total asset threshold, in addition to exceeding the thresholds in Section 12(g), will be granted a two-year transition period before it will be required to register its class of securities pursuant to Section 12(g), provided it timely files all its ongoing reports pursuant to Rule 202 of Regulation Crowdfunding during such period.[1155] Section 12(g) registration will be required only if, on the last day of the fiscal year the company has total assets in excess of the $25 million total asset threshold, the class of equity securities is held by more than 2,000 persons or 500 persons who are not accredited investors.[1156] In such circumstances, an issuer that exceeds the thresholds in Section 12(g) and has total assets of $25 million or more will be required to begin reporting under the Exchange Act the fiscal year immediately following the end of the two-year transition period.[1157] An issuer entering Exchange Act reporting will be considered an "emerging growth company" to the extent the issuer otherwise qualifies for such status.[1158]

An issuer seeking to exclude a person from the record holder count has the responsibility for demonstrating that the securities held by the person were initially issued in an offering made under Section 4(a)(6). As noted in the proposal, we believe that allowing issuers to sell securities pursuant to Section 4(a)(6) without becoming Exchange Act reporting issuers is consistent with the intent of Title III.[1159] In this regard, we note that Title III provides for an alternative reporting

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1155 *Id.*

1156 15 U.S.C. 78*l*(g).

1157 17 CFR 240.12g-6.

1158 Under Section 2(a)(19) of the Securities Act, an "emerging growth company" is defined as, among other things, an issuer that had total annual gross revenues of less than $1 billion during its most recently completed fiscal year. 15 U.S.C. 77b(a)(19). *See also* Section 3(a)(80) of the Exchange Act (which repeats the same definition). 15 U.S.C. 78c(a)(80).

1159 *See* 158 CONG. REC. S1829 (daily ed. Mar. 20, 2012) (statement of Sen. Jeff Merkley) ("It also provides a very important provision so the small investors do not count against the shareholder number that drives

system under which issuers using the crowdfunding exemption are required to file annual reports with the Commission.[1160] We believe that conditionally exempting securities issued in reliance on Section 4(a)(6) from the record holder count under Section 12(g), and thereby from the more extensive reporting obligations under the Exchange Act, is appropriate in light of the existence of the alternative ongoing reporting requirements that are tailored to the types of issuers and offerings we anticipate under Regulation Crowdfunding.

In determining to provide a conditional exemption from the provisions of Section 12(g), we have considered a number of factors. First, we believe that conditioning the exemption on the issuer being current in its ongoing reporting requirements is consistent with the intent behind the original enactment of Section 12(g) because this condition requires that relevant, current information about issuers will be made routinely available to investors and the marketplace.[1161] Second, we believe that conditioning the 12(g) exemption on crowdfunding issuers using a registered transfer agent will provide an important investor protection in this context. As discussed in Section II.C.3 above, regarding the need for an issuer to establish means to keep accurate records of its securities holders, we received a number of comments about the benefits of using a registered transfer agent. As noted above, we are not mandating the use of a transfer agent for all crowdfunding offerings, for both flexibility and cost reasons. However, we believe that requiring the use of a transfer agent is appropriate for those issuers that are seeking to have their

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companies to have to become a fully public company. That is critical and interrelates with other parts of the [crowdfunding] bill before us.").

1160 *See* Section II.B.2 for a discussion of the requirement to file annual reports.

1161 Section 12(g) was enacted by Congress as a way to ensure that investors in over-the-counter securities about which there was little or no information, but which had a significant shareholder base, were provided with ongoing information about their investment. *See, generally, Report of the Special Study of Securities Markets of the Securities and Exchange Commission.* House Document No. 95, House Committee on Interstate and Foreign Commerce, 88th Cong., 1st Sess. (1963), at 60-62.

crowdfunding securities exempted from the record holder count under Section 12(g). We expect that issuers at a stage at which they are seeking to rely on the Section 12(g) exemption are likely to be larger and thus better able to incur the costs of a transfer agent. In the absence of a conditional exemption from the provisions of Section 12(g), the use of a transfer agent registered under the Exchange Act would be required of issuers when they register under the Exchange Act.[1162] We note that a registered transfer agent is a regulated entity with experience in maintaining accurate shareholder records, and its use will help to ensure that security holder records and secondary trades will be handled accurately. Third, we believe that the condition of total assets not exceeding $25 million will result in phasing out the Section 12(g) exemption once companies grow and expand their shareholder base and is consistent with the intent behind Title III of the JOBS Act, which was enacted to facilitate smaller company capital formation.

Rule 12g-6 does not extend the exclusion from the Section 12(g) record holder count to different securities issued in exchange for Section 4(a)(6)-issued securities in a subsequent restructuring, recapitalization or similar transaction. While some commenters requested such an extension in instances where the parties to the transaction are affiliates of the original issuer, or in certain restructuring transactions, we do not believe that such an expansion in the context of shares initially issued using Regulation Crowdfunding would be appropriate because certain restructuring and recapitalization transactions could change the pool of holders of the securities

[1162] Section 3(a)(25) of the Exchange Act provides that a "transfer agent" is any person who engages on behalf of an issuer of securities or on behalf of itself as an issuer of securities in: (A) countersigning such securities upon issuance; (B) monitoring the issuance of such securities with a view to preventing unauthorized issuance (i.e., a registrar); (C) registering the transfer of such securities; (D) exchanging or converting such securities; or (E) transferring record ownership of securities by bookkeeping entry without the physical issuance of securities certificates. 15 U.S.C. 78c(a)(25). Section 17A(c)(1) of the Exchange Act generally requires any person performing any of these functions with respect to any security registered pursuant to Section 12 of the Exchange Act to register with the Commission or other appropriate regulatory agency. 15 U.S.C. 78q-1(c)(1).

beyond those who initially acquired the securities in a crowdfunding transaction, denying those holders the protections of Section 12(g) registration.

5. Scope of Statutory Liability

Securities Act Section 4A(c) provides that an issuer will be liable to a purchaser of its securities in a transaction exempted by Section 4(a)(6) if the issuer, in the offer or sale of the securities, makes an untrue statement of a material fact or omits to state a material fact required to be stated or necessary in order to make the statements, in light of the circumstances under which they were made, not misleading, provided that the purchaser did not know of the untruth or omission, and the issuer does not sustain the burden of proof that such issuer did not know, and in the exercise of reasonable care could not have known, of the untruth or omission. Section 4A(c)(3) defines, for purposes of the liability provisions of Section 4A, an issuer as including "any person who offers or sells the security in such offering."

In describing the statutory liability provision in the Proposing Release, the Commission noted that it appears likely that intermediaries would be considered issuers for purposes of the provision. Several commenters agreed that Section 4A(c) liability should apply to intermediaries noting that it "may serve as a meaningful backstop against fraud"[1163] and would create a "true financial incentive" for intermediaries to conduct checks on issuers and their key personnel.[1164]

However, a large number of other commenters disagreed that Section 4A(c) liability should apply to intermediaries.[1165] Some of these commenters stated their views that applying

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1163 *See, e.g.,* Farnkoff Letter.

1164 *See, e.g.*, BackTrack Letter. *See also* Patel Letter.

1165 *See, e.g.*, ABA Letter; AngelList Letter; BetterInvesting Letter; CFIRA Letter 10; City First Letter; EarlyShares Letter; EMKF Letter; FSI Letter; Graves Letter; Guzik Letter 1; IAC Recommendation; Inkshares Letter; Milken Institute Letter; PPA Letter; RocketHub Letter; SBA Office of Advocacy Letter; SBEC Letter; SeedInvest Letter 3; Seyfarth Letter; StartupValley Letter; Wefunder Letter; Winters Letter.

statutory liability to intermediaries would have a chilling effect on intermediaries' willingness to facilitate crowdfunding offerings.[1166] Others cited the cost of being subject to this liability as overly burdensome on funding portals, to the extent that they may not be able to conduct business.[1167] Several commenters also explained that the nature of funding portals, as intended by Congress, is distinct from that of registered broker-dealers.[1168] According to these commenters, a funding portal's role is not to offer and sell securities, but rather to provide a platform through which issuers may offer and sell securities. As such, these commenters asserted that it would not be appropriate to hold them liable for statements made by issuers.[1169] In addition, one commenter suggested that applying statutory liability to funding portals, while precluding their ability to limit the offerings that they facilitate, is an "untenable" framework.[1170] Some commenters stated that the statutory construct could unnecessarily lead to lawsuits against funding portals,[1171] with one of these commenters asserting that such suits would arise "for any deal that loses money" because the burden of proof is on the funding portal to prove it could not have known of material

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1166 *See, e.g.*, Guzik Letter 1; Inkshares Letter; RocketHub Letter; StartupValley Letter.

1167 *See, e.g.*, City First Letter; Guzik Letter 1; SeedInvest Letter 3; Wefunder Letter; Winters Letter.

1168 *See, e.g.*, Inkshares Letter (likening funding portals to "impartial engineers of transactions" similar to online service providers under the Digital Millennium Copyright Act, that exist "for the transmission of information, and with it securities, between third parties"); RocketHub Letter; SeedInvest Letter 3; Seyfarth Letter.

1169 *Id.*

1170 AngelList Letter. *See also, e.g.*, Graves Letter (stating that "to achieve the appropriate balance of creating a usable crowdfunding model for small businesses while providing adequate protections for investors, the Commission should remove the liability placed on funding portals in the proposed rules or permit them to curate offerings. . . . Otherwise it is highly improbable that any rational business would establish a web portal in a heads-you-win, tails-I-lose environment"); Milken Institute Letter (noting also that funding portals should be permitted to make subjective judgments in deciding which offerings to list, including based on an assessment of the merits or shortcomings of an offering); Wefunder Letter. *See also* Section II.D.3.a (discussing Rule 402(b)(1)).

1171 *See, e.g.*, Inkshares Letter; SeedInvest Letter3.

misstatements."[1172] One commenter stated that risk disclosures should require an explanation to investors that lawsuits by investors are only potentially viable if based on claims sounding in fraud or negligence and that "lawsuits cannot be filed just because the retail investor loses their risk capital."[1173]

One commenter suggested that the Commission retract its statement in the Proposing Release that "it appears likely that intermediaries, including funding portals, would be considered issuers for purposes of this liability provision."[1174] Other commenters suggested that the Commission should take action, such as: (i) exempting funding portals from liability, provided conditions are met such as compliance with Regulation Crowdfunding[1175] or disclosure of the specific steps the funding portal has taken in its due diligence;[1176] (ii) providing a safe harbor for activities funding portals can undertake in posting issuer materials on their platforms,[1177] and (iii) providing a list of reasonable steps funding portals can take in reviewing an offering in order to rely on the reasonable care defense.[1178]

We have considered the comments both in support of and against funding portals being considered issuers for purposes of Section 4A(c) liability. Specifically, we acknowledge commenters' concerns that statutory liability may adversely affect funding portals, and

1172 *See* SeedInvest Letter 3.

1173 *See* CarbonTech Letter.

1174 *See* SeedInvest Letter 3.

1175 CFIRA Letter 10; SeedInvest Letter 3 (stating also that directors and officers of funding portals should be excluded from the definition of "issuer" for purposes of the statutory provision); StartupValley Letter.

1176 EarlyShares Letter.

1177 CFIRA Letter 10; StartupValley Letter.

1178 CFIRA Letter 10; Milken Institute Letter (stating that funding portals "should not be required to 'look behind' every material statement in an offering, but rather should be held to a standard of satisfying the statute's and proposed rule's steps for ensuring that an offering does not invoke concerns of fraud or investor protection"); StartupValley Letter.

suggestions that, under the statutory scheme, funding portals and broker-dealers engage in different activities that do not warrant a funding portal being subject to statutory liability. One difference commenters highlighted was the inability of a funding portal to limit the offerings on its platform under the proposed rules, and the untenable position of imposing statutory liability while precluding funding portals' ability to limit the offerings on their platforms. In response to this comment, as described above, we have modified the language of the Rule 402 safe harbor from the proposal to permit funding portals to exercise discretion to limit the offerings and issuers that they allow on their platforms.[1179] We believe this will avoid the "untenable" framework that commenters described. We are specifically declining to exempt funding portals (or any intermediaries) from the statutory liability provision of Section 4A(c) or to interpret this provision as categorically excluding such intermediaries. We do not believe that we should preclude the ability of investors to bring private rights of action against funding portals (or any intermediaries). Such a categorical exemption or exclusion could pose undue risks to investors by providing insufficient incentives for intermediaries to take steps to prevent their platforms from becoming vehicles for fraud.

Accordingly, we believe that the determination of "issuer" liability for an intermediary under Section 4A(c) will turn on the facts and circumstances of the particular matter in question. While we acknowledge the concerns of commenters about the potential application of Section 4A(c) liability, we note that Congress provided a defense to any such liability if an intermediary did not know, and in the exercise of reasonable care could not have known, of the untruth or omission. We continue to believe, as we identified in the Proposing Release, that there are appropriate steps that intermediaries might take in exercising reasonable care in light of this

1179 *See* Rule 402(b)(1); Section II.D.3.a.

liability provision. These steps may include establishing policies and procedures[1180] that are reasonably designed to achieve compliance with the requirements of Regulation Crowdfunding, and conducting a review of the issuer's offering documents, before posting them to the platform, to evaluate whether they contain materially false or misleading information.

6. Disqualification Provisions

Section 302(d) of the JOBS Act requires the Commission to establish disqualification provisions under which an issuer would not be eligible to offer securities pursuant to Section 4(a)(6) and an intermediary would not be eligible to effect or participate in transactions pursuant to Section 4(a)(6). Section 302(d)(2) specifies that the disqualification provisions must be "substantially similar" to the "bad actor" disqualification provisions contained in Rule 262 of Regulation A[1181] and they also must cover certain actions by state regulators enumerated in Section 302(d)(2).

The disqualification provisions included in Section 302(d) of the JOBS Act are modeled on the disqualification provisions included in Section 926 of the Dodd-Frank Act, which also required the Commission to adopt rules "substantially similar" to Rule 262 of Regulation A that disqualify securities offerings involving certain "felons and other 'bad actors'" from reliance on Rule 506 of Regulation D. On July 10, 2013, we adopted rules to implement Section 926 of the Dodd-Frank Act to disqualify certain securities offerings from reliance on Rule 506 of Regulation

1180 With respect to intermediaries that are funding portals, see Rule 403(a) of Regulation Crowdfunding and the discussion in Section II.D.4.

1181 17 CFR 230.262.

D.[1182] On March 25, 2015, we adopted amendments to Rule 262 of Regulation A[1183] that made those provisions substantially similar to those adopted under Rule 506 of Regulation D.

a. Issuers and Certain Other Associated Persons

(1) Proposed Rules

As described in more detail below, the proposed disqualification rules as they relate to issuers and certain other associated persons would have been substantially similar to the disqualification rules in Rules 262 and 506. Under those rules, disqualification arises only with respect to events occurring after effectiveness of the rules and disqualified persons may seek a waiver from the Commission from application of the disqualification provisions.

(2) Comments on Proposed Rules

Commenters were generally supportive of the proposed disqualification rules.[1184] A few commenters recommended that pre-existing events should be subject to the disqualification rules,[1185] although another supported the proposed approach of imposing disqualification only for events after effectiveness.[1186] One commenter recommended that the Commission expand the list

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1182 See Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings, Release No. 33-9414 (July 10, 2013) [78 FR 44729 (July 24, 2013)] ("Disqualification Adopting Release").

1183 *See* Rule 506(c) Adopting Release, *supra*, note 5.

1184 *See, e.g.*, ABA Letter (expressing general support and recommending the Commission provide guidance on the term "voting securities" and regarding the waiver process); Commonwealth of Massachusetts Letter; Consumer Federation Letter (expressing an understanding of why the proposed disqualification rules are consistent with those under Regulation D, but noting their belief that those rules were weak when adopted); FundHub Letter 1 (stating that the proposed disqualification rules "are, to a certain degree, overkill" and too costly, but that disqualifying bad actors is good for the future of equity crowdfunding); Joinvestor (supporting the proposed look-back periods and waiver rules). *But see* Public Startup Letter 3 (stating the proposed rules are unconstitutional without explaining its reasoning); Public Startup Letter 5 (recommending the Commission establish an "offender registry" that requires issuers to maintain a "public profile" containing information about potential issuers in a standardized format, similar to FINRA's BrokerCheck).

1185 *See, e.g.*, Guzik Letter 1; NASAA Letter.

1186 *See* Joinvestor Letter.

of covered persons to include transfer agents and lawyers who are subject to certain disqualifications.[1187]

(3) **Final Rules**

We are adopting bad actor disqualification provisions for Regulation Crowdfunding[1188] substantially as proposed with the exception of several modifications to further align the final rules with similar provisions in Rules 262 and 506. We believe that the final rules are appropriate in light of the JOBS Act Section 302(d) mandate. We further believe that creating a uniform set of bad actor standards for all exemptions that include bad actor disqualification is likely to simplify due diligence, particularly for issuers that may engage in different types of exempt offerings.

Under the final disqualification rules, covered persons include the issuer and any predecessor of the issuer or affiliated issuer; directors, officers, general partners or managing members of the issuer; beneficial owners of 20% or more of the issuer's outstanding voting equity securities (which we believe should be calculated based on the present right to vote for the election of directors, irrespective of the existence of control or significant influence); any promoter connected with the issuer in any capacity at the time of such sale; compensated solicitors of investors; and general partners, directors, officers or managing members of any such solicitor.[1189] We have not expanded the list of covered persons, as suggested by a commenter, because we believe that the limited additional investor protection that such an expansion may

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[1187] *See* Brown J. Letter (also recommending the Commission adopt similar bad actor provisions under Rule 504).

[1188] *See* Rule 503 of Regulation Crowdfunding.

[1189] *See* Rule 503(a) of Regulation Crowdfunding.

provide would not justify the costs that would result from inconsistent bad actor disqualification rules.

The disqualifying events include:

- felony and misdemeanor convictions within the last five years in the case of issuers, their predecessors and affiliated issuers, and 10 years in the case of other covered persons in connection with the purchase or sale of a security, involving the making of a false filing with the Commission; or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser, funding portal or paid solicitor of purchasers of securities;[1190]
- injunctions and court orders within the last five years against engaging in or continuing conduct or practices in connection with the purchase or sale of securities; involving the making of any false filing with the Commission; or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser, funding portal or paid solicitor of purchasers of securities;[1191]
- certain final orders and bars of certain state and other federal regulators;[1192]
- Commission cease-and-desist orders relating to violations of scienter-based anti-fraud provisions of the federal securities laws or Section 5 of the Securities Act;[1193]
- filing, or being named as an underwriter in, a registration statement or Regulation A offering statement that is the subject of a proceeding to determine whether a stop order or

1190 *See* Rule 503(a)(1) of Regulation Crowdfunding.

1191 *See* Rule 503(a)(2) of Regulation Crowdfunding.

1192 *See* Rule 503(a)(3) of Regulation Crowdfunding.

1193 *See* Rule 503(a)(5) of Regulation Crowdfunding.

suspension should be issued, or as to which a stop order or suspension was issued within the last five years;[1194]

- United States Postal Service false representation orders within the last five years;[1195] and
- for covered persons other than the issuer:
  - being subject to a Commission order:
    - revoking or suspending their registration as a broker, dealer, municipal securities dealer, investment adviser or funding portal;
    - placing limitations on their activities as such;
    - barring them from association with any entity; or
    - barring them from participating in an offering of penny stock;[1196] or
  - being suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or national securities association for conduct inconsistent with just and equitable principles of trade.[1197]

Consistent with Rules 262 and 506 and the proposal, we also are adopting provisions allowing for a waiver from and a reasonable care exception to the disqualification provisions.[1198] Under the final rules, an issuer will not lose the benefit of the Section 4(a)(6) exemption if it is able to show that it did not know, and in the exercise of reasonable care could not have known, of

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1194 *See* Rule 503(a)(7) of Regulation Crowdfunding.

1195 *See* Rule 503(a)(8) of Regulation Crowdfunding.

1196 *See* Rule 503(a)(4) of Regulation Crowdfunding.

1197 *See* Rule 503(a)(6) of Regulation Crowdfunding.

1198 *See* Rule 503(b) of Regulation Crowdfunding.

the existence of a disqualification.[1199] Further, persons that are disqualified from relying on the exemption may request a waiver of disqualification from the Commission.[1200]

The final rules also specify that triggering events that pre-date effectiveness of the final rules will not cause disqualification, but instead must be disclosed on a basis consistent with Rules 262 and 506(e).[1201] Specifically, issuers will be required to disclose in their offering materials matters that would have triggered disqualification had they occurred after the effective date of proposed Regulation Crowdfunding.[1202] In a change from the proposal, Rule 201(u) does not include the word "timely" as is included in Rule 506(e) of Regulation D, because unlike the disclosure associated with Rule 506(e), the disclosure required by Rule 201(u) must be included in an issuer's offering statement and thus is required to be timely to the offering.

We believe this disclosure will put investors on notice of events that would, but for the timing of such events, have disqualified the issuer from relying on Section 4(a)(6). We also believe that this disclosure is particularly important because, as a result of the implementation of Section 302(d), investors may have the impression that all bad actors are disqualified from participating in offerings under Section 4(a)(6). If disclosure of a pre-existing, otherwise disqualifying event is required and not provided to an investor, we would not view this as an insignificant deviation from Regulation Crowdfunding under Rule 502.

Consistent with the proposal and with Rule 506, the final disqualification rules provide that events relating to certain affiliated issuers are not disqualifying if the events pre-date the affiliate relationship. Specifically, Rule 503(c) provides that events relating to any affiliated

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1199 *See* Rule 503(b)(4) of Regulation Crowdfunding.

1200 *See* Rule 503(b)(2) of Regulation Crowdfunding.

1201 *See* Rules 201(u) and 503(b)(1) of Regulation Crowdfunding.

1202 *See* Rule 201(u) of Regulation Crowdfunding.

issuer that occurred before the affiliation arose will be not considered disqualifying if the affiliated entity is not (1) in control of the issuer or (2) under common control with the issuer by a third party that was in control of the affiliated entity at the time of such events.[1203]

We also have modified the final rules to expressly include funding portals in the list of entities that could be subject to felony and misdemeanor convictions, injunctions and court orders that would constitute disqualifying events.[1204] As proposed, funding portals would have been included because they meet the definition of broker; however, for clarity, the final rule expressly includes them.

b. Intermediaries and Certain Other Associated Persons

(1) Proposed Rules

Section 302(d)(1)(B) requires the Commission to establish disqualification provisions under which an intermediary would not be eligible to effect or participate in transactions conducted pursuant to Securities Act Section 4(a)(6). Section 302(d)(2) requires that the disqualification provisions be substantially similar to the provisions of Securities Act Rule 262, which applies to issuers. Exchange Act Section 3(a)(39)[1205] currently defines the circumstances in which a broker would be subject to a "statutory disqualification" with respect to membership or participation in a self-regulatory organization such as FINRA or any other registered national

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[1203] *See* Rule 503(c) of Regulation Crowdfunding.

[1204] *See* Rules 503(a)(1)(iii) and 503(a)(2)(iii) of Regulation Crowdfunding. Because funding portals are brokers within the meaning of Exchange Act Section (3)(a)(4) (albeit exempt from registration as such), we believe that they would be covered by the term "broker" in the final rule. Nevertheless, for clarity, we are adding funding portals to the final rule text to avoid any confusion in this regard.

[1205] 15 U.S.C. 78c(39).

securities association. We believe that the definition of "statutory disqualification" under Section 3(a)(39) is substantially similar to, while somewhat broader than, the provisions of Rule 262.[1206]

As proposed, Rule 503(d) would have prohibited any person subject to a statutory disqualification as defined in Exchange Act Section 3(a)(39) from acting as, or being an associated person of, an intermediary unless permitted to do so by Commission rule or order. The term "subject to a statutory disqualification" has an established meaning under Exchange Act Section 3(a)(39) and defines circumstances that subject a person to a statutory disqualification with respect to membership or participation in, or association with a member of, a self-regulatory organization.[1207] Because funding portals, like broker-dealers, are required to be members of FINRA or any other applicable registered national securities association, we anticipate that funding portals will take appropriate steps to check the background of any person seeking to become associated with them, including whether such person is subject to a statutory disqualification.

In addition, we proposed to clarify that associated persons of intermediaries engaging in transactions in reliance on Section 4(a)(6) must comply with Exchange Act Rule 17f-2,[1208] relating to the fingerprinting of securities industry personnel. Under the proposal, Exchange Act

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[1206] See the Proposing Release at note 812 for a discussion of differences between Exchange Act Section 3(a)(39) and Rule 262. Despite the differences, we believe that Section 3(a)(39) and Rule 262 are substantially similar, in particular with regard to the persons and events they cover, their scope and their purpose.

[1207] Events that could result in a statutory disqualification for an associated person under Section 3(a)(39) include, but are not limited to: certain misdemeanor and all felony criminal convictions; temporary and permanent injunctions issued by a court of competent jurisdiction involving a broad range of unlawful investment activities; expulsions (and current suspensions) from membership or participation in an SRO; bars (and current suspensions) ordered by the Commission or an SRO; denials or revocations of registration by the CFTC; and findings by the Commission, CFTC or an SRO that a person: (1) "willfully" violated the federal securities or commodities laws, or the Municipal Securities Rulemaking Board (MSRB) rules; (2) "willfully" aided, abetted, counseled, commanded, induced or procured such violations; or (3) failed to supervise another who commits violations of such laws or rules. 15 U.S.C. 78c(a)(39).

[1208] 17 CFR 240.17f-2.

Rule 17f-2 would have applied to all brokers, including registered funding portals. The proposed instruction to Rule 503(d) would have clarified that Rule 17f-2 generally requires the fingerprinting of every person who is a partner, director, officer or employee of a broker, subject to certain exceptions.

(2) Final Rules

We are adopting Rule 503(d) as proposed. We received two comments on the proposed rule. One commenter was in favor,[1209] while another commenter was opposed.[1210] The Section 3(a)(39) standard is an established one among financial intermediaries and their regulators. For this reason, we believe the Section 3(a)(39) standard is more appropriate for intermediaries than Rule 262 or the issuer disqualification rules under Regulation Crowdfunding. We are concerned that if we imposed a new or different statutory disqualification standard only for those intermediaries that engage in transactions in reliance on Section 4(a)(6), we may create confusion and unnecessary burdens on market participants. We note that such a divergence in standards would cause brokers that act as intermediaries in reliance on Section 4(a)(6) (and their associated persons) to become subject to two distinct standards for disqualification. Instead, we believe that intermediaries should be subject to the same statutory disqualification standard regardless of whether or not they are engaging in transactions involving the offer or sale of securities in reliance on Section 4(a)(6), and note that applying consistent standards for all brokers and funding portals will also assist FINRA or any other registered national securities association in its oversight of its members. Further, Exchange Act Rule 19h-1 prescribes the form and content of, and establishes the mechanism by which the Commission reviews, proposals submitted by SROs (such as

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[1209] *See* NASAA Letter.

[1210] *See* Public Startup Letter 3.

FINRA) for its members, to allow a member or associated person subject to a statutory disqualification to become or remain a member or be associated with a member ("notice of admission or continuance notwithstanding a statutory disqualification," as described in Rule 19h-1(a)). Among other things, Rule 19h-1 provides for Commission review of notices filed by SROs proposing to admit any person to, or continue any person in, membership or association with a member notwithstanding a statutory disqualification as defined in Section 3(a)(39). Because intermediaries are required to be members of a registered national securities association (which is an SRO), actions taken by the SRO with respect to a proposed admission or continuance with respect to an intermediary or its associated persons will be subject to Rule 19h-1. Thus, the "pursuant to Commission rule" provision in Rule 503(d) will be satisfied if the admission or continuance request was subject to the requirements and process of Exchange Act Rule 19h-1. We also are adopting, as proposed, the instruction to Rule 503(d) clarifying that the Rule 17f-2 fingerprinting requirements are applicable to all associated persons of intermediaries engaging in transactions in reliance on Section 4(a)(6).

7. Secondary Market Trading

In addition to the actions the Commission is taking today to permit the offer and sale of securities in reliance on Section 4(a)(6), the Commission also recently adopted rules that exempt from the registration requirements of the Securities Act certain offerings of up to $50 million of securities annually,[1211] and rules to eliminate the prohibition against general solicitation in certain offerings pursuant to Regulation D under the Securities Act.[1212] The Commission is mindful of

1211 *See* Regulation A Adopting Release, *supra*, note 506.

1212 *See* Rule 506(c) Adopting Release, *supra*, note 5.

the need for market participants to have updated information in connection with the secondary market trading of securities issued pursuant to these rules.[1213]

The anti-fraud provisions of the federal securities laws, and rules adopted thereunder, apply to the secondary market trading of securities, including securities offered and sold in reliance on Section 4(a)(6). For example, Exchange Act Rule 15c2-11 governs broker-dealers' publication of quotations for certain over-the-counter securities in a quotation medium other than a national securities exchange.[1214] The Commission adopted Rule 15c2-11 to prevent fraudulent and manipulative trading schemes that had arisen in connection with the distribution and trading of certain unregistered securities.[1215] The rule prohibits broker-dealers from publishing quotations (or submitting quotations for publication) in a "quotation medium"[1216] for covered over-the-counter securities without first reviewing basic information about the issuer, subject to certain exceptions.[1217] A broker-dealer also must have a reasonable basis for believing that the issuer information is accurate in all material respects and that it was obtained from a reliable source.[1218]

1213 As discussed in Section II.E.2, Rule 501 imposes a one-year restriction on the transfer of securities issued in a transaction exempt from registration pursuant to Section 4(a)(6) of the Securities Act, other than to the issuer, an accredited investors, or to a family member of the purchaser or the equivalent in connection with certain specified events.

1214 17 CFR 240.15c2-11.

1215 *See generally* Initiation or Resumption of Quotations by a Broker or Dealer Who Lacks Certain Information, Exchange Act Release No. 9310 (Sept. 13, 1971), 36 FR 18641 (Sept. 18, 1971). *See also* Publication or Submission of Quotations Without Specified Information, Exchange Act Release No. 39670 (Feb. 17, 1998), 63 FR 9661, 9662 (Feb. 25, 1998).

1216 17 CFR 240.15c2-11(e)(1) (defining quotation medium as "any 'interdealer quotation system' or any publication or electronic communications network or other device which is used by brokers or dealers to make known to others their interest in transactions in any security, including offers to buy or sell at a stated price or otherwise, or invitations of offers to buy or sell").

1217 17 CFR 240.15c2-11(a). See Publication or Submission of Quotations Without Specified Information, Exchange Act Release No. 34-39670 (Feb. 17, 1998), 63 FR 9661 (Feb. 25, 1998).

1218 *Id.*

To be clear, the rules adopted today do not affect the obligations of a broker-dealer under Exchange Rule 15c2-11 to have a reasonable basis under the circumstances for believing that the information required by Rule 15c2-11 is accurate in all material respects, and that the sources of the information are reliable, prior to publishing any quotation, absent an exception,[1219] for a covered security in any quotation medium.[1220] The staff is directed to begin promptly an evaluation of the operation of Rule 15c2-11, both historically and in light of recent market developments, including Regulation Crowdfunding and earlier proposals for amendments to Rule 15c2-11,[1221] to assess how the rule is meeting regulatory objectives and to recommend any appropriate changes. In addition, and not withstanding any changes which may be made to Rule 15c2-11 in the interim, the staff is also directed to review the development of secondary market trading in these securities during the study it plans to undertake within three years following the effective date of Regulation Crowdfunding, and to recommend to the Commission such additional actions with respect to Rule 15c2-11, as may be warranted.[1222]

[1219] *See* 17 CFR 240.15c2-11(f). For example, the rule includes an exception for unsolicited orders. 17 CFR 240.15c2-11(f)(2). We remind broker-dealers that such unsolicited orders must be made by a customer (other than a person acting as or for a dealer) and that broker-dealers should be prepared to demonstrate that a customer initiated the order. 17 CFR 240.15c2-11(b)(1).

[1220] Rule 15c2-11(c) further requires that broker-dealers keep the documents that they reviewed to establish this reasonable basis for believing that the required information is accurate in all material respects for a period of not less than three years. 17 CFR 240.15c2-11(c). The lack of documents used at the time the broker-dealer established the reasonable basis for its belief or presentation of incomplete or non-responsive documents, including later-dated filings, would not be sufficient to demonstrate that the broker-dealer had satisfied its obligations in this regard. See Initiation or Resumption of Quotations Without Specified Information, Exchange Act Release No 27247 (Sept. 14, 1989), 54 FR 39194, 39196 (Sept. 25, 1989) ("Subject to certain exceptions, the Rule prohibits a broker or dealer from submitting a quotation for a security in a quotation medium unless it has in its records specified information concerning the security and the issuer. . .").

[1221] *See* Exchange Act Release No. 41110 (Feb. 25, 1999), 64 FR 11124 (Mar. 8, 1999).

[1222] *See* Section II.

III. ECONOMIC ANALYSIS

Title III sets forth a comprehensive regulatory structure for startups and small businesses to raise capital through securities-based crowdfunding transactions using the Internet. In particular, Title III provides an exemption from registration for certain offerings of securities by adding Securities Act Section 4(a)(6). In addition, Title III:

- adds Securities Act Section 4A, which requires, among other things, that issuers and intermediaries that facilitate transactions between issuers and investors provide certain information to investors, take certain actions and provide notices and other information to the Commission;
- adds Exchange Act Section 3(h), which requires the Commission to adopt rules to exempt, either conditionally or unconditionally, funding portals from having to register as broker-dealers or dealers pursuant to Exchange Act Section 15(a)(1);
- mandates that the Commission adopt disqualification provisions under which an issuer would not be able to avail itself of the exemption for crowdfunding if the issuer or other related parties, including an intermediary, were subject to a disqualifying event; and
- adds Exchange Act Section 12(g)(6), which requires the Commission to adopt rules to exempt from Section 12(g), either conditionally or unconditionally, securities acquired pursuant to an offering made in reliance on Section 4(a)(6).

As discussed in detail above, we are adopting Regulation Crowdfunding to implement the requirements of Title III. The final rules implement the new exemption for the offer and sale of securities pursuant to the requirements of Section 4(a)(6) and provide a framework for the regulation of issuers and intermediaries, which include broker-dealers and funding portals

engaging in such transactions. The final rules also permanently exempt securities offered and sold in reliance on Section 4(a)(6) from the record holder count under Exchange Act Section 12(g).

We are mindful of the costs imposed by, and the benefits to be obtained from, our rules. Securities Act Section 2(a) and Exchange Act Section 3(f) require us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation. Exchange Act Section 23(a)(2) requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition and to not adopt any rule that would impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. The discussion below addresses the economic effects of the final rules, including the likely costs and benefits of Regulation Crowdfunding, as well as the likely effect of the final rules on efficiency, competition and capital formation. Given the specific language of the statute and our understanding of Congress's objectives, we believe that it is appropriate for the final rules generally to follow the statutory provisions. We nonetheless also rely on our discretionary authority to adopt certain additional provisions and make certain other adjustments to the final rules. While the costs and benefits of the final rules in large part stem from the statutory mandate of Title III, certain costs and benefits are affected by the discretion we exercise in connection with implementing this mandate. For purposes of this economic analysis, we address the costs and benefits resulting from the mandatory statutory provisions and our exercise of discretion together because the two types of benefits and costs are not separable.

A. Baseline

The baseline for our economic analysis of Regulation Crowdfunding, including the baseline for our consideration of the effects of the final rules on efficiency, competition and capital formation, is the situation in existence today, in which startups and small businesses seeking to raise capital through securities offerings must register the offer and sale of securities under the Securities Act unless they can rely on an existing exemption from registration under the federal securities laws. Moreover, under existing requirements, intermediaries intending to facilitate such transactions generally are required to register with the Commission as broker-dealers under Exchange Act Section 15(a).

1. Current Methods of Raising up to $1 Million of Capital

The potential economic impact of the final rules, including their effects on efficiency, competition and capital formation, will depend on how the crowdfunding method of raising capital compares to existing methods that startups and small businesses currently use for raising capital. Startups and small businesses can potentially access a variety of external financing sources in the capital markets through registered or unregistered offerings of debt, equity and hybrid securities and bank loans.

Issuers seeking to raise capital must register the offer and sale of securities under the Securities Act or qualify for an exemption from registration. Registered offerings, however, are generally too costly to be viable alternatives for startups and small businesses. Issuers conducting registered offerings incur Commission registration fees, legal and accounting fees and expenses, transfer agent and registrar fees, costs associated with periodic reporting requirements and other regulatory requirements and various other fees. Two surveys concluded that the average initial compliance cost associated with conducting an initial public offering is $2.5 million, followed by

an ongoing compliance cost for issuers, once public, of $1.5 million per year.[1223] Hence, for an issuer seeking to raise less than $1 million, a registered offering may not be economically feasible.[1224] Moreover, issuers conducting registered offerings also usually pay underwriter fees, which are, on average, approximately 7% of the proceeds for initial public offerings, approximately 5% for follow-on equity offerings and approximately 1–1.5% for issuers raising capital through public bond issuances.[1225]

An alternative to raising capital through registered offerings is to offer and sell securities by relying on an existing exemption from registration under the federal securities laws. For example, startups and small businesses could rely on current exemptions from registration under the Securities Act, such as Section 3(a)(11),[1226] Section 4(a)(2),[1227] Regulation D,[1228] and

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1223 *See* IPO Task Force, *Rebuilding the IPO On-Ramp*, at 9 (Oct. 20, 2011) for the two surveys, *available at* http://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf ("IPO Task Force"). These estimates should be interpreted with the caveat that most firms in the IPO Task Force surveys likely raised more than $1 million. The IPO Task Force surveys do not provide a breakdown of costs by offering size. However, compliance related costs of an initial public offering and subsequent compliance related costs of being a reporting company likely have a fixed cost component that would disproportionately affect small offerings.

Title I of the JOBS Act provided certain accommodations to issuers that qualify as emerging growth companies (EGCs). According to a recent working paper, the underwriting, legal and accounting fees of EGC and non-EGC initial public offerings were similar (based on a time period from April 5, 2012 to April 30, 2014). For a median EGC initial public offering, gross spread comprised 7% of proceeds and accounting and legal fees comprised 2.4% of proceeds. *See* Susan Chaplinsky, Kathleen W. Hanley, and S. Katie Moon, *The JOBS Act and the Costs of Going Public*, Working Paper (2014), *available at* http://ssrn.com/abstract_id=2492241.

1224 *Id.*

1225 *See, e.g.*, Hsuan-Chi Chen and Jay R. Ritter, *The Seven Percent Solution*, 55 J. FIN. 1105–1131 (2000); Mark Abrahamson, Tim Jenkinson, and Howard Jones, *Why Don't U.S. Issuers Demand European Fees for IPOs?* 66 J. FIN. 2055–2082 (2011); Shane A. Corwin, *The Determinants of Underpricing for Seasoned Equity Offers*, 58 J. FIN. 2249–2279 (2003); Lily Hua Fang, *Investment Bank Reputation and the Price and Quality of Underwriting Services*, 60 J. FIN. 2729–2761 (2005); Rongbing Huang and Donghang Zhang, *Managing Underwriters and the Marketing of Seasoned Equity Offerings*, 46 J. FIN. QUANT. ANALYSIS 141–170 (2011); Stephen J. Brown, Bruce D. Grundy, Craig M. Lewis and Patrick Verwijmeren, *Convertibles and Hedge Funds as Distributors of Equity Exposure*, 25 REV. FIN. STUD. 3077–3112 (2012).

1226 Securities Act Section 3(a)(11), generally known as the "intrastate offering exemption," provides an exemption from registration for issuers doing business within a particular state or territory. To qualify for this exemption, the offering must be "part of an issue offered and sold only to persons resident within a

Regulation A.[1229] While we do not have complete data on offerings relying on an exemption under Section 3(a)(11) or Section 4(a)(2), certain data available from Regulation D and Regulation A filings allow us to gauge how frequently issuers seeking to raise up to $1 million use these exemptions.

Based on Regulation D filings by issuers that are not pooled investment vehicles from 2009 to 2014,[1230] a substantial number of issuers chose to raise capital by relying on Rule 506, even though their offering size would qualify for an exemption under Rule 504 or Rule 505.[1231] The 2013 amendment to Rule 506 of Regulation D permits an issuer to engage in general solicitation and general advertising in offering and selling securities pursuant to Rule 506(c), subject to certain conditions,[1232] which can enable issuers to reach a potentially broader base of accredited investors. As shown in the table below, although issuers can raise unlimited amounts of capital relying on the Rule 506(c) exemption, most of the issuers made offers for amounts of up to $1 million.

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single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory."

[1227] Securities Act Section 4(a)(2) provides that the registration provisions of the Securities Act shall not apply to "transactions by an issuer not involving a public offering."

[1228] Regulation D provides exemptions and a nonexclusive safe harbor from registration for certain types of securities offerings.

[1229] Regulation A provides a conditional exemption from registration for certain small issuances.

[1230] *See* Scott Bauguess, Rachita Gullapalli, and Vladimir Ivanov, *Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009–2014* (October 2015) ("*Unregistered Offerings White Paper*"), *available at*: http://www.sec.gov/dera/staff-papers/white-papers/unregistered-offering10-2015.pdf.

[1231] This tendency could, in part, be attributed to two features of Rule 506: preemption from state registration ("blue sky") requirements and an unlimited offering amount. *See also* U.S. Government Accountability Office, *Factors That May Affect Trends in Regulation A Offerings*, GAO-12-839 (Jul. 3, 2012), *available at* http://www.gao.gov/products/GAO-12-839 ("GAO Report").

[1232] In particular, all purchasers of securities sold in any offering under the exemption must be accredited investors, and the issuer must take reasonable steps to verify that purchasers of securities sold in any offering are accredited investors (17 CFR 230.506). *See* Rule 506(c) Adopting Release, *supra*, note 5.

Regulation D exemption	Offering size			
	≤$1 Million	$1-5 million	$5-50 million	>$50 million
Rule 504	3,643	--	--	--
Rule 505	501	774	--	--
Rule 506(b)	27,106	25,746	18,670	2,733
Rule 506(c)	588	531	419	89
Total	31,838	27,051	19,089	2,822
Regulation A	5	33	--	--

Note: Data based on Form D, excluding issuers that are pooled investment vehicles, and Form 1-A filings from 2009 to 2014. We consider only new offerings and exclude offerings with amounts sold reported as $0 on Form D. Data on Rule 506(c) offerings covers the period from September 23, 2013 (the day the rule became effective) to December 31, 2014. We also use the maximum amount indicated in Form 1-A to determine offering size for Regulation A offerings.[1233]

Based on the table above, from 2009 to 2014, almost no issuers in offerings of up to $1 million relied on Regulation A. This data does not reflect the recent changes to Regulation A adopted by the Commission on March 25, 2015. Those changes allow issuers to raise up to $50 million over a 12-month period and exempt certain Regulation A offerings (Tier 2 offerings) from state registration requirements. Because these changes are so recent, more time is needed to observe how the amendments to Regulation A will affect capital raising by small issuers.[1234]

Each of these exemptions, however, includes restrictions that may limit its suitability for startups and small businesses. The table below lists the main requirements of these exemptions. For example, the exemption under Securities Act Section 3(a)(11) is limited to intrastate offerings.[1235] Issuers conducting a Regulation A offering may be required to register their

1233 We only consider Regulation A offerings that have been qualified by the Commission. For purposes of counting filings, we exclude amendments or multiple Form 1-A filings by the same issuer in a given year. For purposes of determining the offering size for Regulation A offerings, we use the maximum amount indicated on the latest pre-qualification Form 1-A or amended Form 1-A. We reclassify two offerings that are dividend reinvestment plans with unclear offering amounts as having the maximum permitted offering amount.

1234 *See Regulation A Adopting Release.*

1235 *See* note 1226.

Regulation A.[1229] While we do not have complete data on offerings relying on an exemption under Section 3(a)(11) or Section 4(a)(2), certain data available from Regulation D and Regulation A filings allow us to gauge how frequently issuers seeking to raise up to $1 million use these exemptions.

Based on Regulation D filings by issuers that are not pooled investment vehicles from 2009 to 2014,[1230] a substantial number of issuers chose to raise capital by relying on Rule 506, even though their offering size would qualify for an exemption under Rule 504 or Rule 505.[1231] The 2013 amendment to Rule 506 of Regulation D permits an issuer to engage in general solicitation and general advertising in offering and selling securities pursuant to Rule 506(c), subject to certain conditions,[1232] which can enable issuers to reach a potentially broader base of accredited investors. As shown in the table below, although issuers can raise unlimited amounts of capital relying on the Rule 506(c) exemption, most of the issuers made offers for amounts of up to $1 million.

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single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory."

1227 Securities Act Section 4(a)(2) provides that the registration provisions of the Securities Act shall not apply to "transactions by an issuer not involving a public offering."

1228 Regulation D provides exemptions and a nonexclusive safe harbor from registration for certain types of securities offerings.

1229 Regulation A provides a conditional exemption from registration for certain small issuances.

1230 *See* Scott Bauguess, Rachita Gullapalli, and Vladimir Ivanov, *Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009–2014* (October 2015) ("*Unregistered Offerings White Paper*"), *available at:* http://www.sec.gov/dera/staff-papers/white-papers/unregistered-offering10-2015.pdf.

1231 This tendency could, in part, be attributed to two features of Rule 506: preemption from state registration ("blue sky") requirements and an unlimited offering amount. *See also* U.S. Government Accountability Office, *Factors That May Affect Trends in Regulation A Offerings*, GAO-12-839 (Jul. 3, 2012), *available at* http://www.gao.gov/products/GAO-12-839 ("GAO Report").

1232 In particular, all purchasers of securities sold in any offering under the exemption must be accredited investors, and the issuer must take reasonable steps to verify that purchasers of securities sold in any offering are accredited investors (17 CFR 230.506). *See* Rule 506(c) Adopting Release, *supra*, note 5.

Regulation D exemption	Offering size			
	≤$1 Million	$1-5 million	$5-50 million	>$50 million
Rule 504	3,643	--	--	--
Rule 505	501	774	--	--
Rule 506(b)	27,106	25,746	18,670	2,733
Rule 506(c)	588	531	419	89
Total	31,838	27,051	19,089	2,822
Regulation A	5	33	--	--

Note: Data based on Form D, excluding issuers that are pooled investment vehicles, and Form 1-A filings from 2009 to 2014. We consider only new offerings and exclude offerings with amounts sold reported as $0 on Form D. Data on Rule 506(c) offerings covers the period from September 23, 2013 (the day the rule became effective) to December 31, 2014. We also use the maximum amount indicated in Form 1-A to determine offering size for Regulation A offerings.[1233]

Based on the table above, from 2009 to 2014, almost no issuers in offerings of up to $1 million relied on Regulation A. This data does not reflect the recent changes to Regulation A adopted by the Commission on March 25, 2015. Those changes allow issuers to raise up to $50 million over a 12-month period and exempt certain Regulation A offerings (Tier 2 offerings) from state registration requirements. Because these changes are so recent, more time is needed to observe how the amendments to Regulation A will affect capital raising by small issuers.[1234]

Each of these exemptions, however, includes restrictions that may limit its suitability for startups and small businesses. The table below lists the main requirements of these exemptions. For example, the exemption under Securities Act Section 3(a)(11) is limited to intrastate offerings.[1235] Issuers conducting a Regulation A offering may be required to register their

[1233] We only consider Regulation A offerings that have been qualified by the Commission. For purposes of counting filings, we exclude amendments or multiple Form 1-A filings by the same issuer in a given year. For purposes of determining the offering size for Regulation A offerings, we use the maximum amount indicated on the latest pre-qualification Form 1-A or amended Form 1-A. We reclassify two offerings that are dividend reinvestment plans with unclear offering amounts as having the maximum permitted offering amount.

[1234] *See Regulation A Adopting Release.*

[1235] *See* note 1226.

offerings with states or meet additional regulatory requirements, such as investment limitations (if the investor is not an accredited investor), audited financial statements and ongoing reporting. In addition, issuers in all Regulation A offerings are required to file with the Commission an offering document on Form 1-A. Such compliance related costs may be a more significant constraint on issuers in offerings of up to $1 million.[1236] Issuers of securities pursuant to Securities Act Section 4(a)(2) and Rules 504, 505 and 506(b) under Regulation D generally may not engage in general solicitation and general advertising to reach investors, which also can place a significant limitation on offerings by startups and small businesses. While Rule 506 under Regulation D preempts the applicability of state registration requirements and new Rule 506(c) permits general solicitation and general advertising, an issuer seeking to rely on Rule 506(c) is limited to selling securities only to accredited investors.[1237]

The table below summarizes the main features of each exemption.

1236 *See* Rutheford B. Campbell, Jr., *Regulation A: Small Businesses' Search for "A Moderate Capital"*, 31 DEL. J. CORP. L. 77, 106 (2006). *See also GAO Report*, note 1231.

1237 *See Rule 506(c) Adopting Release*, note 5.

Type of Offering	Offering Limit[1238]	Solicitation	Issuer and Investor Requirements	Filing Requirement	Resale Restrictions	Blue Sky Law Preemption
Section 3(a)(11)	None	All offerees must be resident in state	All issuers and investors must be resident in state	None	No[1239]	No
Section 4(a)(2)	None	No general solicitation	Transactions by an issuer not involving any public offering[1240]	None	Restricted securities	No
Regulation A	Tier 1: $20 million with $6 million limit on secondary sales by affiliates of the issuer; Tier 2: $50 million with $15 million limit on secondary sales by affiliates of the issuer	Testing the waters permitted both before and after filing the offering statement	U.S. or Canadian issuers, excluding investment companies, blank-check companies, reporting companies, and issuers of fractional undivided interests in oil or gas rights, or similar interests in other mineral rights[1241]	File testing the waters materials and Form 1-A for Tiers 1 and 2; file annual, semi-annual, and current reports for Tier 2; file exit report for Tier 1 and to suspend or terminate reporting for Tier 2	No	Tier 1: No Tier 2: Yes

1238 Aggregate offering limit on securities sold within a twelve-month period.

1239 Although Section 3(a)(11) does not have explicit resale restrictions, the Commission has explained that "to give effect to the fundamental purpose of the exemption, it is necessary that the entire issue of securities shall be offered and sold to, and come to rest only in the hands of residents within the state." *See* SEC Rel. No. 33-4434 (Dec. 6, 1961) [26 FR 11896 (Dec. 13, 1961)]. State securities laws, however, may have specific resale restrictions. Securities Act Rule 147, a safe harbor under Section 3(a)(11), limits resales to persons residing in-state for a period of nine months after the last sale by the issuer. [17 CFR 230.147].

1240 Section 4(a)(2) of the Securities Act provides a statutory exemption for "transactions by an issuer not involving any public offering." *See SEC v. Ralston Purina Co.* 346 U.S. 119 (1953) (holding that an offering to those who are shown to be able to fend for themselves is a transaction "not involving any public offering.")

1241 The Regulation A exemption also is not available to companies that have been subject to any order of the Commission under Exchange Act Section 12(j) entered within the past five years; have not filed ongoing reports required by the regulation during the preceding two years, or are disqualified under the regulation's "bad actor" disqualification rules.

Type of Offering	Offering Limit[1238]	Solicitation	Issuer and Investor Requirements	Filing Requirement	Resale Restrictions	Blue Sky Law Preemption
Rule 504 Regulation D	$1 million	General solicitation permitted in some cases[1242]	Excludes investment companies, blank-check companies, and Exchange Act reporting companies	File Form D[1243]	Restricted in some cases[1244]	No
Rule 505 Regulation D	$5 million	No general solicitation	Unlimited accredited investors and up to 35 non-accredited investors	File Form D[1245]	Restricted securities	No
Rule 506(b) Regulation D	None	No general solicitation	Unlimited accredited investors and up to 35 non-accredited investors	File Form D[1246]	Restricted securities	Yes
Rule 506(c) Regulation D	None	General solicitation is permitted subject to certain conditions [1247]	Unlimited accredited investors; no non-accredited investors	File Form D[1248]	Restricted securities	Yes

2. Current Sources of Funding for Startups and Small Businesses that Could Be Substitutes or Complements to Crowdfunding

At present, startups and small businesses can raise capital from several sources that could be close substitutes for or complements to crowdfunding transactions that rely on Section 4(a)(6). This capital raising generally is conducted through unregistered securities offerings, involves lending by financial institutions or derives from family and friends.

1242 No general solicitation or advertising is permitted unless the offering is registered in a state requiring the use of a substantive disclosure document or sold under a state exemption for sales to accredited investors with general solicitation.

1243 Filing is not a condition of the exemption, but it is required under Rule 503.

1244 Restricted unless the offering is registered in a state requiring the use of a substantive disclosure document or sold under a state exemption for sale to accredited investors.

1245 Filing is not a condition of the exemption, but it is required under Rule 503.

1246 Filing is not a condition of the exemption, but it is required under Rule 503.

1247 General solicitation and general advertising are permitted under Rule 506(c), provided that all purchasers are accredited investors and the issuer takes reasonable steps to verify accredited investor status.

1248 Filing is not a condition of the exemption, but it is required under Rule 503.

a. Family and Friends

Family and friends are sources through which startups and small businesses can raise capital. This source of capital is usually available early in the lifecycle of a small business, before the business engages in arm's-length and more formal funding channels.[1249] Among other things, family and friends may donate funds, loan funds or acquire an equity stake in the business. A recent study of the financing choices of startups finds that most of the capital supplied by friends and family is in the form of loans.[1250] In contrast to a commercial lender that, for example, would need to assess factors such as the willingness and ability of a borrower to repay the loan and the viability of its business, family and friends may be willing to provide capital based primarily or solely on personal relationships. Family and friends, however, may be able to provide only a limited amount of capital compared to other sources. In addition, financial arrangements with family and friends may not be an optimal source of funding if any of the parties is not knowledgeable about the structuring of loan agreements, equity investments or related areas of accounting. We do not have data available on these financing sources that allow us to quantify their magnitude and compare them to other current sources of capital.

[1249] *See* Paul Gompers and Josh Lerner, THE VENTURE CAPITAL CYCLE (MIT Press 2006) ("Gompers"); Alicia M. Robb and David T. Robinson, *The Capital Structure Decisions of New Firms*, 27 REV. FIN. STUD. 153-179 (2014) ("Robb").

[1250] *See* Robb, note 1249.

b. Commercial Loans, Peer-to-Peer Loans and Microfinance

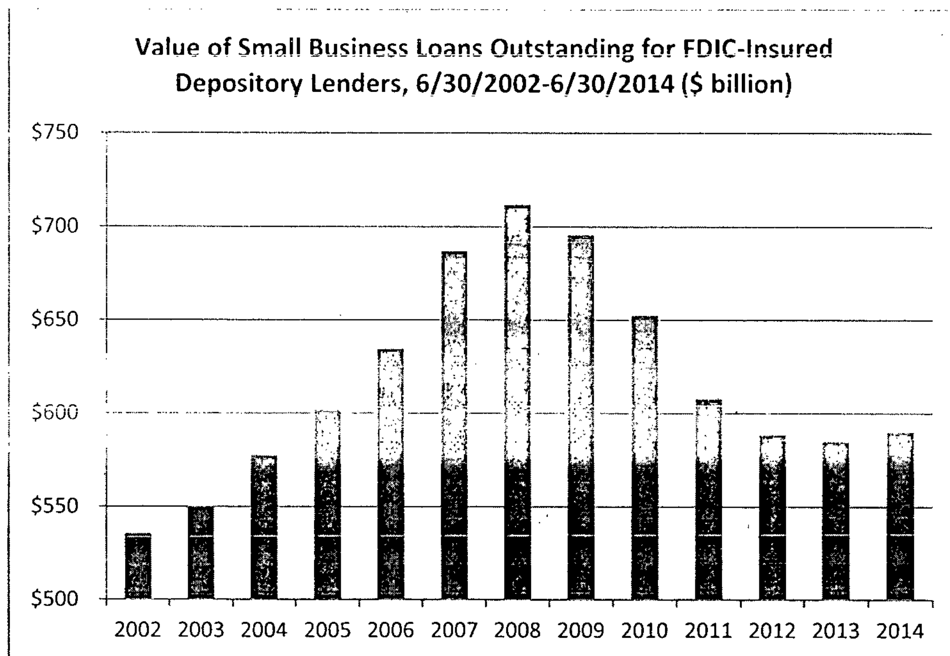
Startups and small businesses also may seek loans from financial institutions.[1251] A 2014 study of the financing choices of startups suggests that they resort to bank financing early in their lifecycle.[1252] The study finds that businesses rely heavily in the first year after being formed on external debt sources such as bank financing, mostly in the form of personal and commercial bank loans, business credit cards and credit lines. Another recent report, however, suggests that bank lending to small businesses fell by $100 billion from 2008 to 2011 and that, by 2012, less than one-third of small businesses reported having a business bank loan.[1253] Trends in small business lending by FDIC-insured depository institutions are illustrated in the figure below. As of June 2014, business loans of up to $1 million amounted to approximately $590 billion, approximately 17% lower than the 2008 level.[1254]

[1251] Using data from the 1993 Survey of Small Business Finance, one study indicates that financial institutions account for approximately 27% of small firms' borrowings. *See* Allen N. Berger and Gregory F. Udell, *The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets in the Financial Growth Cycle*, 22 J. BANKING & FIN. 613 (1998). *See also* 1987, 1993, 1998 and 2003 Surveys of Small Business Finances, *available at* http://www.federalreserve.gov/pubs/oss/oss3/nssbftoc.htm. The Survey of Small Business Finances was discontinued after 2003. Using data from the Kauffman Foundation Firm Surveys, one study finds that 44% of startups use loans from financial institutions. *See* Rebel A. Cole and Tatyana Sokolyk, *How Do Start-Up Firms Finance Their Assets? Evidence from the Kauffman Firm Surveys* (2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2028176.

[1252] *See* Robb, note 1249.

[1253] *See* The Kauffman Foundation, *2013 State of Entrepreneurship Address* (Feb. 5, 2013), *available at* http://www.kauffman.org/uploadedFiles/DownLoadableResources/SOE%20Report_2013pdf. The report cautions against prematurely concluding that banks are not lending enough to small businesses as the sample period of the study includes the most recent recession.

[1254] We define small business loans to include commercial and industrial loans to U.S. addressees of up to $1 million and loans secured by nonfarm nonresidential properties. *See* Federal Deposit Insurance Corporation, *Statistics on Depository Institutions Report*, *available at* http://www2.fdic.gov/SDI/SOB/ ("FDIC Statistics").



Additionally, although covering the pre-recessionary period, a Federal Reserve Board staff study analyzing data from the 2003 Survey of Small Business Finance suggests that 60 percent of small businesses have outstanding credit in the form of a credit line, a loan or a capital lease.[1255] These loans were borrowed from two types of financial institutions – depositary and non-depositary institutions (*e.g.*, finance companies, factors or leasing companies).[1256] Lines of credit were the most widely used type of credit.[1257] Other types included mortgage loans, equipment loans and motor vehicle loans.[1258]

Various loan guarantee programs of the Small Business Administration ("SBA") make credit more accessible to small businesses by either lowering the interest rate of the loan or

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1255 *See* Federal Reserve Board, *Financial Services Used by Small Businesses: Evidence from the 2003 Survey of Small Business Finances* (October 2006), *available at* http://www.federalreserve.gov/pubs/bulletin/2006/smallbusiness/smallbusiness.pdf ("2003 Survey").

1256 *See* Rebel Cole, *What Do We Know About the Capital Structure of Privately Held Firms? Evidence from the Surveys of Small Business Finance*, 42 FIN. MANAGEMENT 777–813 (2013).

1257 *See* 2003 Survey, note 1255 (estimating that 34% of small businesses use lines of credit).

1258 *Id.*

enabling a market-based loan that a lender would not be willing to provide absent a guarantee.[1259] Although the SBA does not itself act as a lender, the agency guarantees a portion of loans made and administered by lending institutions. SBA loan guarantee programs include 7(a) loans[1260] and CDC/504 loans.[1261] For example, in SBA fiscal year 2014, the SBA supported approximately $28.7 billion in 7(a) and CDC/504 loans distributed to approximately 51,500 small businesses.[1262] SBA-guaranteed loans, however, currently account for a relatively small share (18 percent) of the balances of small business loans outstanding.[1263] The SBA also offers the Microloan program, which provides funds to specially designated intermediary lenders that administer the program for eligible borrowers.[1264]

[1259] Numerous states also offer a variety of small business financing programs, such as Capital Access Programs, collateral support programs and loan guarantee programs. These programs are eligible for support under the State Small Business Credit Initiative, *available at* http://www.treasury.gov/resource-center/sb-programs/Pages/ssbci.aspx.

[1260] 15 U.S.C. 631 *et seq.* The 7(a) loans provide small businesses with financing guarantees for a variety of general business purposes through participating lending institutions.

[1261] 15 U.S.C. 695 *et seq.* The CDC/504 loans are made available through "certified development companies" or "CDCs," typically structured with the SBA providing 40% of the total project costs, a participating lender covering up to 50% of the total project costs and the borrower contributing 10% of the total project costs.

[1262] *See* U.S. Small Business Administration, *FY 2016 Congressional Budget Justification and FY 2014 Annual Performance Report*, available at https://www.sba.gov/content/fiscal-year-2016-congressional-budget-justificationannual-performance-report ("2014 Annual Performance Report").

[1263] As of the end of SBA fiscal year 2014, the SBA-guaranteed business loans outstanding (including 7(a) and 504 loans) equaled $107.5 billion. *See Small Business Administration Unpaid Loan Balances by Program, available at* https://www.sba.gov/sites/default/files/files/WDS_Table1_UPB_Report.pdf. This comprises approximately 18% of the approximately $590 billion in outstanding small business loans for commercial real estate and commercial and industrial loans discussed above. In 2014 the SBA expanded eligibility for loans under its business loan programs. *See* SBA *504 and 7(a) Loan Programs Updates* (Mar. 21, 2014) [79 FR 15641 (Apr. 21, 2014)]. In addition to loan guarantees, the SBA program portfolio also includes direct business loans, which are mainly microloans (outstanding direct business loans equaled $137.1 billion), and disaster loans.

[1264] 15 U.S.C. 631 *et seq.* The Microloan program provides small, short-term loans to small businesses and certain types of not-for-profit childcare centers. The maximum loan amount is $50,000, but the average microloan is about $13,000. Intermediaries are nonprofit community-based organizations with experience in lending, as well as management and technical assistance. Intermediaries set their own lending requirements and generally require some type of collateral as well as the personal guarantee of the business owner. *See Microloan Program,* U.S. Small Business Administration, *available at* http://www.sba.gov/content/microloan-program.

Many startups and small businesses may find loan requirements imposed by financial institutions difficult to meet and may not be able to rely on these institutions to secure funding. For example, financial institutions generally require a borrower to provide collateral and/or a guarantee,[1265] which startups, small businesses and their owners may not be able to provide. Collateral and/or a guarantee may similarly be required for loans guaranteed by the SBA.

Another source of debt financing for startups and small businesses is peer-to-peer lending, which began developing in 2005.[1266] Such debt transactions are facilitated by online platforms that connect borrowers and lenders and potentially offer small businesses additional flexibility on pricing, repayment schedules, collateral or guarantee requirements, and other terms. Some market participants offer a secondary market for loans originated on their own sites.[1267] At least one of the platforms sells third-party issued securities to multiple individual investors, thus improving the liquidity of these securities.[1268] Like in any traditional lending arrangement, however, borrowers are required to make regular payments to their lenders. This requirement could make it a less attractive option for small businesses with negative cash flows and short operating histories, both of which may make it more difficult for such businesses to demonstrate their ability to repay loans. According to some estimates, the global volume of "lending-based" crowdfunding, which

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As of the end of SBA fiscal year 2014, the SBA Microloans outstanding equaled $136.7 billion. *See Small Business Administration Unpaid Loan Balances by Program, available at* https://www.sba.gov/sites/default/files/files/WDS_Table1_UPB_Report.pdf.

1265 Approximately 92% of all small business debt to financial institutions is secured, and about 52% of that debt is guaranteed, primarily by the owners of the firm. *See* Berger, note 1251.

1266 *See* Ian Galloway, *Peer-to-Peer Lending and Community Development Finance*, Federal Reserve Bank of San Francisco, Working Paper (2009), *available at* http://www.frbsf.org/publications/community/wpapers/2009/wp2009-06.pdf.

1267 *Id.*

1268 *Id.* We note that under current law, this activity would require broker-dealer registration.

includes peer-to-peer lending to consumers and businesses, had risen to approximately $11.08 billion in 2014.[1269]

Technology has facilitated the growth of alternative models of small business lending. According to one study,[1270] the outstanding portfolio balance of online lenders has doubled every year, although this market represents less than $10 billion in outstanding loan capital as of the fourth quarter of 2013. Several models of online small business lending have emerged: online lenders raising capital from institutional investors and lending on their own account (for example, short-term loan products similar to a merchant cash advance); peer-to-peer platforms; and "lender-agnostic" online marketplaces that facilitate small business borrower access to various loan products (such as term loans, lines of credit, merchant cash advances and factoring products) from traditional and alternative lenders.[1271] According to the 2014 Small Business Credit survey,[1272] 18% of all small businesses surveyed applied for credit with an online lender. The survey also showed differences in the use of online lenders by type of borrower: 22% of small businesses categorized in the survey as "startups" (*i.e.,* businesses that have been in business for less than

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1269 *See* Massolution, *2015CF Crowdfunding Industry Report: Market Trends, Composition and Crowdfunding Platforms*, *available at* http://reports.crowdsourcing.org/index.php?route=product/product&product_id=54 ("Massolution 2015") at 56. The Massolution 2015 report refers to peer-to-peer lending to consumers and peer-to-business lending to small businesses as "lending-based" crowdfunding. The discussion in this economic analysis refers to peer-to-peer business lending more broadly in a sense synonymous with "lending-based" crowdfunding.

1270 *See* Karen Gordon Mills and Brayden McCarthy, *The State of Small Business Lending: Credit Access during the Recovery and How Technology May Change the Game*, Harvard Business School Working Paper 15-004 (2014), *available at* http://ssrn.com/abstract=2470523.

1271 *Id.*

1272 The survey was conducted by the Federal Reserve Banks of New York, Atlanta, Cleveland, and Philadelphia between September and November of 2014. It focused on credit access among businesses with fewer than 500 employees in Alabama, Connecticut, Florida, Georgia, Louisiana, New Jersey, New York, Ohio, Pennsylvania, and Tennessee. The survey authors note that since the sample is not a random sample, results were reweighted for industry, age, size, and geography to reduce coverage bias. *See* Federal Reserve Banks of New York, Atlanta, Cleveland and Philadelphia, *Joint Small Business Credit Survey Report* (2014), *available at* http://www.newyorkfed.org/smallbusiness/SBCS-2014-Report.pdf.

five years) applied for credit with online lenders. By comparison, 8% of small businesses categorized in the survey as "growers" (*i.e.,* businesses that were profitable and experienced an increase in revenue) applied with online lenders, and 3% of small businesses categorized in the survey as "mature firms" (*i.e.,* businesses that have been in business for more than five years, had over ten employees, and had prior debt) applied with an online lender. The latter two categories of small businesses were more likely to apply for credit with bank lenders than with online lenders.

Microfinance is another source of debt financing for startups and small businesses. Microfinance consists of small, working capital loans provided by microfinance institutions ("MFIs") that are invested in microenterprises or income-generating activities.[1273] The typical users of microfinance services and, in particular, of microcredit are family-owned enterprises or self-employed, low-income entrepreneurs, such as street vendors, farmers, service providers, artisans and small producers, who live close to the poverty line in both urban and rural areas.[1274]

The microfinance market has evolved and grown considerably in the past decades. While data on the size of the overall industry is sparse, according to one report, in fiscal year 2012, the U.S. microfinance industry was estimated to have disbursed $292.1 million across 36,936 microloans and was estimated to have $427.6 million in outstanding microloans (across 45,744 in microloans).[1275] As of 2013, this report identified 799 microenterprise programs that provide

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1273 *See* Craig Churchill and Cheryl Frankiewicz, *Making Microfinance Work: Managing for Improved Performance*, Geneva International Labor Organization (2006).

1274 *See* Joanna Ledgerwood, *Microfinance Handbook: An Institutional and Financial Perspective*, Washington DC, World Bank Publications (1999).

1275 *See* FIELD at the Aspen Institute, *U.S. Microenterprise Census Highlights*, FY 2012, *available at* http://fieldus.org/Publications/CensusHighlightsFY2012.pdf.

loans, training, technical assistance and other microenterprise services directly to micro-entrepreneurs.[1276]

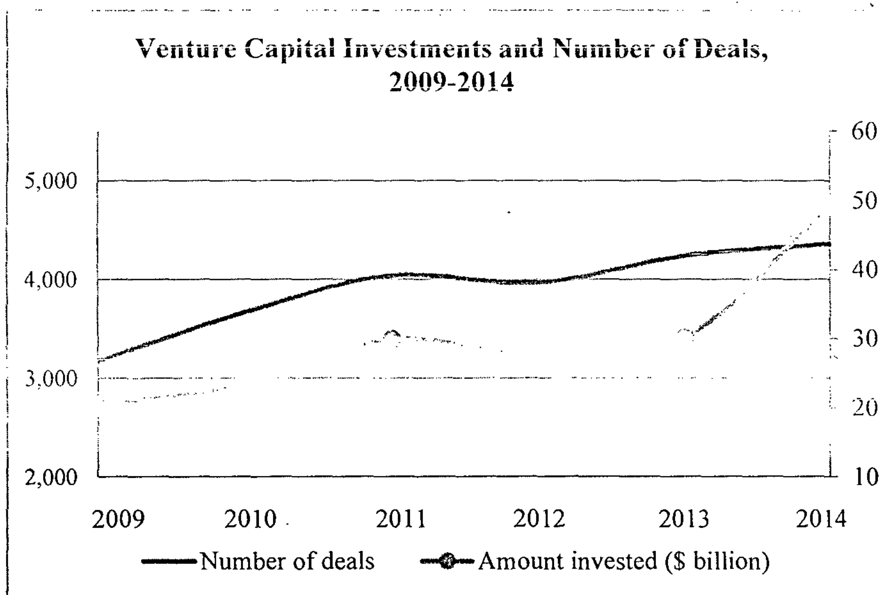
c. Venture Capitalists and Angel Investors

Startups and small businesses also may seek funding from venture capitalists ("VCs") and angel investors. Entrepreneurs seek VC and angel financing usually after they have exhausted sources of capital that generally do not require the entrepreneurs to relinquish control rights (*e.g.*, personal funds from family and friends).

According to data from the National Venture Capital Association, in calendar year 2014, VCs invested approximately $49.3 billion in 4,361 transactions involving 3,665 companies, which included seed, early-stage, expansion, and late-stage companies. Seed and early-stage deals represented 1.5% and 32.2%, respectively, of the dollar volume of deals and 4.4% and 49.7%, respectively of the overall number of VC deals.[1277]

[1276] *Id. See also* note 1264 (describing the SBA Microloan program).

[1277] *See* National Venture Capital Association, *2015 National Venture Capital Association Yearbook, available at* http://nvca.org/?ddownload=1868 ("NVCA").



Some startups, however, may struggle to attract funding from VCs because VCs tend to invest in startups with certain characteristics. A defining feature of VCs is that they tend to focus on startup companies with high-growth potential and a high likelihood of going public after a few years of financing. VCs also tend to invest in companies that have already used some other sources of financing, tend to be concentrated in certain geographic regions (*e.g.*, California and Massachusetts) and often require their investments to have an attractive business plan, meet certain growth benchmarks or fill a specific portfolio or industry niche.[1278] In addition, when investing in companies, VCs tend to acquire significant control rights (*e.g.*, board seats, rights of first refusal, *etc.*), which they gradually relinquish as the company approaches an initial public offering.[1279] In 2014, according to an industry source, information technology and medical/health/life sciences deals attracted the largest dollar volume of VC financing.[1280]

1278 *See* Gompers, note 1249.

1279 *See* Steven N. Kaplan and Per Stromberg, *Financial Contracting Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 REV. ECON. STUD. 281–316 (2003).

1280 *See* NVCA, note 1277.

According to a 2012 academic study, VCs appear to focus on scale or potential for scale rather than short-term profitability in their selection of targets, and firms that receive VC financing tend to be significantly larger than non-VC firms, based on employment and sales.[1281]

According to a recent report, angel investments amounted to $24.1 billion in 2014, with approximately 73,400 entrepreneurial ventures receiving angel funding and approximately 316,600 active angel investors.[1282] In 2014, angel investments were concentrated in software, healthcare, and IT services. The average angel deal size was approximately $328,500. Seed/startup stage deals accounted for 25% and early stage deals accounted for 46%.[1283] As suggested by an academic study, angel investors tend to invest in younger companies than VCs.[1284]

3. Current Crowdfunding Practices

A recent crowdfunding industry report[1285] defines the current crowdfunding activity in the United States generally as "lending-based,"[1286] "reward-based," "donation-based," "royalty-based," "equity-based,"[1287] and "hybrid." We note that the definitions of crowdfunding types used

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[1281] *See* Manju Puri and Rebecca Zarutskie, *On the Life Cycle Dynamics of Venture-Capital- and Non-Venture-Capital-Financed Firms*, 67 J. FIN., 2247–2293 (2012) ("Puri").

[1282] *See* Jeffrey Sohl, *The Investor Angel Market in 2014: A Market Correction in Deal Size, Center for Venture Research*, May 14, 2015, *available at* https://paulcollege.unh.edu/sites/paulcollege.unh.edu/files/webform/2014%20Analysis%20Report.pdf ("Sohl").

[1283] *Id.*

[1284] *See* Gompers, note 1249.

[1285] *See* Massolution 2015.

[1286] *Id.* In this industry report, "lending-based" crowdfunding includes peer-to-peer lending to consumers and peer-to-business lending.

[1287] The report does not identify which jurisdictions were represented in the survey. For example, France, Italy, Japan, and the UK have adopted specialized equity crowdfunding regimes. It should be noted that "equity-based" crowdfunding is not a one-size-fits-all model. The crowdfunding regimes in these four countries differ on a number of dimensions (*e.g.*, securities allowed to be sold by issuers, or types of issuers allowed to use the exemption), amongst themselves and when compared to Regulation Crowdfunding. Some number

in this industry report and the characteristics of crowdfunding activity currently in existence are not directly comparable to the contours of security-based crowdfunding transactions contemplated by the rules being adopted today. Thus, considerable caution must be exercised when generating projections of future crowdfunding volume from current activity broadly attributed to the "crowdfunding" industry. In particular, the industry report defines reward-based crowdfunding as a model where funders receive a "reward," such as a perk or a pre-order of a product, and it defines donation-based crowdfunding as a model where funders make philanthropic donations to causes that they want to support, with no return on their investment expected.[1288] According to the industry report, royalty-based crowdfunding, which involves a percentage of revenue from a license or a usage-based fee for the other parties' right to the ongoing use of an asset, continues to grow.[1289]

The industry report indicates that, in 2014, crowdfunding platforms raised approximately $16.2 billion globally, which represented a 167% increase over the amount raised in 2013.[1290] These amounts include various types of crowdfunding: lending-based crowdfunding accounted for the largest share of volume (approximately $11.08 billion) followed by equity-based crowdfunding (approximately $1.11 billion), reward-based crowdfunding (approximately $1.33 billion), donation-based crowdfunding (approximately $1.94 billion), royalty-based crowdfunding

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also allow equity crowdfunding through their general securities laws. *See Eleanor Kirby and Shane Worner, Crowd-funding: An Infant Industry Growing Fast*, Staff Working Paper of the IOSCO Research Department, *available* at http://www.iosco.org/research/pdf/swp/Crowd-funding-An-Infant-Industry-Growing-Fast.pdf.

1288 *See* Massolution 2015 at 42. Many of the current domestic crowdfunding offerings relate to individual projects and may not have a defined or sustained business model commensurate with typical issuers of securities.

1289 *Id.* at 43. The Massolution 2015 report did not provide separate statistics on royalty-based and hybrid crowdfunding models prior to the 2013 report.

1290 *Id.* at 13.

(approximately $273 million), and hybrid crowdfunding (approximately $487 million).[1291] In 2014, North American crowdfunding volume was approximately $9.46 billion, which represented a 145% increase over the amount raised in 2013[1292] (including approximately $1.23 billion in reward-based crowdfunding, approximately $959 million in donation-based crowdfunding, and approximately $787.5 million in equity-based crowdfunding, with the remainder comprised of lending-based, royalty-based, and hybrid models[1293]). The industry report further indicates that global equity-based crowdfunding volume grew by 182% in 2014.[1294] According to the report, this rapid growth in equity-based crowdfunding has been driven largely by North America and Europe.[1295]

The industry report further indicates that, in 2014 the worldwide average size of a funded campaign was less than $4,000 for consumer lending-based, reward-based, and donation-based crowdfunding types.[1296] Crowdfunded business loans and equity-based campaigns, however, were substantially higher. In 2014, the global average size of a funded peer-to-business lending-based crowdfunding campaign was $103,618.[1297] In 2014, a typical equity-based campaign was larger, with the global average size of $275,461.[1298] These figures suggest that the types of ventures financed through equity-based crowdfunding could be different than those financed

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1291 *Id.* at 14.

1292 *Id.* at 53.

1293 *Id.* at 55.

1294 *Id.* at 14. By comparison, in 2014, "reward-based" crowdfunding grew by 84%, "lending-based" crowdfunding by 223%; "donation-based" crowdfunding by 45%; "royalty-based" crowdfunding by 336%; and "hybrid" crowdfunding by 290%.

1295 *Id.* at 55. "Equity-based" crowdfunding in North America ($787.5 million) and Europe ($177.5 million) grew by 301% and 145%, respectively.

1296 *Id.* at 59.

1297 *Id.* at 60.

1298 *Id.* at 60.

through other crowdfunding methods. In 2014, the average size of a funded equity-based campaign in North America was $175,000.[1299]

Since the passage of the JOBS Act, many U.S. states have made changes to their securities laws to accommodate intrastate securities-based crowdfunding transactions. Based on information from NASAA, as of September 2015, 29 states and the District of Columbia have enacted state crowdfunding provisions that rely, at the federal level, on the intrastate offering exemptions under Securities Act Section 3(a)(11) and Rule 147 or on Rule 504 of Regulation D. These state crowdfunding rules allow businesses in a state to use securities-based crowdfunding to raise capital from investors within that state.[1300] There is limited information available to us about the scope of domestic crowdfunding activity in reliance on the intrastate exemptions. Since December 2011, when the first state (Kansas) enacted its crowdfunding provisions, 118 state crowdfunding offerings have been reported to be filed with the respective state regulator and 102 were reported to be approved or cleared, as of August 1, 2015.[1301]

4. Survival Rates for Startups and Small Businesses

Startups and small businesses that lack tangible assets or business experience needed to obtain conventional financing might turn to securities-based crowdfunding in reliance on

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[1299] *Id.* at 60. The report does not provide the average size of North American donation-based, reward-based, or lending-based crowdfunding campaigns. The report notes that, in 2014, the average funded North American donation-based and reward-based campaigns were 56% and 54%, respectively, of the average size of funded European donation-based and reward-based campaigns. *Id.* at 60.

[1300] *See* NASAA's Intrastate Crowdfunding Resource Center at http://www.nasaa.org/industry-resources/corporation-finance/instrastate-crowdfunding-resource-center/, accessed in September 2015. *See also* NASAA's State Crowdfunding Update, *available at:* http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2014/12/Intrastate-Crowdfunding-Overview-2015.pdf.

[1301] Based on information provided by NASAA. The jurisdictions included in the estimate are Alabama, District of Columbia, Georgia, Idaho, Indiana, Kansas, Maine, Maryland, Massachusetts, Michigan, Oregon, Texas, Vermont, Washington, and Wisconsin.

Section 4(a)(6) as an attractive potential source of financing. There is broad evidence that many of these potential issuers are likely to fail after receiving funding. For example, a 2010 study reports that of a random sample of 4,022 new high-technology businesses started in 2004, only 68% survived by the end of 2008.[1302]

Similarly, other studies suggest that startups and small businesses financed by venture capitalists also tend to have high failure rates. One study finds that for 16,315 VC-backed companies that received their first institutional funding round between 1980 and 1999, approximately one-third failed after the first funding round.[1303] Additionally, another study of more than 2,000 companies that received at least $1 million in venture funding, from 2004 through 2010, finds that almost three-quarters of these companies failed.[1304] Another study, based on a sample ending in 2005, found cumulative failure rates of 34.1% for VC-financed firms and 66.3% for non-VC-financed firms, with the difference driven by lower failure rates of VC-financed firms in the initial years after receiving VC financing.[1305]

Taken all together, the failure rates documented in these studies are high for startups and small businesses, even with the involvement of sophisticated investors like VCs. Because we expect that issuers that will engage in offerings made in reliance on Section 4(a)(6) will be in an

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1302 *See* Alicia Robb, E.J. Reedy, Janice Ballou, David DesRoches, Frank Potter and Zhanyun Zhao, *An Overview of the Kauffman Firm Survey: Results from the 2004-2008 Data*, Kauffman Foundation, *available at* http://www.kauffman.org/uploadedFiles/kfs_2010_report.pdf ("Kauffman Firm Survey").

1303 *See* Yael V. Hochberg, Alexander Ljungqvist and Yang Lu, *Whom You Know Matters: Venture Capital Networks and Investment Performance*, 62 J. OF FIN. 251-301 (2007).

1304 *See* Deborah Gage, *The Venture Capital Secret: 3 Out of 4 Start-Ups Fail*, WALL ST. J., Sept. 19, 2012.

1305 *See* Puri, note 1281. According to this study, the difference in the outcomes of VC-financed and non-VC-financed firms decreases after accounting for observable differences in firm characteristics, but it does not disappear. However, as the study notes, in evaluating the remaining differences in the outcomes of VC-financed and non-VC-financed firms, it is not possible to fully differentiate the effects of superior selection on the basis of unobservable firm characteristics from the effects of VC monitoring and expertise.

earlier stage of business development than the businesses included in the above studies, we believe that issuers that engage in securities-based crowdfunding may have higher failure rates than those in the studies cited above.

5. Market Participants

The final rules will have their most significant impact on the market for the financing of startups and small businesses. The number of participants in this market and the amounts raised through alternative sources indicate that this is a large market. In 2013, there were more than 5 million small businesses, defined by the U.S. Census Bureau as having fewer than 500 paid employees.[1306] As of June 2014, FDIC-insured depositary institutions held approximately $590 billion in approximately 23.4 million small business loans.[1307] According to the SBA's fiscal year 2014 annual performance report, approximately 51,500 small businesses received funding in 2014 through SBA's main lending programs, 7(a) and 504 loans.[1308] In 2014, VCs invested $49.3 billion of capital in in 4,361 transactions involving 3,665 startups, according to an industry source.[1309] In 2014, angel investors contributed $24.1 billion, with approximately 73,400 entrepreneurial ventures receiving angel funding.[1310]

Below, we analyze the economic effect of the final rules on the following parties: (1) issuers, typically startups and small businesses, that seek to raise capital by issuing securities; (2) intermediaries through which issuers seeking to engage in transactions in reliance on

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1306 *See* U.S. Department of Commerce, United States Census Bureau, *Business Dynamics Statistics, Data: Firm Characteristics* (2013), *available at* http://www.census.gov/ces/dataproducts/bds/data_firm.html.

1307 For the purposes of this figure, small business loans are defined as loans secured by nonfarm nonresidential properties and commercial and business loans of $1,000,000 or less. *See* FDIC Statistics, note 1254.

1308 *See* 2014 Annual Performance Report, note 1262.

1309 *See* NVCA, note 1277.

1310 *See* Sohl, note 1282.

Section 4(a)(6) will offer and sell their securities; (3) investors who purchase or may consider purchasing securities in such offerings; and (4) other capital providers, broker-dealers and finders who currently participate in private offerings. The potential economic impact of the final rules will depend on how these market participants respond to the final rules. Each of these parties is discussed in further detail below.

a. Issuers

The final rules will permit certain entities to raise capital by issuing securities for the first time. The number, type and size of the potential issuers that will seek to use crowdfunding to offer and sell securities in reliance on Section 4(a)(6) is uncertain, but data on current market practices may help identify the number and characteristics of potential issuers.

It is challenging to precisely predict the number of future securities offerings that might rely on Section 4(a)(6), particularly because rules governing the process are being adopted today.[1311]

According to filings made with the Commission, from 2009 to 2014, there were approximately 4,559 issuers per year in new Regulation D offerings with offer sizes of up to $1 million (excluding issuers that are pooled investment vehicles), including approximately 1,020 (22%) per year that reported having no revenue and approximately 861 (19%) per year that reported revenues of up to $1 million.[1312] Among issuers in new Regulation D offerings with offer sizes of up to $1 million (excluding issuers that are pooled investment vehicles) during this period, the overwhelming majority of issuers (approximately 80%) are younger than 5 years old,

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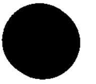
1311 *See also* Section IV.B.1.

1312 In addition, in an average year, approximately 50% of issuers in new Regulation D offerings with offer sizes of up to $1 million (excluding issuers that are pooled investment vehicles) declined to disclose their revenues. It is also possible that some issuers in Regulation D offerings that report revenues in excess of $1 million may participate in offerings in reliance on Section 4(a)(6).



with the median age of approximately one year. Approximately 92% of these issuers were organized as either a corporation or a limited liability company.

It is expected that many future issuers of securities in crowdfunding offerings would have otherwise raised capital from one of the alternative sources of financing discussed above, while others would have been financed by friends and family or not financed at all. Due to the differences between small business loans (including SBA-guaranteed loans) and securities-based crowdfunding offerings that can be conducted under the final rules, we are not able to estimate how many small businesses utilizing these forms of financing may instead pursue an offering in reliance on Section 4(a)(6). Similarly, due to the differences between the terms of crowdfunding campaigns in existence today and the provisions of the final rules, is not clear how many current campaigns can instead become offerings in reliance on Section 4(a)(6).[1313] Hence, while some of the businesses using these alternative funding sources may become issuers offering and selling securities in reliance on Section 4(a)(6) in the future, we cannot know how many of these businesses will elect securities-based crowdfunding in reliance on Section 4(a)(6) once it becomes available, nor can we know how many future businesses may not be financed at all.

We believe that many potential issuers of securities through crowdfunding will be startups and small businesses that are close to the "idea" stage of the business venture and that have

[1313] A recent industry report estimated that the equity-based crowdfunding volume in North America in 2014 was $787.5 million and the average size of a successful equity-based crowdfunding campaign was $175,000. *See* Massolution 2015 at 55 and 60. This allows us to estimate approximately 4,500 successful equity-based crowdfunding campaigns for North America in 2014. The report does not provide statistics for the United States alone. Equity-based crowdfunding campaigns in the United States are currently limited to accredited investors or intrastate offerings in certain jurisdictions. Further, the industry report does not provide information that would allow us to estimate the number of crowdfunding campaigns of other types (such as reward-based or donation-based) in North America or the United States in 2014. We note that many such campaigns, particularly those that relate to individual projects, may not have a defined or sustained business model commensurate with typical issuers of securities. In particular, many of the current reward-based or donation-based crowdfunding projects likely entail endeavors that may not be suitable to a long-lived securities issuance (*e.g.*, certain artistic endeavors or artistic projects).

business plans that are not sufficiently well-developed or do not offer the growth potential or business model to attract VCs or angel investors. In this regard, a study of one large platform revealed that relatively few companies on that platform operate in technology sectors that typically attract VC investment activity.[1314]

b. Intermediaries

Section 4(a)(6)(C) requires that an offer and sale of securities in reliance on Section 4(a)(6) be conducted through a registered funding portal or a broker. Registered broker-dealers, both those that are already registered with the Commission and those that will register, might wish to facilitate securities-based crowdfunding transactions. New entrants that do not wish to register as broker-dealers might decide to register as funding portals to facilitate securities-based crowdfunding transactions in reliance on Section 4(a)(6). Donation-based or reward-based crowdfunding platforms with established customer relationships might seek to leverage these relationships and register as funding portals, or register as or associate with registered broker-dealers. Although the number of potential intermediaries that will fill these roles is uncertain, practices of existing broker-dealers and crowdfunding platforms provide insight into how the market might develop.

Based on FOCUS Reports filed with the Commission, as of December 2014, there were 4,267 broker-dealers registered with the Commission, with average total assets of approximately $1.1 billion per broker-dealer. The aggregate total assets of these registered broker-dealers are approximately $4.9 trillion. Of these registered broker-dealers, 816 also are dually registered as investment advisers.

[1314] *See* Ethan R. Mollick, *The Dynamics of Crowdfunding: An Exploratory Study*, Working Paper (June 26, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2088298.

Existing crowdfunding platforms are diverse and actively involved in financing, allowing thousands of projects to search for capital. A recent industry report estimates that, as of 2014, 1,250 crowdfunding platforms were operating worldwide, including 375 platforms operating in North America.[1315] Globally, approximately 19% (236) of platforms were engaged in equity-based crowdfunding, 18.3% in lending-based crowdfunding, 22.6% in donation-based crowdfunding, 28.9% in reward-based crowdfunding, with the remainder engaged in royalty-based and hybrid crowdfunding.[1316] An earlier industry report indicated that crowdfunding platforms typically charge entrepreneurs a "transaction fee" that is based on how large the target amount is and/or upon reaching the target and that fees from survey participants worldwide ranged from 2% to 25%, with an average of 7% in North America and Europe.[1317] The 2012 industry report provides one case study of fees for a "large-securities-based CFP" stating "[t]here are no management fees for uncommitted capital, but a "2 and 20" arrangement is set on deals funded."[1318]

We do not know at present which market participants will become intermediaries under Section 4(a)(6) and Regulation Crowdfunding, but we believe that existing crowdfunding platforms might seek to leverage their already-existing Internet-based platforms, brand recognition and user bases to facilitate offerings in reliance on Section 4(a)(6).[1319]

1315 *See* Massolution 2015 at 84. The report does not provide separate statistics for the United States.

1316 *Id.* at 89.

1317 *See* Massolution *Crowdfunding Industry Report: Market Trends, Composition and Crowdfunding Platforms* (May 2012) ("Massolution 2012") at 38.

1318 *Id.*

1319 For example, the Massolution 2012 industry report suggests that funding portal reputation is important in the crowdfunding market, especially for equity-based crowdfunding. *See* Massolution 2012 at 46.

Under the statute and the final rules, funding portals are constrained in the services they can provide, and persons (or entities) seeking the ability to participate in activities unavailable to funding portals, such as offering investment advice or holding, managing, possessing or otherwise handling investor funds, would instead need to register as broker-dealers or investment advisers, depending on their activities. Although we expect that initially, upon adoption of the final rules, more new registrants will register as funding portals than as broker-dealers given the less extensive regulatory requirements imposed on funding portals, it is possible that market competition to offer broker-dealer services as part of intermediaries' service capabilities might either drive more broker-dealer growth in the longer term or provide registered funding portals with the incentive to form long-term partnerships with registered broker-dealers. One commenter suggested that funding portals may find it beneficial to cooperate with registered broker-dealers and transfer agents.[1320] Other commenters on the proposal did not provide additional information on this issue. There is anecdotal evidence that such partnerships are already forming under existing regulations in crowdfunding transactions involving accredited investors.[1321] The final rules provide that intermediaries will be deemed to have satisfied the requirement to have a

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1320 *See* TinyCat Letter (but noting that such partnerships should be optional).

1321 *See* David Drake, *Rich Man's Crowd Funding*, FORBES, Jan. 15, 2013, *available at* http://www.forbes.com/sites/groupthink/2013/01/15/rich-mans-crowd-funding/. *See also* Mohana Ravindranath, *For broker/dealers, crowdfunding presents new opportunity*, WASH. POST, Mar. 29, 2013, *available at* http://www.washingtonpost.com/business/on-small-business/for-brokerdealers-crowdfunding-presents-new-opportunity/2013/03/28/bb835942-8075-11e2-8074-b26a871b165a_story.html; J.J. Colao, *In the Crowdfunding Gold Rush, This Company Has a Rare Edge*, FORBES, June 5, 2013, *available at* http://www.forbes.com/sites/jjcolao/2013/06/05/in-the-crowdfunding-gold-rush-this-company-has-a-rare-edge/; Arina Shulga, *Crowdfunding Right Now (Fund Model, Broker-Dealer Model, Lending Platforms and Intrastate Offerings)*, LEXISNEXIS.COM, Aug. 7, 2014, *available at* http://www.lexisnexis.com/legalnewsroom/banking/b/venture-capital/archive/2014/08/07/crowdfunding-right-now-fund-model-broker-dealer-model-lending-platforms-and-intrastate-offerings.aspx; Alessandra Malito, *Broker-dealer expands crowdfunding reach with new partnership*, INVESTMENTNEWS, Apr. 14, 2015, *available* at http://www.investmentnews.com/article/20150414/FREE/150419972/broker-dealer-expands-crowdfunding-reach-with-new-partnership.

reasonable basis for believing that an issuer has established means to keep accurate records of the holders of the securities it would offer and sell through the intermediary's platform if the issuer has engaged the services of a registered transfer agent.[1322] This registered transfer agent safe harbor may lead intermediaries to encourage issuers to use a registered transfer agent.

c. Investors

It is unclear what types of investors will participate in offerings made in reliance on Section 4(a)(6), but given the investment limitations in the final rules, we believe that many investors affected by the final rules will likely be individual retail investors who currently do not have broad access to investment opportunities in early-stage ventures. Offerings made in reliance on Section 4(a)(6) may provide retail investors with additional investment opportunities, although the extent to which they invest in such offerings will likely depend on their view of the potential return on investment as well as the risk for fraud.

In contrast, larger, more sophisticated or well-funded investors may be less likely to invest in offerings made in reliance on Section 4(a)(6). The relatively low investment limits set by the statute for crowdfunding investors may make these offerings less attractive for professional investors, including VCs and angel investors.[1323] While an offering made in reliance on Section 4(a)(6) can bring an issuer to the attention of these investors, it is possible that professional investors will prefer, instead, to invest in offerings in reliance on Rule 506, which are not subject to the investment limitations applicable to offerings made in reliance on Section 4(a)(6).

1322 *See* Rule 301(b) of Regulation Crowdfunding.

1323 An observer suggests that, unlike angels, VCs may be less interested in crowdfunding because, if VCs rely on crowdfunding sites for their deal flow, it would be difficult to justify charging a 2% management fee and 20% carried interest to their limited partners. *See* Ryan Caldbeck, *Crowdfunding – Why Angels, Venture Capitalists And Private Equity Investors All May Benefit*, FORBES, Aug. 7, 2013.

d. Other Capital Providers, Broker-Dealers and Finders in Private Offerings

The final rules may affect other parties that provide sources of capital, such as small business lenders, VCs, family and friends and angel investors that currently finance small private businesses. The current scope of financing provided by these capital providers is discussed above. As discussed below, the magnitude of the final rules' economic impact will depend on whether crowdfunding in reliance on Section 4(a)(6) emerges as a substitute or a complement to these financing sources.

In addition, issuers conducting private offerings may, outside of offerings in reliance on Section 4(a)(6), currently use broker-dealers to help them with various aspects of the offering and to help ensure compliance with the ban on general solicitation and advertising that exists for most private offerings. Private offerings also could involve finders who connect issuers with investors for a fee.[1324] These private offering intermediaries also may be affected by the final rules, because once issuers can undertake offerings in reliance on Section 4(a)(6), some issuers might no longer need the services of those broker-dealers and finders.

Although we are unable to predict the exact size of the market for broker-dealers and finders in private offerings that are comparable to those that the final rules permit, data on the use of broker-dealers and finders in the Regulation D markets suggest that they may not currently play a large role in private offerings. Based on a staff study, only 21% of all new Regulation D offerings from 2009 to 2014 used an intermediary such as a broker-dealer or a finder.[1325] The use of a broker-dealer or a finder increased with offering size; they participated in approximately 17%

[1324] Depending on their activities, these persons may need to be registered as broker-dealers.

[1325] *See Unregistered Offerings White Paper*, note 1230.

of offerings for up to $1 million and 30% of offerings for more than $50 million. Moreover, the fee tends to decrease with offering size. Unlike the gross spreads in registered offerings, the differences in fees for Regulation D offerings of different sizes are large: the average total fee (commission plus finder fee) paid by issuers conducting offerings of up to $1 million (6.4% in 2014) is almost three times larger on a percentage basis than the average total fee paid by issuers conducting offerings of more than $50 million (1.9% in 2014).[1326] These estimates, however, only reflect practices in the Regulation D market. It is possible that issuers engaging in other types of private offerings (*e.g.*, those relying on Section 4(a)(2)), for which we do not have data, may use broker-dealers and finders more frequently and have different fee structures.

B. Analysis of Final Rules

As noted above, we are mindful of the costs and benefits of the final rules, as well as the impact that the final rules may have on efficiency, competition and capital formation. In enacting Title III, Congress established a framework for a new type of exempt offering and required us to adopt rules to implement that framework. To the extent that crowdfunding rules are successfully utilized, the crowdfunding provisions of the JOBS Act are expected to provide startups and small businesses with the means to raise relatively modest amounts of capital, from a broad cross section of investors, through securities offerings that are exempt from registration under the Securities Act. They also are expected to permit small investors to participate in a wider range of securities offerings than may be currently available.[1327] Specifically, the statutory provisions and the final rules address several challenges specific to financing startups and small businesses,

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[1326] *Id.*

[1327] *See, e.g.*, 158 CONG. REC. S1781 (daily ed. Mar. 19, 2012) (statement of Sen. Carl Levin) ("Right now, the rules generally prohibit a company from raising very small amounts from ordinary investors without significant costs.").

including, for example, accessing a large number of investors, the regulatory requirements associated with issuing a security, protecting investors and making such securities offerings cost-effective for the issuer.

In the sections below, we analyze the costs and benefits associated with the crowdfunding regulatory regime, as well as the potential impacts of such a regulatory regime on efficiency, competition and capital formation, in light of the baseline discussed above.

1. Broad Economic Considerations

In this release, we discuss the potential costs and benefits of the final rules. Many of these costs and benefits are difficult to quantify or estimate with any degree of certainty, especially considering that Section 4(a)(6) provides a new method for raising capital in the United States. Some costs are difficult to quantify or estimate because they represent transfers between various participants in a market that does not yet exist. For instance, costs to issuers can be passed on to investors and costs to intermediaries can be passed on to issuers and investors. These difficulties in estimating and quantifying such costs are exacerbated by the limited public data that indicates how issuers, intermediaries and investors will respond to these new capital raising opportunities.

The discussion below highlights several general areas where uncertainties about the new crowdfunding market might affect the potential costs and benefits of the final rules, as well as our ability to quantify those costs and benefits. It also highlights the potential effects on efficiency, competition and capital formation.

The extent to which the statute and the final rules affect capital formation and the cost of capital to issuers depends in part on the issuers that choose to participate. In particular, if offerings in reliance on Section 4(a)(6) only attract issuers that are otherwise able to raise capital through another type of exempt offering, the statute and the final rules may result in a

redistribution of capital flow, which may enhance allocative efficiency but have a limited impact on the aggregate level of capital formation.[1328]

Notwithstanding the existence of these alternative methods of capital raising, we believe that offerings pursuant to Section 4(a)(6) will likely represent a new source of capital for many small issuers that currently have difficulty raising capital. Startups and small businesses usually have smaller and more variable cash flows than larger, more established companies, and internal financing from their own business operations tends to be limited and unstable. Moreover, these businesses tend to have smaller asset bases[1329] and, thus, less collateral for traditional bank loans. As discussed above, startups and small businesses, which are widely viewed to have more financial constraints than publicly-traded companies and large private companies, could therefore benefit significantly from a securities-based crowdfunding market. Some small businesses may not qualify for traditional bank loans and may find alternative debt financing too costly or incompatible with their financing needs. While some small businesses may attract cquity investments from angel investors or VCs, other small businesses, particularly, businesses at the seed stage may have difficulty obtaining external equity financing from these sources. We believe that the statute, as implemented by the final rules, may increase both capital formation and the efficiency of capital allocation among small issuers by expanding the range of methods of external financing available to small businesses and the pool of investors willing to finance such types of

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1328 For example, a 2012 GAO report on Regulation A offerings suggests that a significant decline in the use of this funding alternative after 1997 could be partially attributed to a shift to Rule 506 offerings under Regulation D, as a result of the preemption of state law registration requirements for Rule 506 offerings that occurred in 1996. *See* GAO Report, note 1231.

1329 *See, e.g.*, John Asker, Joan Farre-Mensa and Alexander Ljungqvist, *Corporate Investment and Stock Market Listing: A Puzzle?* European Corporate Governance Institute Finance Working Paper (June 2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1603484.

businesses. The extent to which such issuers will use the Section 4(a)(6) offering exemption, however, is difficult to assess.

If startups and small businesses find other capital raising options more attractive than securities-based crowdfunding, the impact of Section 4(a)(6) on capital formation may be limited. Even so, the availability of securities-based crowdfunding as a financing option may increase competition among suppliers of capital, resulting in a potentially lower cost of capital for all issuers, including those that choose not to use securities-based crowdfunding.

For issuers that pursue offerings in reliance on Section 4(a)(6), establishing an initial offering price might be challenging. Offerings relying on Section 4(a)(6) will not involve an underwriter who, for larger offerings, typically assists the issuer with pricing and placing the offering. Investors in offerings relying on Section 4(a)(6) may lack the sophistication to evaluate the offering price. Thus, the involvement of these investors, who are likely to have a more limited capacity for conducting due diligence on deals, may contribute to less accurate valuations.

Moreover, because of the investment limitations in securities-based crowdfunding transactions, there may not be a strong incentive, even assuming adequate knowledge and experience, for an investor to perform a thorough analysis of the issuer disclosures. To the extent that these potential information asymmetries resulting from the lack of a thorough analysis of the disclosures are anticipated by prospective investors, investor participation in offerings made in reliance on Section 4(a)(6) may decline and the associated benefits of capital formation may be lower.

Uncertainty surrounding exit strategies for investors in crowdfunding offerings also may limit the benefits. In particular, it is unlikely that purchasers in crowdfunding transactions will be able to follow the typical path to liquidity that investors in other exempt offerings follow. For

instance, investors in a VC-backed startup may eventually sell their securities in an initial public offering on a national securities exchange or to another company in an acquisition.[1330] We anticipate that most businesses engaging in offerings in reliance on Section 4(a)(6) will be unlikely to progress directly to an initial public offering on a national securities exchange given their small size,[1331] and investors may lack adequate strategies or opportunities to eventually divest their holdings.[1332] A sale of the business will require the issuer to have a track record in order to attract investors with the capital willing to buy the business.

Further, the likely broad geographical dispersion of crowdfunding investors may make shareholder coordination difficult. It may also exacerbate information asymmetries between issuers and investors, if the distance between them diminishes the ability for investors to capitalize on local knowledge that may be of value in assessing the viability of the issuer's business. The use of electronic means may mitigate some of these difficulties. Even if an issuer can execute a sale or otherwise offer to buy back or retire the securities, it might be difficult for investors to determine whether the issuer is offering a fair market price. These uncertainties may limit the use of the Section 4(a)(6) exemption.

The potential benefits of the final rules also may depend on how investors respond to potential liquidity issues unique to the securities-based crowdfunding market. It is currently unclear how securities offered and sold in transactions conducted in reliance on Section 4(a)(6)

1330 *See* Gompers, note 1249.

1331 As noted, under the statute and the final rules, issuers relying on Section 4(a)(6) would be limited to raising an aggregate of $1 million during a 12-month period. By contrast, as noted in the IPO Task Force, the size of an initial public offering generally exceeds $50 million. *See* IPO Task Force, note 1223.

1332 In contrast, given the required investor qualifications and offering limit amounts, Regulation D offerings may generally attract issuers that are more experienced and better capitalized. Moreover, such offerings are likely to have a larger proportion of accredited investors because, in contrast to securities-based crowdfunding, there are no limitations on individual investment amounts. As a result, we believe that Regulation D issuers and investors are more likely to have potential exit strategies in place.

will be transferred in the secondary market after the one-year restricted period ends, and investors who purchased securities in transactions conducted in reliance on Section 4(a)(6) and who seek to divest their securities may not find a liquid market.[1333] Assuming a secondary market develops, securities may be quoted on the over-the-counter market or on trading platforms for shares of private companies.[1334] Nevertheless, it is possible that secondary trading costs for investors may be substantial, effective and quoted spreads may be wide, trading volume may be low, and price volatility may be high compared to those of listed securities.[1335] Illiquidity, to different degrees, remains a concern for other exempt offerings and for registered offerings by small issuers. However, because investors purchasing securities sold in reliance on Section 4(a)(6) may be less sophisticated than investors in other private offerings due to the fact that there are no investor qualification requirements, they may face additional challenges in addressing the impact of illiquidity, either in finding a suitable trading venue or negotiating with the issuer for an alternative liquidity option. The potentially high degree of illiquidity associated with securities

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[1333] Academic studies have shown that the over-the-counter market is less liquid than the national exchanges. *See* Nicolas Bollen and William Christie, *Market Microstructure of the Pink Sheets*, 33 J. BANKING & FIN. 1326–1339 (2009); Andrew Ang, Assaf Shtauber and Paul Tetlock, *Asset Pricing in the Dark: The Cross Section of OTC Stocks*, 26 REV. FIN. STUD. 2985–3028 (2013).

[1334] Given the services that funding portals are permitted to provide under the statute and the final rules, investors will not be able to use funding portals to trade in securities offered and sold in reliance on Section 4(a)(6) in the secondary market.

[1335] Academic studies show that reducing the information transparency about an issuer increases the effective and quoted spreads of its shares, reduces share price and increases price volatility. Specifically, percentage spreads triple and volatility doubles when NYSE issuers are delisted to the Pink Sheets. *See* Jonathan Macey, Maureen O'Hara and David Pompilio, *Down and Out in the Stock Market: The Law and Finance of the Delisting Process*, 51 J.L. & ECON 683–713 (2008). When NASDAQ issuers delist and subsequently trade on the OTC Bulletin Board and/or the Pink Sheets, share volume declines by two-thirds, quoted spreads more than double, effective spreads triple and volatility triples. *See* Jeffrey H. Harris, Venkatesh Panchapagesan and Ingrid M. Werner, *Off But Not Gone: A Study of NASDAQ Delistings*, Fisher College of Business Working Paper No. 2008-03-005 and Dice Center Working Paper No. 2008-6 (Mar. 4, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=628203. One factor that may alleviate transparency concerns is the fact that issuers that sold securities in an offering made in reliance on Section 4(a)(6) will have an ongoing reporting obligation, so disclosure of information about the issuer will continue to be required.

purchased in reliance on Section 4(a)(6) may discourage some investors from investing in issuers through such offerings, thus limiting the potential efficiency, competition and capital formation benefits of the final rules.

Even with the mandated disclosures, unsophisticated investors purchasing securities issued in reliance on Section 4(a)(6) may face certain expropriation risks, potentially limiting the upside of their investment, even when they select investments in successful ventures. This can occur if issued securities include certain features (*e.g.*, callable securities or securities with differential control rights) or if issuers conduct insider-only financing rounds or financing rounds at reduced prices (so-called "down rounds") that have the effect of diluting an investor's interest or otherwise diminishing the value of the securities offered and sold in reliance on Section 4(a)(6). Investors purchasing securities issued in reliance on Section 4(a)(6) may not have the experience or the market power to negotiate various anti-dilution provisions, right of first refusal, tag-along rights, superior liquidation preferences and rights upon a change in control that have been developed by institutional and angel investors as protections against fundamental changes in a business.[1336] Moreover, the disperse ownership stakes of investors in securities-based crowdfunding offerings may weaken their incentives to monitor the issuer to minimize the risk of expropriation. The ensuing expropriation risk may discourage some investors from participating in offerings made in reliance on Section 4(a)(6), potentially limiting the efficiency, competition and capital formation benefits of the final rules.

The final rules also may have an effect on broker-dealers and finders participating in private offerings. Some issuers that previously relied on broker-dealers and finders to assist with raising capital through private offerings may, instead, begin to rely on the Section 4(a)(6)

[1336] *See* Kaplan, note 1279.

exemption to find investors. The precise impact of the final rules on these intermediaries will depend on whether (and, if so, to what extent) issuers switch from using existing exemptions to using the exemption provided by Section 4(a)(6) or whether the final rules primarily attract new issuers. The impact of the final rules on registered broker-dealers will also depend on the extent to which broker-dealers participate as intermediaries in the securities-based crowdfunding market. If a significant number of issuers switch from raising capital under existing private offering exemptions to relying on the exemption provided by Section 4(a)(6), this may negatively affect the revenue of finders and broker-dealers in the private offerings market. While this may disadvantage existing private offering market intermediaries, the new competition may ultimately lead to more efficient allocation of capital.

If securities-based crowdfunding primarily attracts new issuers to the market, the impact on broker-dealers and finder revenue may be negligible and the final rules may even have a positive effect on their revenues by revealing more potential clients for them, particularly to the extent that they chose to operate a funding portal. Additionally, greater investor interest in private company investment may increase capital formation, creating new opportunities for broker-dealers and finders that otherwise would have been unavailable.

The final rules also may encourage current participants in the crowdfunding market to diversify their funding models to attract a broader group of companies and to provide additional investment opportunities for investors. For example, donation-based crowdfunding platforms that currently offer investment opportunities in micro-loans generally do not permit donors to collect interest on their investments because of concerns that this activity will implicate the federal

securities laws unless an exemption from registration is available.[1337] Under the final rules, these platforms may choose to register as funding portals and permit businesses to offer securities that provide investors with the opportunity to obtain a return on investment. This can broaden their user base and attract a group of investors different from those already participating in reward-based or donation-based crowdfunding. It is likely that some registered broker-dealers will find it profitable to enter the securities-based crowdfunding market and operate funding portals as well. Such an entry will increase the competition among intermediaries and likely lead to lower issuance costs for issuers.

However, many projects that are well suited for reward-based or donation-based crowdfunding (*e.g.*, because they have finite lives, their payoffs to investors could come before the project is completed or could be contingent on the project's success, etc.) may have little in common with startups and small businesses that are well suited for an offering in reliance on Section 4(a)(6). As a result, diversification among existing platforms may not always be optimal or preferred, particularly if complying with the final rules proves disproportionately costly compared to the potential amount of capital to be raised.

2. Crowdfunding Exemption

a. Limitation on Capital Raised

The statute imposes certain limitations on the total amount of securities that may be sold by an issuer during the 12-month period preceding the date of the transaction made in reliance on Section 4(a)(6). Specifically, Section 4(a)(6)(A) provides for a maximum aggregate amount of $1 million sold in reliance on the exemption during a 12-month period.[1338] The final rules preserve

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[1337] *See, e.g.*, *Deutsche Bank Microcredit Development Fund, Inc.*, SEC No-Action Letter (Apr. 8, 2012).

[1338] *See also* Rule 100(a)(1) of Regulation Crowdfunding.

the $1 million limit. The limitation on the amount that may be raised is expected to benefit investors by reducing the potential loss from dilution or fraud[1339] in the securities-based crowdfunding market. However, we recognize that this limit on the amount that may be sold in reliance on Section 4(a)(6) also can prevent certain issuers from raising all the capital they need to make their businesses viable, which in turn can result in lost opportunities, as indicated by various commenters.[1340] It also is likely to limit efficiency to the extent that capital cannot be channeled to the most productive use. Due to the lack of data, however, we are not able to quantify the unrealized efficiency or capital formation associated with the adoption of the $1 million limit instead of the alternative of a higher limit. Since issuers in securities-based crowdfunding offerings bear certain fixed costs, as discussed in Section III.B.3., offering costs as a percentage of offering proceeds will be larger under the $1 million limit than under the alternative of a higher limit.

As an alternative, we could have defined the $1 million limit to be net of intermediary fees, as suggested by some commenters.[1341] If a funding portal announces in advance the fees it

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1339 While we lack information to predict the potential incidence of fraud in securities-based crowdfunding offerings made in reliance on Section 4(a)(6) and note that current crowdfunding practices differ significantly from the securities-based crowdfunding market that may develop upon effectiveness of the final rules, some concern has been expressed about the potential for fraud in this area. *See, e.g.*, NASAA Enforcement Report: 2015 Report on 2014 data, September 2015, available at http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/08/2015-Enforcement-Report-on-2014-Data_FINAL.pdf (listing Internet fraud (including social media and crowdfunding) among the products and schemes that are frequently investigated by states, without statistics specific to securities-based crowdfunding).

1340 *See, e.g.*, Advanced Hydro Letter; Bushroe Letter; Cole D. Letter; Concerned Capital Letter; Hamman Letter; Harrison Letter; Hillside Letter; Jazz Letter; Kickstarter Coaching Letter; McCulley Letter; McGladrey Letter; Meling Letter; Miami Nation Enterprises Letter; Multistate Tax Service Letter; Peers Letter; Pioneer Realty Letter; Public Startup Letter 2; Qizilbash Letter; Rosenthal O. Letter; Sarles Letter; SBM Letter; Taylor R. Letter; Taylor T. Letter; Wales Capital Letter 1; Wales Capital Letter 3; WealthForge Letter; Wear Letter; Wilhelm Letter; Winters Letter; Yudek Letter.

1341 *See, e.g.*, Benjamin Letter; FundHub Letter 1; Hackers/Founders Letter; Joinvestor Letter; Odhner Letter; Omara Letter; Public Startup Letter 2; RFPIA Letter; RoC Letter; RocketHub Letter; Seed&Spark Letter; Thomas Letter 1; Wales Capital Letter 1; Whitaker Chalk Letter; Wilson Letter.

charges for a given transaction (fixed or variable), the economic effects of such an alternative definition would be qualitatively similar to the effects of raising the offering limit. If the funding portal fees are not known in advance, then this alternative may also create uncertainty for issuers about how much capital they would be able to raise. Several commenters opposed such an alternative.[1342]

The costs associated with not increasing the investment limit above $1 million are mitigated in part by the ability of issuers to concurrently seek additional financing in reliance on another type of exempt offering, such as Regulation D or Regulation A, in addition to the offering in reliance on Section 4(a)(6). In this release, we provide guidance clarifying our view that issuers may conduct other exempt offerings without having those offerings integrated with the offering made in reliance on Section 4(a)(6), provided that each offering complies with the applicable exemption relied upon for that particular offering. Several commenters opposed this approach on the ground that it could result in fewer investor protections than if the offerings were integrated. Some commenters noted that a potential cost to investors associated with not requiring integration is a reduction in investor protection due to the possibility of an issuer's use of advertising for one offering to indirectly promote another exempt offering that would have been subject to more stringent advertising restrictions.[1343] While we recognize this concern, we note that the final rules do not provide a blanket exemption from integration with other private offerings that are conducted simultaneously with, or around the same time as, a Section 4(a)(6) offering. Rather, we provide guidance that an offering made in reliance on Section 4(a)(6) is not required to be

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[1342] *See, e.g.*, Arctic Island Letter 4; ASSOB Letter; Commonwealth of Massachusetts Letter; MCS Letter; PeoplePowerFund Letter.

[1343] *See* AFR Letter; BetterInvesting Letter; Consumer Federation Letter; Fund Democracy Letter; IAC Recommendation; MCS Letter.

integrated with another exempt offering made by the issuer to the extent that each offering complies with the requirements of the applicable exemption that is being relied upon for that particular offering. As mentioned earlier, an issuer conducting a concurrent exempt offering for which general solicitation is not permitted will need to be satisfied that purchasers in that offering were not solicited by means of the offering made in reliance on Section 4(a)(6). Alternatively, an issuer conducting a concurrent exempt offering for which general solicitation is permitted, for example, under Rule 506(c), cannot include in any such general solicitation an advertisement of the terms of an offering made in reliance on Section 4(a)(6), unless that advertisement otherwise complies with Section 4(a)(6) and the final rules. This may partly alleviate some of commenters' concerns because each offering will have the investor protections of the offering exemption upon which it relies.

As an alternative, in line with the suggestions of some commenters,[1344] we could have provided guidance that the amounts offered in reliance on Section 4(a)(6) should be integrated with the amounts offered pursuant to other exempt offerings. Under such an alternative, the amounts raised in other exempt offerings would count toward the maximum offering amount under Section 4(a)(6). Such an alternative would potentially limit the amount of capital raised by issuers, including the set of issuers eligible to conduct an exempt offering relying on Section 4(a)(6), and thus potentially limit the capital formation benefits of the final rules. Compared to this alternative, the ability of issuers to conduct other exempt offerings that do not count toward the maximum offering amount under Section 4(a)(6) may alleviate some of the concerns that certain issuers will not be able to raise sufficient capital. The net effect on capital

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1344 *See, e.g.,* AFL-CIO Letter; Brown J. Letter; Consumer Federation Letter; Fund Democracy Letter; MCS Letter; NASAA Letter.

formation will also depend on whether issuers seeking an aggregate exempt offering amount in excess of $1 million elect to rely on Regulation Crowdfunding as part of their capital raising or elect to rely on a different exemption, such as Rule 506 of Regulation D. These considerations and the relative differences in the investor protections associated with the different offering exemptions will determine the net effect on the amount of information about issuers available to market participants and the level of investor protection.

b. Investment Limitations

Since offering documents for offerings made in reliance on Section 4(a)(6) will not be subject to review by Commission staff prior to the sale of securities, we are sensitive to potential investor protection concerns arising from the participation of less sophisticated investors in these exempt offerings. Some commenters[1345] raised concerns that the "wisdom of the crowd" will not result in investors pooling information so as to lead to better informed investment decisions.[1346]

1345 *See, e.g.,* AFR Letter; Brown J. Letter; Consumer Federation Letter.

1346 Predictions in research studies regarding the impact of social interaction on investor decisions are mixed. On the one hand, a recent study of opinions that were posted on the Internet website http://seekingalpha.com finds evidence of predictability of earnings surprises and returns that is interpreted as potentially suggesting the value relevance of user opinions rather than a naïve investor reaction. *See* Hailiang Chen, Prabuddha de, Yu Hu, and Byoung-Hyoun Hwang, *Wisdom of Crowds: The Value of Stock Opinions Transmitted Through Social Media,* 27 REV. FIN. STUD. 1367–1403 (2014). An earlier theoretical paper shows that word-of-mouth can, under some circumstances, result in superior decisions. *See* Glenn Ellison and Drew Fudenberg, *Word-of-Mouth Communication and Social Learning,* 110 QUARTERLY J. ECON. 93–125 (1995). On the other hand, some behavioral finance literature examines irrational herding and contagion of thought and behavior through social interaction, such as the propagation of investing memes, which need not be predictive of superior trading performance. For example, one article characterizes memes as "mental representation (such as an idea, proposition, or catchphrase) that can be passed from person to person". The article provides an example of investors using "verbal 'reasons' to decide how to trade" and notes that these reasons "are often not cogent". The article notes that such reasons, or financial memes, can be simple or can be elaborate structures of analysis, examples, terminology, catchphrases, and modeling. *See* for example, David A. Hirshleifer and Siew Hong Teoh, *Thought and Behavior Contagion in Capital Markets*, HANDBOOK OF FINANCIAL MARKETS: DYNAMICS AND EVOLUTION (2009). Another article compares the investment decisions of stock clubs and individuals. It finds that while both individuals and clubs are more likely to purchase stocks that are associated with "good reasons" (such as a company that is featured on a list of "most-admired" companies), stock clubs favor such stocks more than individuals, despite the fact that such reasons do not improve performance. The article analyzes social dynamics that may make "good reasons" more important for groups than individuals. *See* Brad Barber, Chip Heath, and Terrance Odean, *Good*

While we acknowledge these concerns, we note that, by adding Section 4(a)(6) to the Securities Act, Congress made an express determination to facilitate securities-based crowdfunding transactions under the federal securities laws, subject to certain specified investor protections.

Consistent with the statute, the final rules incorporate several important investor protections, including limits on the amount that can be raised, issuer eligibility criteria, and issuer and intermediary requirements, including statutorily mandated investor education requirements. The statute and the final rules also impose certain limitations on the aggregate dollar amount of securities in offerings in reliance on Section 4(a)(6) that may be sold to an investor during a 12-month period.[1347] These provisions are designed to limit the potential investment and, consequently, the potential losses for any single investor, thus providing downside protection for investors.

We recognize that these provisions also will limit the potential upside for investors. This may particularly affect the decisions of investors with large portfolios who might be able to absorb losses and understand the risks associated with risky investments and who may have more expertise and stronger incentives to acquire and analyze information about an issuer. For these investors, the $100,000 aggregate limit may reduce their incentive to participate in the securities-based crowdfunding market, compared to other types of investments, potentially depriving the securities-based crowdfunding market of more experienced and knowledgeable investors and impeding capital formation. Moreover, limiting the participation of such investors may negatively affect the informational efficiency of the securities-based crowdfunding market because

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Reasons Sell: Reason-Based Choice Among Group and Individual Investors in the Stock Market, 49 MANAGEMENT SCIENCE 1636–1652 (2003).

1347 *See* Section 4(a)(6)(B). *See also* Rule 100(a)(2) of Regulation Crowdfunding.

sophisticated investors are better able to accurately price such offerings. These investors also can add value to the discussions taking place through an intermediary's communication channels about a potential offering by providing their views on the issuer's financial viability and potential for fraud. Persons with larger portfolios are also likely to be in a better position to monitor the issuer's insiders, which can reduce the extent of moral hazard and the risk of fraud on the part of the issuer and the issuer's insiders, yielding benefits for all investors. Such investors also can add value by advising the issuer and contributing strategic expertise, which can be particularly beneficial for early-stage issuers. Some of these potential benefits, however, may still be available to issuers that seek to attract such investors through another type of exempt offering, such as a Regulation D offering.

The aggregate limit on crowdfunding investments also can impede the ability of investors to diversify within the securities-based crowdfunding market. As securities-based crowdfunding investments might have inherently high failure rates,[1348] investors who do not or cannot diversify their investments across a number of offerings can face an increased risk of incurring large losses, relative to their investments, even when they investigate offerings thoroughly. By comparison, VC firms typically construct highly diversified portfolios with the understanding that many ventures fail, resulting in a complete loss of some investments, but with the expectation that those losses will be offset by the large upside of the relatively fewer investments that succeed.[1349] The securities-based crowdfunding market is expected to involve earlier-stage financing compared to venture capital financing, and therefore, the chances of investment success may be lower.[1350] The

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[1348] *See* discussion in Section III.A.4 above.

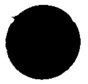
[1349] *See*, e.g., John Cochrane, *The Risk and Return of Venture Capital*, 75 J. OF FIN. ECON. 3 (2005).

[1350] *See* Rajshree Agarwal and Michael Gort, *Firm and Product Life Cycles and Firm Survival*, 92 AM. ECON. REV. 184–190 (2002)

ıtutory caps on aggregate securities-based crowdfunding investments under Section 4(a)(6) may
nit an investor's ability to choose a sufficiently large number of investments to offset this risk
d to recover the due diligence costs of sufficiently investigating individual investments. One
ıtential solution to this diversification problem is to invest smaller amounts in a greater number
ventures. However, such a strategy has limited benefit to the extent that there is a fixed cost to
e due diligence associated with identifying and reviewing each investment opportunity, making
more costly to implement than a strategy that relies on the selection of fewer investment
ɔpportunities.

In a change from the proposed rules, both the investor's annual income and net worth must
e above $100,000 for the 10 percent limitation to apply. This change is intended to strengthen
ıvestor protections for investors whose annual income or net worth is below $100,000. Such
ıvestors may not be as well situated to bear the risk of loss (*e.g.*, in the event of fraud on the part
f an issuer) as investors with both income and net worth of $100,000 or more. According to
Commission staff analysis of the data in the 2013 Survey of Consumer Finances, approximately
7% of U.S. households have both income and net worth of $100,000 or higher. By comparison,
9% of U.S. households have either income or net worth of $100,000 or higher.[1351] Thus,
ıpproximately 22% of households will be subject to a lower investment limit under the final rules
han under the proposal. We note that these figures are only available at the household level
ather than at the individual level. We further note that these figures do not account for the fact
hat only some households might seek to invest in an offering in reliance on Section 4(a)(6).

1351 Based on data from the 2013 Survey of Consumer Finances, a triennial survey sponsored by the Federal Reserve Board, *available* at http://www.federalreserve.gov/econresdata/scf/scfindex.htm.



Thus, we are not able to determine the actual percentage of investors affected by this change in the final rules relative to the proposal.

Within each investment limitation tier, the investment limitation percentage is multiplied by the "lesser of" an investor's annual income or net worth in the investment limitation calculation, which was suggested by several commenters.[1352] This change from the proposal is expected to reduce the permitted investment limit for each individual investor because most investors are unlikely to have annual income and net worth amounts that are identical.[1353]

Investment limitations will likely have a negative effect on capital formation. For example, investment limitations may make it more difficult for some issuers to reach their funding targets. However, these limits also are expected to reduce the risk and impact of potential loss for investors that accompany the high failure rates associated with investments in small businesses and startups, thus potentially improving investor protection. There is no available market data that would allow us to empirically evaluate the magnitude of these effects.

Consistent with the proposed rules, the final rules allow an issuer to rely on the efforts that an intermediary is required to undertake in order to determine that the aggregate amount of securities purchased by an investor will not cause the investor to exceed the investor limits, provided that the issuer does not have knowledge that the investor had exceeded, or would exceed, the investor limits as a result of purchasing securities in the issuer's offering, which was supported

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1352 *See, e.g.*, AFR Letter; BetterInvesting Letter; Consumer Federation Letter; Fund Democracy Letter; Fryer Letter; Growthfountain Letter; IAC Recommendation (but also stating that the "greater of" approach would be appropriate for accredited investors); Merkley Letter; NASAA Letter; Schwartz Letter; Zhang Letter (recommending that net worth not be used to calculate the investment limit).

1353 Although we lack information to determine the average change in the applicable investment limit resulting from this change, based on Commission staff analysis of the 2013 Survey of Consumer Finances, a larger percentage of households exceeded a particular dollar threshold, such as $100,000 or $200,000, based on the net worth standard than the percentage of households that exceeded the same dollar threshold based on the income standard.

by various commenters.[1354] This may result in aggregate verification cost savings since a given intermediary may be involved in and have information on crowdfunding transactions pertaining to the offerings of multiple issuers, which makes it potentially less costly to identify investors that exceed the investment limitation. As a potential alternative, we could have imposed more extensive verification requirements on issuers, which would have resulted in larger compliance costs for issuers but could have potentially increased investor compliance with the investment limitations, with corresponding investor protection benefits. As noted above, we believe the final rules appropriately consider investor protection and facilitating capital formation.

c. Issuer Eligibility

Section 4A(f) of the statute excludes certain categories of issuers from eligibility to engage in securities-based crowdfunding transactions in reliance on Section 4(a)(6). The final rules exclude those categories of issuers.[1355] The final rules also exclude two additional categories of issuers, beyond those identified in the statute, from being eligible to rely on Section 4(a)(6) to engage in crowdfunding transactions. First, the final rules exclude issuers that sold securities in reliance on Section 4(a)(6) and have not filed with the Commission and provided to investors the ongoing annual reports required by Regulation Crowdfunding during the two years immediately preceding the filing of the required offering statement,[1356] which is generally consistent with

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[1354] *See, e.g.*, Arctic Island Letter 4; CFA Institute Letter; Consumer Federation Letter; CrowdBouncer Letter; EarlyShares Letter; EMKF Letter; Finkelstein Letter; Fund Democracy Letter; Heritage Letter; Joinvestor Letter; Public Startup Letter 2; RoC Letter; RocketHub Letter; Vann Letter; Wefunder Letter; Whitaker Chalk Letter.

[1355] These categories of issuers are: (1) issuers that are not organized under the laws of a state or territory of the United States or the District of Columbia; (2) issuers that are subject to Exchange Act reporting requirements; (3) investment companies as defined in the Investment Company Act or companies that are excluded from the definition of investment company under Section 3(b) or 3(c) of the Investment Company Act. *See* Section 4A(f). *See also* Rule 100(b) of Regulation Crowdfunding.

[1356] *See* discussion in Section II.A.4 above.

suggestions from several commenters.[1357] This additional exclusion is not expected to impose any additional burdens and costs on an issuer that it would not have already incurred had it complied with the ongoing reporting requirements as they came due. Further, the requirement that a delinquent issuer prepare and file up to two annual reports at one time in order to become eligible to rely on Section 4(a)(6) is expected to incentivize issuers to provide updated and current information to investors, if they intend to rely again on Section 4(a)(6) to raise additional capital, without necessarily requiring an issuer to become fully current in its reporting obligations. We recognize that conditioning an issuer's Section 4(a)(6) eligibility on the requirement that issuers provide ongoing reports for only the previous two years may result in less information being available to investors in some periods, with potential adverse effects on the price formation and liquidity of the securities in the secondary market. The potential damage to an issuer's reputation resulting from being delinquent along with potential enforcement action for failure to comply with a regulatory reporting obligation and the modification from the proposed rules to require an issuer to disclose in its offering statement if it or any of its predecessors previously failed to comply with the ongoing reporting requirements of Rule 203 of Regulation Crowdfunding, however, may help to mitigate these potential adverse effects. As an alternative, we could have chosen not to impose this exclusion or adopted a shorter look-back period, as suggested by some commenters.[1358] Compared to the provisions in the final rules, either of these alternatives could result in less information being available to investors and reduced informational efficiency of securities prices

[1357] *See, e.g.*, ASSOB Letter; Commonwealth of Massachusetts Letter; Consumer Federation Letter; Fund Democracy Letter; Grassi Letter; Joinvestor Letter; NASAA Letter; Wefunder Letter.

[1358] *See, e.g.*, ABA Letter; Parsont Letter; Projectheureka Letter; Public Startup Letter 2; RocketHub Letter.

or possibly increased likelihood of issuer misconduct in offerings made in reliance on Section 4(a)(6).

Second, the final rules exclude a company that has no specific business plan or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies, as suggested by several commenters.[1359] This requirement is intended to help ensure that investors have adequate information about the issuer's proposed business plan to make an informed investment decision, which may increase investor protection in some instances. As an alternative, we could have chosen not to impose this exclusion or to impose a less restrictive exclusion, as suggested by several commenters.[1360] Although these alternatives might increase capital formation by allowing a subset of additional issuers to rely on Section 4(a)(6), they may also result in less informed investor decisions in such offerings.

Overall, categories of issuers that are excluded from eligibility under the final rules may be at a competitive disadvantage relative to those that are eligible to offer securities under the final rules, to the extent that excluded issuers may raise less external capital or incur a higher direct or indirect cost of financing, or additional restrictions, when seeking financing from alternative sources.

3. Issuer Requirements

a. Issuer Costs

We recognize that there are benefits and costs associated with Regulation Crowdfunding's requirements pertaining to issuers, including the final rule's disclosure requirements. In the

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[1359] *See, e.g.,* Anonymous Letter 2; CFA Institute Letter; CFIRA Letter 7; Commonwealth of Massachusetts Letter; Consumer Federation Letter; NASAA Letter; ODS Letter; Traklight Letter; Whitaker Chalk Letter.

[1360] *See, e.g.,* ABA Letter; FundHub Letter 1; Projectheureka Letter; Public Startup Letter 2; RoC Letter; RocketHub Letter; SBM Letter; Wilson Letter.

Proposing Release, we provided cost estimates for each of these requirements and requested comment on our estimates.[1361] In response, we received several comment letters providing alternative cost estimates, some of which were lower and some of which were higher than the cost estimates in the Proposing Release.[1362] For example, one commenter[1363] provided the following cost estimates: portal fees of 6% to 15%[1364]; accounting review fees of $1,950 to $9,000; accounting audit fees of $3,100 to $9,000; financial statements/projections costs of $2,000 to $5,000; Title III disclosure/compliance costs of $1,000 to $4,000; and corporate formation costs of $300 to $500.[1365] In addition, the commenter estimated the total cost to raise $99,000 of capital under the proposed rules to be $9,300 to $24,500 (9.4% to 24.7%); to raise $499,000 of capital to be $33,240 to $84,750 (6.7% to 17%); and to raise $1 million of capital to be $72,800 to $168,500 (7.3% to 16.9%). The commenter stated that the entry of new vendors into the market and ensuing competition may lead to a decline in some of these costs over time. Another commenter[1366] estimated that a $200,000 offering will incur the following average costs: legal fees of $10,000; intermediary fees of $20,000 (10%); accounting fees of $5,000; accounting review fees of $8,000; and other fees (transfer agent, campaign development, filing and other) of $7,000. A different commenter estimated that the cost to issuers could range from 26% to 601% of the offering amount over a five-year period, depending on the size of the offering, which does not

1361 *See* Proposing Release, Section III.B.3.

1362 *See, e.g.*, StartEngine Letter 2; FundHub Letter 2; Heritage Letter; SeedInvest Letter 1; SeedInvest Letter 2; Traklight Letter.

1363 *See* StartEngine Letter 2.

1364 The commenter does not specify whether these fees are expressed as a percentage of the amount sought or raised in the offering.

1365 We do not consider the costs associated with the incorporation or formation of the business itself to be part of the incremental costs of Regulation Crowdfunding, as these are costs associated with forming any business endeavor that relies on outside sources of capital.

1366 *See* Grassi Letter.

account for additional estimated opportunity costs of internal personnel time of $35,000 to $85,000 over a five-year period.[1367] Some commenters referred to estimates of total costs without estimating individual components of those costs.[1368] Other commenters provided additional analysis of costs under different scenarios and offering sizes based on the estimates in the Proposing Release.[1369]

In general, commenters identified the following as the main costs for issuers in securities-based crowdfunding offerings: the intermediary fees; the costs of preparing, ensuring compliance with, and filing of Form C and Form C-AR; and the cost of accounting review or audit of financial statements.[1370] Below we discuss the comments received on each of these costs and any revisions to our estimates made in response.

With regard to intermediary fees, the estimates of the commenters that quantified these fees[1371] were generally very close to our estimates in the Proposing Release (5% to 15%). We

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[1367] *See* SeedInvest Letter 1.

[1368] *See, e.g.*, WealthForge Letter (suggesting that the costs associated with completing a crowdfunding transaction under the current regulations can be as high as one hundred thousand dollars, including audit fees, intermediary fees, legal fees and other offering costs); Berlingeri Letter (suggesting that the total cost would amount to between 15% and 20% of the offering); Traklight Letter (suggesting that the total cost would amount to between 15% and 20% of the offering for offerings above $100,000); FundHub Letter 1 (referring to potential costs, based on the Commission's estimates and the commenter's assumptions, of between $15,000 and $25,000 associated with raising $100,000); Harrison Letter and Ramsey Letter (referencing a Forbes estimate that the costs of disclosure documents, engaging an intermediary, performing background checks, and filing annual reports with the Commission might be upwards of $100,000). *See also* *SEC Proposes Crowdfunding Rules*, FORBES, Oct. 23, 2013, http://www.forbes.com/sites/deborahljacobs/2013/10/23/sec-proposes-crowdfunding-rules/.

[1369] *See, e.g.*, EarlyShares Letter; RocketHub Letter; SeedInvest Letter 1.

[1370] *But see* Growthfountain Letter (suggesting that crowdfunding issuers will also incur investor relations costs). We do not consider investor relations costs to be incremental to Regulation Crowdfunding, as these costs may be incurred by any business that relies on outside sources of capital and a widely dispersed investor base. However, to the extent that investment limitations in crowdfunding offerings increase the number of investors in a typical offering and to the extent that some investor relations costs are variable, issuers in crowdfunding offerings may incur higher investor relations costs than issuers in types of offerings that typically have fewer investors.

[1371] *See* StartEngine Letter 2 (estimating portal fees of 6-15%). *See also* Grassi Letter (estimating an intermediary fee of $20,000 for a $200,000 offering, which amounts to 10% of the offering). *But see*

agree with the commenter that suggested that there is likely to be a fixed component to these costs that reflects a certain necessary level of due diligence and background screening, which will result in these costs as a percentage of offering size being higher for smaller offerings.[1372] Thus, we have revised our intermediary fee estimates in the following way: we project (as a percentage of offering proceeds) 5% to 15% for offerings of $100,000 or less, 5% to 10% for offerings between $100,000 and $500,000, and 5% to 7.5% for offerings above $500,000. Data on Regulation D offerings that involve intermediaries suggests that offerings of up to $1 million have an intermediary fee (commission and/or finder fee) of approximately 6.5% on average, which is within the range we estimate for larger crowdfunding offerings. Although crowdfunding intermediaries are not expected to provide issuers with services commensurate with those provided by underwriters in registered offerings (and, in fact, funding portals would be prohibited from doing so), the fees charged in a crowdfunding offering can be significantly larger on a percentage basis relative to the underwriting fees for registered offerings, which range from as high as 7% for initial public offerings to less than 1% for certain bond issuances.[1373] In general, to the extent that a significant component of these fees is fixed, the transaction costs for issuers will make smaller offerings more expensive on a percentage basis. As previously discussed, we

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Wefunder Letter (noting that, in contrast to the assumption in the Proposing Release, "good startups will pay a maximum of $0" and citing three accredited investor crowdfunding platforms that use a "carried interest" model for Rule 506 offerings, including the example of the commenter itself that does not charge a fee to startups but that charges investors a $25 fee and 10% carried interest (share of profits upon acquisition or initial public offering)).

[1372] *See* Heritage Letter.

[1373] *See, e.g.*, Hsuan-Chi Chen and Jay R. Ritter, *The Seven Percent Solution*, 55 J. FIN. 1105–1131 (2000); Mark Abrahamson, Tim Jenkinson, and Howard Jones, *Why Don't U.S. Issuers Demand European Fees for IPOs*? 66 J. FIN. 2055–2082 (2011); Shane A. Corwin, *The Determinants of Underpricing for Seasoned Equity Offers*, 58 J. FIN. 2249–2279 (2003); Lily Hua Fang, *Investment Bank Reputation and the Price and Quality of Underwriting Services*, 60 J. FIN. 2729–2761 (2005); Rongbing Huang and Donghang Zhang, *Managing Underwriters and the Marketing of Seasoned Equity Offerings*, 46 J. FIN. QUANT. ANALYSIS 141–170 (2011); Stephen J. Brown, Bruce D. Grundy, Craig M. Lewis and Patrick Verwijmeren, *Convertibles and Hedge Funds as Distributors of Equity Exposure*, 25 REV. FIN. STUD. 3077–3112 (2012).

believe that competition among crowdfunding venues and the potential development of new products and services may have a significant impact on these estimates over time.

The next major cost driver for issuers in securities-based crowdfunding offerings, as suggested by commenters, is the cost of preparing and filing disclosure documents and the internal burden of ensuring compliance with the disclosure requirements of the final rules. Issuers will incur costs to comply with the disclosure requirements and file the information in the new Form C: Offering Statement and Form C-U: Progress Update before the offering is funded. Thus, issuers will incur those costs regardless of whether their offerings are successful. In addition, for successful offerings, issuers will incur costs to comply with the ongoing reporting requirements and file information in the new Form C-AR: Annual Report.[1374]

Several commenters provided estimates of these costs. One commenter stated that Form C could be prepared by third-party service providers, such as itself, at much lower costs than those estimated by the Commission, noting that it can prepare Form C and other required disclosure documents, perform "bad actor" checks, verify investor status and fulfill other compliance requirements for an estimated total cost of $2,500 for an offering of $100,000 and that, in most cases, its services and associated legal fees will cost an issuer between $2,500 and $5,000 for an offering up to $500,000 and between $5,000 and $10,000 for an offering between $500,000 and $1,000,000.[1375]

Other commenters indicated that the compliance costs for issuers are likely to be higher than the Commission's estimates. One commenter indicated that the burden of completing Form C would likely exceed the 60 burden hours estimated by the Commission in the proposed rules

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1374 *See* Rule 203(b) of Regulation Crowdfunding. *See also* Section II.B.3 above.

1375 *See* FundHub Letter 2.

and that the sum of attorney and accounting fees and management and administrative time and other costs to prepare these required disclosures will likely exceed $10,500, except in cases of start-ups with no operating history.[1376] The commenter also noted that most Regulation D offerings, which tend to be less complex than crowdfunding offerings, based on the requirements in the proposed rules, incur accounting and legal fees above $2,500.[1377] Another commenter noted that issuers and intermediaries will likely incur higher attorney and accounting fees and financial and administrative burdens than estimated in the proposed rules but did not provide estimates.[1378]

One commenter submitted several estimates of the compliance costs associated with the final rules' disclosure requirements. In one comment letter, the commenter estimated the upfront compliance costs of the proposed rules to be potentially hundreds of hours in internal company time and $20,000 to $50,000 in outside professional costs and noted that such costs will likely be a significant deterrent to crowdfunding.[1379] In a different comment letter,[1380] this commenter stated that, based on an informal survey of potential vendors, it believes the costs of preparing a Form C-AR would range from $6,000 to $20,000, with the median being roughly $10,000. The commenter[1381] further estimated that an additional $15,000 worth of internal burden per year would be required to prepare Form C-AR and an additional $5,000 to $10,000 worth of internal

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1376 *See* Heritage Letter.

1377 *Id.*

1378 *See* NSBA Letter.

1379 *See* SeedInvest Letter 2.

1380 *See* SeedInvest Letter 1.

1381 *Id.*

burden would be required to prepare financial statements. In yet another comment letter,[1382] this commenter estimated the cost of ongoing disclosure obligations and ongoing requirements to file financial statements under the proposed rules to be upwards of $10,000 to $40,000 per year.

Based on these comments, we have revised our estimates of the compliance costs associated with the disclosure requirements of the final rules and Forms C and C-AR. On the lower end of the spectrum, one commenter suggested that the cost of preparing and filing these forms and the associated compliance costs would range from $3,000 to $9,000.[1383] Another commenter estimated preparation and compliance costs of $2,500 for an offering of $100,000, between $2,500 and $5,000 for an offering between $100,000 and $500,000, and between $5,000 and $10,000 for an offering between $500,000 and $1,000,000.[1384] We rely on this commenter's estimates of the costs of preparing and filling Form C for offerings of up to $100,000 and offerings between $100,000 and $500,000. Another commenter presented higher estimates, ranging from $6,000 to $20,000, with a median cost of $10,000, but did not provide estimates for different offering sizes.[1385] Given commenters' estimates, we think that the $6,000 to $20,000 estimate is more appropriate for larger offerings (of more than $500,000). Thus, to estimate the costs of preparing, filing, and complying with Form C for large offerings, we combine the cost ranges provided by the two commenters for these types of offerings, resulting in a cost estimate between $5,000 and $20,000. As in the Proposing Release, we estimate that the cost of preparing and complying with the requirements related to Form C-AR will be approximately two-thirds of that for Form C. We base this estimate on the fact that no offering-specific information will be

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[1382] *See* SeedInvest Letter 4.

[1383] *See* StartEngine Letter 2.

[1384] *See* FundHub Letter 2.

[1385] *See* SeedInvest Letter 1.

required in Form C-AR and issuers may thus be able to update disclosure previously provided on Form C. Our estimates of the costs of Forms C and C-AR are exclusive of the costs of an accounting review or audit, which are discussed separately below.

We expect that the cost of preparing and filing Forms C and C-AR will vary based on the characteristics of issuers, but we do not have the information to quantify such variation. For example, issuers with little operating activity may have less to disclose than issuers with more complex operations. Further, some issuers may rely to a greater extent on the services of outside professionals in preparing the required filings,[1386] while other issuers may choose to prepare and file the required forms without seeking the assistance of outside professionals.[1387] We also recognize the possibility that many if not all of the filing requirements may ultimately be performed by funding portals on behalf of issuers using their platforms.

The other significant cost for crowdfunding issuers, as identified by commenters, is the cost of an independent accounting review or audit. As discussed above, reviewed financial statements will be required in offerings of more than $100,000 but not more than $500,000, unless the issuer has audited statements otherwise available. Audited financial statements are required in offerings of more than $500,000.

In a change from the proposal, issuers that have not previously sold securities in reliance on Section 4(a)(6) will be permitted to provide reviewed financial statements in offerings of more than $500,000 but not more than $1,000,000, unless the issuer has audited statements otherwise available. This change is expected to greatly reduce the initial costs associated with providing

[1386] *See, e.g.*, McGladrey Letter (suggesting that issuers that are startups may rely on outside professional services to a greater extent, which would increase costs).

[1387] For purposes of the PRA, we estimate that, for the average issuer, 25 percent of the burden associated with preparing and filing Form C and Form C-AR will be carried by outside professionals. *See* Section IV.C.1.a below.

financial statements for first-time crowdfunding issuers offering more than $500,000 but not more than $1,000,000. According to one commenter, the difference in cost for reviewed versus audited financial statements could easily run into tens of thousands of dollars.[1388]

Some commenters argued that the cost of reviewed or audited financial statements of startup companies, which is the type of companies expected to use Regulation Crowdfunding, would be lower than our estimates because such companies would be less complex and because a competitive industry would develop to support the compliance and disclosure needs of securities-based crowdfunding issuers.[1389] Commenters provided estimates for the cost of an accounting review of financial statements that generally ranged from $1,500 – $10,000.[1390] One commenter suggested that the cost of an accounting review is approximately 60% of the cost of an audit.[1391] Consistent with this comment, we also use an alternative way to estimate the cost of an accounting review: indirectly, from the cost of an audit.

Commenters provided several estimates of the cost of an audit for securities-based crowdfunding issuers, most of which ranged from $2,500 to $10,000.[1392] Other commenters,

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[1388] *See* FundHub Letter 1. The comment letter also cites the commenter's article, which notes that "while a review could be in the range of $1000 in some cases, a formal audit by a CPA typically starts at $5,000 and could be much more." *See* Kendall Almerico, *Has The SEC Made Equity Crowdfunding Economically Unfeasible?* CROWDFUND INSIDER (Nov. 21, 2014), *available* at http://www.crowdfundinsider.com /2013/11/26291-sec-made-equity-crowdfunding-economicallyunfeasible.

[1389] *See, e.g.,* CrowdFunding Network Letter; dbb*mckennon* Letter; Denlinger Letter 2; FundHub Letter 2; Holm Letter; StartEngine Letter 1; StartEngine Letter 2.

[1390] *See, e.g.,* Grassi Letter (estimating the cost of accounting review for a $200,000 offering as $8,000); NPCM Letter (suggesting that the minimum cost to obtain an audit, or even a review, would be $5,000); StartEngine Letter 1 (estimating accounting review and audit costs of $1,500 – $10,000 for smaller, newer companies); StartEngine Letter 2 (estimating accounting review costs of $1,950 – $9,000).

[1391] *See* Traklight Letter.

[1392] *See, e.g.,* dbb*mckennon* Letter (estimating audit costs of $4,000 – $9,000 for new companies with limited historical operations); Denlinger Letter 2 (noting that audit costs may be in the range of $2,000 – $4,000 for a pre-revenue startup); FundHub Letter 2 (noting the emergence of CPA firms willing to perform a complete audit for a startup for $2,500 or less); NPCM Letter (suggesting that the minimum cost to obtain an audit, or even a review, would be $5,000); StartEngine Letter 1 (estimating accounting review and audit costs of

however, provided higher annual audit cost estimates of up to $20,000 – $30,000.[1393] Based on a compilation of audit fee data from reporting companies for fiscal year 2014, the average cost of an audit for an issuer with less than $1 million in market capitalization and less than $1 million in revenues is approximately $20,000.[1394] We estimate the audit cost to be approximately $2,500 to $30,000. In the Proposing Release, we estimated the audit cost to be $28,700, which falls within this range. Assuming that, as suggested by one commenter,[1395] the accounting review cost is approximately 60% of the audit cost, this range of audit costs yields an estimate of the accounting review cost of approximately $1,500 to $18,000. In the Proposing Release, we estimated the accounting review cost to be $14,350, which falls within this range. Estimates of the cost of an accounting review that we received from commenters also fall within this range. In light of the wide range of estimates provided by commenters for the cost of a review or audit of financial statements, we use in this release a range of estimates ($1,500 – $18,000 for the accounting review cost and $2,500 – $30,000 for the audit cost) instead of a single point estimate for these anticipated costs for offerings.

$1,500 – $10,000 for smaller, newer companies); StartEngine Letter 2 (estimating audit costs of $3,100 – $9,000).

1393 *See, e.g.,* Frutkin Letter (suggesting a "rough estimate of $30,000 per audit"); Graves Letter (suggesting that audit costs can be upwards of $18,000 to $25,000); Startup Valley Letter (suggesting that audit fees can be up to $10,000 for small startups with no financials and can exceed $20,000 for companies that have been in business for a few years); Traklight Letter (suggesting that audit costs can be up to $20,000).

1394 *See Audit Analytics, Auditor-Fees, available at* http://www.auditanalytics.com/0002/audit-data-company.php. The auditor fee database contains fee data disclosed by Exchange Act reporting companies in electronic filings since January 1, 2001. For purposes of our calculation, we averaged the auditor fee data for companies with both market capitalization and revenues of greater than zero and less than $1 million (the smallest subgroup of companies for which data is compiled). We note that the cost of an audit for many issuers conducting a securities-based crowdfunding offering in reliance on Section 4(a)(6) is likely to be lower than for the subset of Exchange Act reporting companies referenced above, because they likely would be at an earlier stage of development than issuers that file Exchange Act reports with us and, thus, could be less complex to audit.

1395 *See* Traklight Letter.

As discussed below, in a change from the proposal, the final rules do not require issuers to provide reviewed or audited financial statements in the annual report, unless such statements are otherwise available, which is expected to yield cost savings on an annual basis compared with the proposal.

The table below presents the main adjusted cost estimates for the final rules.[1396]

	Offerings of $100,000 or less	Offerings of more than $100,000, but not more than $500,000	Offerings of more than $500,000
Fees paid to the intermediary[1397]	$2,500 – $7,500	$15,000 – $30,000	$37,500 – $56,250
Costs per issuer for preparation and filing of Form C for each offering and related compliance costs	$2,500	$2,500 – $5,000	$5,000 – $20,000
Costs per issuer for preparation and filing of annual report on Form C-AR[1398] and related compliance costs	$1,667	$1,667 – $3,333	$3,333 – $13,333

1396 In addition to the compliance costs outlined in the table, issuers also will incur costs to (1) obtain EDGAR access codes on Form ID; (2) prepare and file progress updates on Form C-U; and (3) prepare and file Form C-TR to terminate ongoing reporting. These additional compliance costs are discussed further below. In addition, for purposes of the Paperwork Reduction Act ("PRA"), we provide burden estimates for each of these filings obligations in Section IV.C.1, below.

1397 For purposes of the table, we estimate the range of fees that an issuer would pay the intermediary assuming the following: (1) the fees would be calculated as a percentage of the offering amount ranging from 5% to 15% of the total offering amount for offerings of $100,000 or less, 5% to 10% for offerings between $100,000 and $500,000, and 5% to 7.5% for offerings of more than $500,000; and (2) the issuer is offering $50,000, $300,000 and $750,000, which are the mid-points of the offering amounts under each of the respective columns. The fees paid to the intermediary may, or may not, cover services to an issuer in connection with the preparation and filing of the forms identified in this table.

1398 As noted above, we estimate that these costs are approximately two-thirds of the costs for preparation and filing of Form C.

Costs per issuer for review or audit of financial statements	Not required	\$1,500 – \$18,000	\$2,500 – \$30,000 (\$1,500 – \$18,000 for first-time issuers raising more than \$500,000 but not more than \$1,000,000[1399])

We do not have additional data on the costs likely to be incurred by crowdfunding issuers to prepare the required disclosures beyond the information discussed above. Overall, we recognize that cost estimates may vary from issuer to issuer and from service provider to service provider. However, even with the additional accommodations provided in the final rules, the costs of compliance may be significant for some issuers.

b. General Disclosure Requirements

The statute and the final rules related to issuer disclosures are intended to reduce the information asymmetries that currently exist between small businesses and investors. Small private businesses typically do not disclose information as frequently or as extensively as public companies, if at all. Moreover, unlike public companies, small private businesses generally are not required to hire an independent accountant to review financial statements. When information about a company is difficult to obtain or the quality of the information is uncertain, investors are at risk of making poorly-informed investment decisions about that company.

Such information asymmetries may be especially acute in the securities-based crowdfunding market because the market includes startups and small businesses that have significant risk factors and other characteristics that may have led them to be rejected by other potential funding sources, including banks, VCs and angel investors. In addition, the securities-

[1399] First-time crowdfunding issuers within this offering range will be permitted to provide reviewed financial statements.

based crowdfunding market may attract unsophisticated investors who may not have the resources necessary to gather and analyze information about issuers before investing or to effectively monitor issuers after investing. Moreover, investment limits in securities-based crowdfunding offerings in reliance on Section 4(a)(6) will likely lead to investors having smaller stakes in the firm, which may reduce their incentives to monitor or gather information for a given investor. These considerations may give rise to adverse selection and moral hazard in offerings in reliance on Section 4(a)(6). For instance, some issuers may use capital to fund riskier projects than what was disclosed to investors, or they may not pursue their stated business objectives. If investors in securities-based crowdfunding have limited information about issuers or a limited ability to monitor such issuers, they may seek higher returns for their investment or choose to withdraw from the securities-based crowdfunding market altogether, which would increase the cost of capital to issuers and limit the capital formation benefits of the final rules. In addition, investors in offerings made in reliance on Section 4(a)(6) may make relatively small investments, due in part to the application of investment limitations. This potential dispersed investor base may make it difficult for investors to solve collective action problems in monitoring the issuer.

The statute and the final rules seek to reduce information asymmetries by requiring issuers to file specified disclosures with the Commission for offerings made in reliance on Section 4(a)(6) during the offering and on an annual basis thereafter.[1400] Issuers also are required to provide these disclosures to investors and, in the case of offering documents, to investors and the relevant intermediary. The disclosure requirements, which are described above,[1401] are more extensive than those required under some other existing exemptions from registration. For example,

[1400] *See* Section 4A(b). *See also* Rules 201, 202 and 203 of Regulation Crowdfunding.

[1401] *See* Section II.B.1 above.

although the current requirements of Tier 1 Regulation A offerings include similar initial financial disclosures, issuers in Tier 1 offerings are not required to file ongoing reports.[1402] Issuers using the Rule 504 exemption under Regulation D to raise up to $1 million are not required to provide audited financial statements, and there are no periodic disclosure requirements. Regulation D offerings under Rules 505 and 506 for up to $2 million require issuers to provide audited current balance sheets (and unaudited statements of income, cash flows and changes in stockholders' equity) to non-accredited investors, but there are no periodic reporting requirements. The disclosure requirements in Regulation Crowdfunding are expected to benefit investors by enabling them to better evaluate the issuer and the offering, monitor how the issuer is performing over time and be aware of when the issuer may terminate its ongoing reporting obligations. This will allow investors with various risk preferences to invest in the offerings best suited for their risk tolerance, thus improving allocative efficiency.

The disclosure requirements also may improve informational efficiency in the market. Specifically, the required disclosure may provide investors with a useful benchmark to evaluate the issuer and compare the issuer to other private issuers both within and outside of the securities-based crowdfunding market.[1403] Additionally, disclosure by issuers engaging in crowdfunding transactions in reliance on Section 4(a)(6) may inform financial markets more generally about

[1402] However, issuers in Tier 1 Regulation A offerings are required to provide information about sales in such offerings and to update certain issuer information by electronically filing a Form 1-Z exit report with the Commission not later than 30 calendar days after the termination or completion of an offering. Further, Tier 1 offerings must be qualified by the Commission and are subject to state registration requirements. Issuers in Tier 2 offerings are subject to annual, semiannual and current reporting requirements. *See Regulation A Adopting Release.*

[1403] *See* Christian Leuz and Peter Wysocki, *Economic Consequences of Financial Reporting and Disclosure Regulation: A Review and Suggestions for Future Research*, (Working Paper, University of Chicago) (2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1105398.

new consumer trends and new products, thus creating externalities that benefit other types of investors and issuers.

We recognize, however, that the disclosure requirements also will have associated limitations and costs, including the direct costs of preparation, certification, independent accounting review (when necessary) and dissemination of the disclosure documents. As noted above, the disclosure requirements for offerings made in reliance on Section 4(a)(6) are more extensive, in terms of breadth and frequency, than those for other exempt offerings. The statute also provides us with the discretion to impose additional requirements on issuers engaging in crowdfunding transactions, and in some cases, the final rules require issuers to disclose information beyond what is specifically mandated by the statute.[1404] We recognize that these additional discretionary disclosure provisions may impose additional compliance costs on issuers compared with the proposal. However, we believe these provisions will improve investor decision-making and may ultimately benefit issuers by improving price efficiency in the securities-based crowdfunding market. Although requiring less disclosure could impose lower compliance costs, we believe that the disclosure requirements we are adopting appropriately consider the need to enhance the ability of issuers relying on Section 4(a)(6) to raise capital while enabling investors to make informed investment decisions. In response to the suggestion by some commenters that issuers not be required to disclose information in multiple places,[1405] under the final rules, an issuer is not required to repeat disclosure that is already provided in the issuer's financial statements. This may help to mitigate the cost of compliance for issuers.

[1404] *See* Section 4A(b)(5). *See also* Section II.B.1.a.i(g) for a description of the additional disclosure requirements.

[1405] *See, e.g.*, EY Letter (noting that certain required disclosure would be included in an issuer's financial statements); Grassi Letter (same).

We note that the disclosure requirements may have indirect costs to the extent that information disclosed by issuers relying on Section 4(a)(6) can be used by their competitors, resulting in a potential loss of a competitive advantage or intellectual property, particularly for high-growth issuers and issuers engaged in significant research and development. Requiring significant levels of disclosure at an early stage of an issuer's lifecycle may affect an issuer's competitive position and may limit the use of the exemption in Section 4(a)(6) by issuers who are especially concerned with confidentiality. These disclosure costs also may make other types of private offerings more attractive to potential securities-based crowdfunding issuers. For example, the 2013 changes to Rule 506 of Regulation D,[1406] which allow for general solicitation, subject to certain conditions, may make it a more attractive option for small business financing and, thus, may divert potential issuers from crowdfunding.

In addition, under the statute and the final rules, issuers that complete a crowdfunding offering in reliance on Section 4(a)(6) are subject to ongoing reporting requirements,[1407] which will increase compliance costs. The ongoing reporting, however, may provide a liquidity benefit for secondary sales of securities issued in crowdfunding transactions and make the prices of such securities more informationally efficient, should a secondary market develop.

c. Financial Condition and Financial Statement Disclosure Requirements

Consistent with the statute, the final rules require narrative disclosure about the issuer's financial condition, including, to the extent material, liquidity, capital resources and the issuer's historical results of operations.[1408] We expect that this discussion will inform investors about the

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1406 *See Rule 506(c) Adopting Release*, note 5.

1407 *See* Rule 202 of Regulation Crowdfunding.

1408 *See* Rule 201(s) of Regulation Crowdfunding. *See also* Section II.B.1.a.(ii)(a) above.

financial condition of the issuer, without imposing significant costs on issuers, because issuers likely will already have such information readily available. In addition, the final rules do not prescribe the content or format for this information.

With respect to the requirement to provide financial statements, the final rules implement tiered financial disclosure requirements based on the aggregate amount of securities offered and sold in reliance on Section 4(a)(6) during the preceding 12-month period, inclusive of the offering amount in the offering for which disclosure is being provided.[1409] The disclosure requirements will provide investors with more information than might otherwise be obtained in private offerings, but also may create additional costs for those issuers that have limited financial and accounting expertise necessary to produce the financial disclosures envisioned by the statute and the final rules.

The final rules, consistent with the proposed rules, require issuers to provide a complete set of their financial statements (balance sheets, statements of comprehensive income, statements of cash flows and statement of changes in stockholders' equity) that are prepared in accordance with U.S. GAAP and cover the shorter of the two most recently completed fiscal years or the period since inception.[1410] We could have chosen an alternative that allows financial statements to be prepared in accordance with other comprehensive bases of accounting, as some commenters suggested.[1411] Such an alternative may have mitigated costs for some issuers, especially those

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1409 *See* Rule 201(t) of Regulation Crowdfunding. *See also* Section II.B.1.a.(ii)(b) above.

1410 *See* Instruction 3 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

1411 *See, e.g.*, ABA Letter (for offerings of $100,000 or less, but stating that the Commission could require providing U.S. GAAP financial statements if available); AICPA Letter; CFIRA Letter 5; CFIRA Letter 7; CrowdCheck Letter 4; EarlyShares Letter; EY Letter (for offerings of $100,000 or less, unless U.S. GAAP financial statements are available); Grassi Letter; Graves Letter (for issuers with less than $5 million in revenue); Mahurin Letter (stating that simple Excel spreadsheets accompanied by bank records should meet the financial statement requirements); Milken Institute Letter (for early-stage issuers); NFIB Letter; SBEC

smaller issuers that historically have prepared their financial statements in accordance with other comprehensive bases of accounting rather than U.S. GAAP. However, as we discussed above, this alternative would reduce the comparability of financial statements across issuers and might not provide investors with a fair representation of a company's financial position and results of operations. Further, it may be difficult for investors to determine whether the issuer complied with such basis of accounting.[1412]

The final rules also specify that an issuer may conduct an offering in reliance on Section 4(a)(6) using financial statements for the fiscal year prior to the most recently completed fiscal year, provided that not more than 120 days have passed since the end of the issuer's most recently completed fiscal year, and financial statements for the most recently completed fiscal year are not otherwise available.[1413] This may impose a cost on investors to the extent that the investors do not have more current financial information about the issuer. However, this concern is somewhat mitigated by the requirement that issuers include a discussion of any material changes or trends known to management in the financial condition and results of operations subsequent to the period for which financial statements are provided.[1414]

Requiring financial statements covering the two most recently completed fiscal years is expected to benefit investors by providing a basis for comparison against the most recently completed fiscal year and by allowing investors to identify changes in the development of the business. Compared to an alternative that we could have selected, that of requiring financial

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Letter; StartupValley Letter; Tiny Cat Letter (for offerings of less than $500,000); Whitaker Chalk Letter (for offerings of less than $500,000 if the issuer has an asset or income level below a certain level).

1412 *See* Section II.B.1.a.(ii)(b) above.

1413 *See* Instruction 10 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

1414 *See* Rule 201(s) of Regulation Crowdfunding.

statements covering only the most recently completed fiscal year, as some commenters suggested,[1415] requiring a second year of financial statements will to some degree increase the cost for the issuer. Also, to the extent that the issuer had little or no operations in the prior year, the benefit of comparability may not be realized. We recognize that many crowdfunding issuers may not have any financial history, and investors may make investment decisions without a track record of issuer performance, relying largely on the belief that an issuer can succeed based on their business plan and other factors. Nevertheless, for those issuers that do have a financial history, we believe this disclosure can contribute to better informed investment decisions and improve the overall allocative efficiency of the securities-based crowdfunding market.

For offerings of $100,000 or less, the final rules require the issuer to provide financial statements that are certified by the principal executive officer to be true and complete in all material respects.[1416] The final rules include a form of certification for the principal executive officer to provide in the issuer's offering statement, which we believe will help issuers comply with the certification required by the statute and the final rules.[1417] However, if reviewed financial statements or audited financial statements are otherwise available, they must be provided.[1418]

The proposed rules would have required income tax returns for the most recently completed year (if any). In a change from the proposed rules, consistent with the suggestions of some commenters and to respond to privacy concerns,[1419] the final rules do not require complete

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1415 *See, e.g.*, Denlinger Letter 1; EY Letter; Fryer Letter; Grassi Letter; Joinvestor Letter; Public Startup Letter 2; RFPIA Letter; RocketHub Letter.

1416 *See* Section 4A(b)(1)(D)(i). *See also* Rule 201(t)(1) of Regulation Crowdfunding.

1417 *See* Instruction 4 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

1418 *See* Rule 201(t)(1) of Regulation Crowdfunding.

1419 *See, e.g.*, AICPA Letter (stating that disclosure of an issuer's tax return "...has the potential to cause serious problems. Tax returns are intended to be confidential and should remain so."); Public Startup Letter 2;

tax returns and instead require that an issuer disclose its total income, taxable income and total tax, or the equivalent line items from the applicable form, and have the principal executive officer certify that those amounts reflect accurately the information in the issuer's federal income tax returns.[1420] We believe that the requirement to provide selected items from the return, rather than the return itself, will alleviate some of the privacy concerns for issuers. This change may increase record keeping costs for issuers and give rise to potential transcription errors. It also may reduce the amount of information available to investors, but as we noted in the Proposing Release, it is not clear to what extent all of the information presented in a tax return would be useful for an investor evaluating whether or not to purchase securities from the issuer. Finally, although principal executive officers will incur some incremental liability for their certification that these amounts reflect accurately the information in the issuer's federal income tax return, we do not expect this change from the proposal to impose substantial additional costs on officers or issuers given the limited scope of the required certification.

Moreover, the final rules specify that if an issuer is offering securities in reliance on Section 4(a)(6) before filing a tax return for the most recently completed fiscal year, the issuer may use information from the tax return filed for the prior year, on the condition that the issuer provides information from the tax return for the most recently completed fiscal year when it is filed, if it is filed during the offering period.[1421] This accommodation is expected to benefit issuers by enabling them to engage in transactions during the time period between the end of their

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RocketHub Letter; SBM Letter; Wilson Letter (suggesting that personal income tax information should be on a voluntary basis only); Zhang Letter.

[1420] *See* Rule 201(t)(1) of Regulation Crowdfunding.

[1421] *See* Instruction 6 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

fiscal year and when they file their tax return for that year. This may impose a cost on investors because they might not receive the most up-to-date tax information about the issuer.

The proposed rules would have required financial statements for offerings exceeding $100,000 but not exceeding $500,000 to be reviewed by a public accountant independent of the issuer and financial statements for offerings exceeding $500,000 to be audited by a public accountant independent of the issuer. The final rules specify that the required financial statements must be reviewed by a public accountant that is independent of the issuer for offerings exceeding $100,000 but not exceeding $500,000.[1422] If, however, financial statements of the issuer are available that have been audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead and need not include the reviewed financial statements.[1423]

Similar to the proposal, issuers in offerings exceeding $500,000 must provide audited financial statements. In a change from the proposal, the final rules specify that issuers that have not previously sold securities in reliance on Section 4(a)(6) and are conducting offerings with a target offering amount exceeding $500,000 but not exceeding $1,000,000 can provide reviewed financial statements, unless audited financial statements are otherwise available.[1424] Audited financial statements can benefit investors in evaluating offerings by issuers with substantive prior business activity by providing them with potentially higher-quality financial statements. However, as noted by a number of commenters[1425] and discussed above, requiring audited

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1422 *See* Rule 201(t)(2) of Regulation Crowdfunding.

1423 *Id.*

1424 *See* Rule 201(t)(3) of Regulation Crowdfunding. *See also* Section II.B.1.a.ii.

1425 *See, e.g.*, AEO Letter; Angel Letter 1; AWBC Letter; CFIRA Letter 5; CfPA Letter; CrowdFundConnect Letter; EarlyShares Letter; EMKF Letter; EY Letter; Finkelstein Letter; FundHub Letter 1; Generation Enterprise Letter; Grassi Letter; Graves Letter; Guzik Letter 1; Hakanson Letter; Holland Letter; Johnston

financial statements could significantly increase the cost to issuers compared to requiring reviewed financial statements.[1426] Further, for issuers that are newly formed, with no or very limited operations, and for small issuers, the benefit of the audit may not justify its cost.

As discussed above,[1427] the approach in the final rules of requiring reviewed financial statements rather than audited financial statements, unless otherwise available, for first-time crowdfunding issuers that undertake offerings of more than $500,000 but not more than $1,000,000 is expected to reduce the costs associated with financial statements for such first-time issuers compared to the proposed requirement of audited financial statements for all issuers in offerings of more than $500,000. This accommodation is expected to alleviate the significant upfront cost of an audit for first-time issuers that have not yet raised capital in a crowdfunding offering and may be more financially constrained. To the extent that their financing needs have not been met through alternative financing methods, first-time crowdfunding issuers are likely to be more financially constrained than issuers that have already established a track record of successful crowdfunding offerings. We recognize, however, that there are costs associated with this accommodation. Not requiring audited financial statements for offerings of more than $500,000 but not more than $1,000,000 by first-time issuers may reduce the quality of financial disclosure, which may be a more significant concern for new crowdfunding issuers due to the fact that their more limited track record may translate into a higher level of information asymmetry between issuers and investors. The potentially reduced quality of financial disclosure associated

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Letter; Kickstarter Coaching Letter; McGladrey Letter; Milken Institute Letter; NACVA Letter; NFIB Letter; NPCM Letter; NSBA Letter; PBA Letter; Reed Letter; RocketHub Letter; Saunders Letter; SBA Office of Advocacy Letter; SBEC Letter; SBM Letter; Seyfarth Letter; Verrill Dana Letter; WealthForge Letter; Wefunder Letter; Woods Letter; Zeman Letter.

[1426] *See also* Section III.B.3.a.

[1427] *Id.*

with offerings of more than $500,000 by first-time issuers may affect the likelihood of detecting fraud, which would decrease investor protection. To the extent that investors anticipate such increased risks, issuers may face a higher cost of capital or be unable to raise the entire amount offered, which would diminish the capital formation benefits of the final rule. We note that some first-time issuers in offerings of more than $500,000 but not more than $1,000,000may have audited statements otherwise available, which could partly mitigate the described effects. We also note that some first-time issuers concerned about investor confidence in the quality of their financial statements may voluntarily provide audited financial statements.

Tiered disclosure requirements aim to partially mitigate the impact of the fixed component of compliance costs on issuers in smaller securities-based crowdfunding offerings. However, it is possible that the thresholds may have an adverse competitive effect on some issuers. For example, the cost of reviewed financial statements may cause issuers in offerings exceeding but close to $100,000 to incur significantly higher offering costs as a percentage of the amount offered compared to issuers offering less than but close to $100,000. Similarly, the cost of audited financial statements may cause issuers in follow-on crowdfunding offerings exceeding but close to $500,000 to incur significantly higher offering costs as a percentage of the amount offered compared to issuers in offerings of less than but close to $500,000. We note, however, that the issuer has the ability to select its offering amount, and since the choice of offering amount determines which financial statement requirements will apply to its offering, the issuer, by choosing its offering amount, effectively also chooses its financial statement requirements.

We considered the alternative of exempting issuers with no operating history or issuers that have been in existence for fewer than 12 months from the requirement to provide financial statements. We believe that financial statements contain valuable information that can aid

investors in making better informed decisions, particularly, when evaluating early-stage issuers characterized by a high degree of information asymmetry. We also expect that other accommodations in the final rules will help alleviate some of these issuer compliance costs.

Similar to the proposed rules, financial statements must be reviewed in accordance with SSARS issued by the AICPA.[1428] Although we could have chosen to develop a new review standard for purposes of the final rules, we believe that issuers will benefit from using the AICPA's widely-utilized review standard. We believe that many accountants reviewing financial statements of issuers raising capital in reliance on Section 4(a)(6) are familiar with the AICPA's standards and procedures for review, which should help to partly mitigate review costs.

As described above, the final rules require certain financial statements to be reviewed or audited by a public accountant that is independent of the issuer.[1429] In a change from the proposed rules, the final rules permit the use of independence standards set forth in Rule 2-01 of Regulation S-X or the independence standards of the AICPA.[1430] This change to allow the use of AICPA standards may reduce issuer compliance costs to the extent that there are higher costs associated with engaging an accountant that satisfies the independence standards set forth in Rule 2-01 of Regulation S-X. The change also will increase the number of public accountants able to perform the reviews or audits, which may lead to a decrease in the price of their services and thus a decrease in the direct issuance costs to issuers compared with the proposal. The benefit from this change will accrue to issuers making offerings of $100,000 to $1,000,000. To the extent that the AICPA independence standards impose fewer restrictions with respect to potential conflicts of

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[1428] *See* Rule 201(t)(2) of Regulation Crowdfunding. *See also* Instruction 8 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

[1429] *See* Section II.B.1 above.

[1430] *See* Instruction 10 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

interest than the independence standards in Rule 2-01 of Regulation S-X, however, this accommodation may weaken investor protection. Moreover, any decrease in investor confidence in the reliability of financial statements as a result of this change will limit the capital formation benefits of the final rules.

In addition, the final rules require an issuer to file a signed review report or audit report, whichever is applicable, and notify the public accountant of the issuer's intended use of the report in the offering.[1431] This can impose an additional cost on issuers to the extent that the accountant or auditor increases the fee associated with the review or audit to compensate for any additional liability that may result from the requirement to file the report. As discussed above,[1432] in a change from the proposal, the final rules do not permit qualified audit reports. This change may impose an additional cost on issuers, which we are not able to quantify. However, this change is expected to provide investors with more reliable financial statements, which should enable investors to better evaluate the prospects of issuers relying on Section 4(a)(6) and thus make better informed investment decisions. By providing investors with a greater degree of confidence in the reliability of the financial information, audited financial statements will reduce the information asymmetry about the issuer's financial condition that exists between issuers and potential investors. This decrease in information asymmetry may lead to greater capital formation.

In a change from the proposed rules, the final rules do not require financial statements in the annual report that meet a standard of review equal to the highest standard provided in a prior offering.[1433] The final rules require an annual report to include financial statements of the issuer

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1431 *See* Instructions 8 and 9 to paragraph (t) of Rule 201 of Regulation Crowdfunding.

1432 *See* Section II.B.1.a.(ii)(b) above.

1433 *See* Section II.B.2.c above.

to be certified by the principal executive officer of the issuer as true and complete in all material respects.[1434] Issuers that otherwise have available financial statements that have been reviewed or audited by an independent certified public accountant, must provide them and will not be required to have the principal executive officer certification.[1435] As discussed above, these changes will reduce the compliance costs to issuers compared with the proposal.[1436] At the same time, they may reduce the quality of the ongoing financial statements, resulting in a potential decrease in investor protection and investor confidence in the quality of these financial statements. We note that some issuers may have reviewed or audited financial statements otherwise available, which would partly mitigate this concern. In addition, an issuer is able to voluntarily provide financial statements that meet a higher standard, so if an issuer is concerned about investor confidence in the quality of financial statements, it can choose to provide reviewed or audited financial statements.

d. Issuer Filing Requirements

As discussed above, issuers will incur costs to prepare and file the various disclosures required under Regulation Crowdfunding.[1437] The statute requires issuers to file and provide to investors certain specified information at the time of offering, such as information about the issuer, officers and directors, and certain shareholders, a description of the business, a description of the purpose and intended use of proceeds, target offering amount and the deadline to reach it, offering price (or the method for determining the price) and other terms of the offering, a

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1434 *See* Rule 202(a) of Regulation Crowdfunding.

1435 *Id.*

1436 *See* Section III.B.3.a. above.

1437 *See* Section III.B.3.a. above.

description of the financial condition of the issuer, as well as certain other disclosures.[1438] These disclosure requirements are expected to strengthen investor protection and enable investors to make better informed investment decisions. The statute does not specify a format that issuers must use to present the required disclosures to the Commission. As noted above, the final rules require issuers to file the mandated disclosure on EDGAR using new Form C.[1439]

Form C requires certain disclosures to be submitted using an XML-based filing,[1440] while allowing the issuer to customize the presentation of other required disclosures. This approach provides issuers with the flexibility to present the required disclosures in a cost-effective manner, while also requiring the disclosure of certain key offering information in a standardized format, which we believe will benefit investors and help facilitate capital formation.

We expect that requiring certain disclosures to be submitted using XML-based filings will produce benefits for issuers, investors and the Commission. For instance, using information filed pursuant to these requirements, investors can track capital generated through crowdfunding offerings without manually inspecting each filing. The ability to efficiently collect information on all issuers also can provide an incentive for data aggregators or other market participants to offer services or analysis that investors can use to compare and choose among different offerings. For example, reporting key financial information using XML-based filings will allow investors, analysts and data aggregators to more easily compile, analyze and compare information about the capital structure and financial position of various issuers. XML-based filings also will provide the Commission with data about the use of the new crowdfunding exemption that will allow the

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1438 *See* Rule 201 of Regulation Crowdfunding. *See also* Section II.B.1 above.

1439 *See* Rule 203(a) of Regulation Crowdfunding. *See also* Section II.B.3 above.

1440 *See* Instruction to paragraph (a)(1) of Rule 203 of Regulation Crowdfunding. *See also* Section II.B.3 above.

Commission to evaluate whether the rules implementing the exemption include appropriate investor protections and are effectively facilitating capital formation.

Certain provisions of the filing requirements in the final rules provide flexibility and potentially reduce the compliance burden compared with the proposal. The final rules allow issuers to customize the presentation of their non-XML disclosures and file those disclosures as exhibits to Form C in PDF format as official filings, consistent with the suggestions of some commenters.[1441] In addition, the final rules include an optional Question and Answer ("Q&A") format that issuers may opt to use to provide the disclosures that are not required to be filed in XML format.[1442] Relative to some other possible formats, this Q&A format may facilitate the preparation of the Form C disclosures by crowdfunding issuers. To the extent that this provision lowers the compliance cost for issuers, it may encourage greater use of Regulation Crowdfunding for raising capital.

The final rules require that issuers file a Form C-U: Progress Update to describe the progress of the issuer in meeting the target offering amount.[1443] In a change from the proposed rules, based on concerns expressed by commenters, the final rules permit issuers to satisfy the progress update requirement by relying on the relevant intermediary to make publicly available on the intermediary's platform frequent updates about the issuer's progress toward meeting the target offering amount. This change is expected to mitigate some of the direct cost for the issuer without reducing the amount of contemporaneous information available to investors. However, an issuer relying on the intermediary to make publicly available frequent progress updates must still file a

[1441] *See, e.g.*, CFIRA Letter 6; CFIRA Letter 7; CrowdCheck Letter 1; Grassi Letter; Hackers/Founders Letter; RocketHub Letter; Wefunder Letter; Wilson Letter.

[1442] *See* Item 1 of General Instruction III to Form C.

[1443] *See* Rule 203(a)(3) of Regulation Crowdfunding. *See also* Sections II.B.1.b and II.B.3 above.

Form C-U at the end of the offering to disclose the total amount of securities sold in the offering.[1444] Although the final offering information likely will be available on the registered intermediary's website, having the information available on EDGAR will allow comparisons across platforms and provide ongoing access to historical information for future investor analyses that may otherwise be difficult or impossible to perform by accessing information from each individual portal. We expect the costs of preparing updates on Form C-U to vary among issuers but to be relatively small.[1445]

As noted above, the statute also requires an issuer to file and provide to investors information about the issuer's financial condition on at least an annual basis, as determined by the Commission.[1446] Ongoing disclosure requirements are expected to strengthen investor protection. Ongoing disclosure requirements are also expected to facilitate better informed investment decisions in secondary market transactions and enhance the informational efficiency of prices of crowdfunding securities, should a secondary market for such securities develop. To implement this statutory requirement, the final rules require any issuer that has sold securities in a crowdfunding transaction in reliance on Section 4(a)(6) to file annually with the Commission a new Form C-AR: Annual Report, no later than 120 days after the end of each fiscal year covered by the report.[1447] We believe that annual reports will inform investors in their portfolio decisions and can enhance price efficiency. Moreover, as discussed above, under the statute and the final

[1444] *See* Rule 203(a)(3)(iii) of Regulation Crowdfunding.

[1445] For purposes of the PRA, we estimate that an issuer's compliance with the Form C-U requirement will result, on average, in approximately 0.50 burden hours per issuer. *See* Section IV.C.1.a below.

[1446] *See* Section 4A(b)(4).

[1447] *See* Rule 202(a) of Regulation Crowdfunding. *See also* Section II.B.2 above for a discussion of the disclosure requirements of Form C-AR.

rules, the securities will be freely tradable after one year,[1448] and therefore, this information also will benefit potential future holders of the issuer's securities by enabling them to update their assessments as new information is made available through the annual updates, potentially allowing for more efficient pricing. More generally, these continued disclosures also may help facilitate the transfer of securities in secondary markets after the one-year restricted period ends, which can mitigate some of the potential liquidity issues that are unique to the securities-based crowdfunding market, as discussed above.

As an alternative, we could have added a current reporting requirement, consistent with the view of some commenters that there may be major events that occur between annual reports about which investors would want to be updated.[1449] Such an alternative could result in better informed investment decisions. We are concerned, however, that the benefits of a current reporting requirement may not justify the additional compliance costs associated with such a requirement, especially given the size and early stage of development of the issuers likely to be involved in offerings in reliance on Section 4(a)(6).

Any issuer terminating its annual reporting obligations will be required to file a notice under cover of Form C-TR: Termination of Reporting to notify investors and the Commission that it will no longer file and provide annual reports pursuant to the requirements of Regulation Crowdfunding.[1450] The final rules enable issuers to terminate reporting if: (1) the issuer becomes a reporting company required to file reports under Exchange Act Sections 13(a) or 15(d); (2) the issuer or another party repurchases all of the securities issued pursuant to Securities Act

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1448 *See* Section 4A(e). *See also* Rule 501 of Regulation Crowdfunding.

1449 *See, e.g.*, ABA Letter; Angel Letter 1; Denlinger Letter 1; EY Letter; Grassi Letter; Hackers/Founders Letter; RocketHub Letter.

1450 *See* Rule 203(b)(3) of Regulation Crowdfunding.

Section 4(a)(6), including any payment in full of debt securities or any complete redemption of redeemable securities; or (3) the issuer liquidates or dissolves its business in accordance with state law.[1451] We expect the costs of preparing Form C-TR to vary among issuers but to be relatively small.[1452]

In a change from the proposed rules, after considering the comments, the final rules also permit termination of ongoing reporting in two additional circumstances: (1) the issuer has filed at least one annual report and has fewer than 300 holders of record, or (2) the issuer has filed annual reports for at least the three most recent years and has total assets not exceeding $10,000,000.[1453] This change is expected to mitigate some of the compliance cost for small issuers and make the final rules a more attractive option for capital formation among small issuers, and at the same time, help to ensure that larger issuers with a significant number of investors continue to provide relevant disclosure.

This change may, however, make relevant information about the financial condition of certain issuers no longer available to investors, resulting in less informed investor decisions. This change may affect a large number of securities-based crowdfunding offerings, since it is likely that many crowdfunding issuers will either have fewer than 300 holders of record or assets below $10 million. Termination of ongoing reporting may result in a decrease in investor protection, particularly in the presence of an investor base with a limited degree of sophistication. Allowing issuers to terminate ongoing reporting can make monitoring of the issuer more difficult for investors and can potentially make it more difficult to detect fraud. We note, however, that the

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1451 *See* Rule 202(b) of Regulation Crowdfunding.

1452 For the purposes of the PRA, we estimate that issuers will spend, on average, approximately 1.5 burden hours to complete this task. *See* Section IV.C.1.a below.

1453 *Id.*

investment limits in the final rules serve to limit the amount of each investor's capital that is exposed to these and other risks of securities-based crowdfunding offerings. We further note that the investment amounts involved in these transactions might limit a typical investor's incentives to analyze the information contained in ongoing disclosures and to monitor issuers, even if all issuers are required to provide ongoing disclosures.

Nevertheless, the risk that an issuer in a securities-based crowdfunding offering may terminate ongoing reporting in the future may discourage prospective investors from making an initial investment in offerings in reliance on Section 4(a)(6) or may cause issuers to obtain lower valuations for the securities they offer, which may limit some of the capital formation benefits of the final rules. We note that issuers who believe that increased investor confidence justifies the cost of annual reporting would be able to continue ongoing reporting voluntarily.

Termination of ongoing reporting may also reduce the informational efficiency of prices and secondary market liquidity, making it more difficult for investors to exit their holdings after the expiration of resale restrictions. A lack of ongoing reporting may reduce the likelihood that a secondary market for such securities develops. We recognize, however, that a secondary market for securities in offerings in reliance on Section 4(a)(6) may not develop even if all issuers are required to provide ongoing reports.

The asset size cap in one of the termination thresholds may create adverse competitive effects for issuers close to but above the termination threshold.

e. Advertising – Notice of Offering

The statute and the final rules prohibit an issuer from advertising the terms of the offering, except for notices that direct investors to an intermediary's platform.[1454] The terms of the offering include the amount offered, the nature of the securities, price of the securities and length of the offering period.[1455] The final rules allow an issuer to publish a notice about the terms of the offering made in reliance on Section 4(a)(6), subject to certain limitations on the content of the notice.[1456] The notices are similar to the "tombstone ads" permitted under Securities Act Rule 134,[1457] except that the final rules require the notices to direct investors to the intermediary's platform, through which the offering made in reliance on Section 4(a)(6) is being conducted.

We believe this approach will allow issuers to generate interest in offerings and to leverage the power of social media to attract investors, potentially resulting in enhanced capital formation. At the same time, we believe it also will protect investors by limiting the ability of issuers to provide certain advertising materials without also directing investors to the disclosures, available on the intermediary's platform, that are required for an offering made in reliance on Section 4(a)(6). Moreover, this requirement is not expected to impose costs on market participants.

As an alternative, we could have required communications about the offering to be conducted through the intermediary, as suggested by some commenters.[1458] To the extent that an issuer might be able to inform more investors about its offering if it is not limited to

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1454 *See* Section 4A(b)(2). *See also* Rule 204 of Regulation Crowdfunding.

1455 *See* Instruction to Rule 204 of Regulation Crowdfunding.

1456 *See* Rule 204(b) of Regulation Crowdfunding. *See also* Section II.B.4 above.

1457 17 CFR 230.134.

1458 *See* Hackers/Founders Letter (supporting the issuer being able to repost the communications elsewhere so long as it first appeared through the intermediary); Joinvestor Letter.

communications through the intermediary's platform, this alternative might limit the issuer's ability to inform a wide range of investors about its offering. Limited recognition among prospective investors might be a particularly significant hurdle for early-stage or small issuers. As another alternative, we could have required issuers to file advertising notices with the Commission and/or the relevant intermediary, as suggested by other commenters.[1459] While this could increase the likelihood of issuer compliance with advertising restrictions, it also would impose an additional cost on the issuer. Overall, in light of the restrictions on advertising already in place, it is not clear to what extent, if any, additional restrictions would enhance investor protection.

Some commenters, suggesting that advertising restrictions are unnecessary because sales must occur through an intermediary's platform,[1460] recommended allowing the issuer more leeway to publicize its business or offering on its own website or social media platform so long as the specific terms of the offering could be found only through the intermediary's platform,[1461] and recommended allowing advertising notices to have a section for supplemental information highlighting certain intangible purposes such as a particular social cause.[1462] The alternative of relaxing or eliminating restrictions on advertising could enhance capital formation efforts of issuers. However, it might also result in a cost to investors if they make less informed investment decisions based on incomplete or selectively presented information about the offering contained in advertising materials.

[1459] *See, e.g.*, Commonwealth of Massachusetts Letter; CFIRA Letter 6.

[1460] *See, e.g.*, FundHub Letter 1; Seed&Spark Letter (noting the proposed advertising restrictions will restrict the ability of filmmakers to market and raise money for their films); Arctic Island Letter 5; PeoplePowerFund Letter.

[1461] *See* Fryer Letter.

[1462] *See* RocketHub Letter.

f. Compensation of Persons Promoting the Offering

The statute and the final rules prohibit an issuer from compensating, or committing to compensate, directly or indirectly, any person to promote the issuer's offering through communication channels provided by the intermediary unless the issuer takes reasonable steps to ensure that such person clearly discloses the receipt of such compensation (both past and prospective) each time a promotional communication is made.[1463]

We believe this requirement will benefit the securities-based crowdfunding market by allowing investors to make better informed investment decisions. Although the requirement to take steps to ensure disclosure of compensation paid to persons promoting the offering will impose compliance costs on issuers, we believe that investors will benefit from knowing if the comments about the investment they are considering are being made by a promoter who is compensated by the issuer and therefore may not be providing an independent, disinterested perspective.

The final rules also require that an issuer not compensate or commit to compensate, directly or indirectly, any person to promote its offerings outside of the communication channels provided by the intermediary, unless the promotion is limited to notices that comply with the advertising rules.[1464] We believe this will similarly serve to improve investors' ability to make informed judgments about the information they encounter through various communication channels about the issuer, and thus, to make better informed investment decisions.

[1463] *See* Section 4A(b)(3). *See also* Rule 205 of Regulation Crowdfunding and Section II.B.5 above.

[1464] *See* Rule 205 of Regulation Crowdfunding. *See also* Section II.B.5 above.

g. Oversubscription and Offering Price

The final rules permit an issuer to accept investments in excess of the target offering amount, subject to the $1 million limitation, but require the issuer to disclose the maximum amount the issuer will accept and how shares in oversubscribed offerings will be allocated.[1465] We continue to believe that permitting oversubscriptions will provide flexibility to issuers so that they can raise the amount of capital they deem necessary to finance their businesses. Given the uncertainty on the part of the issuer about potential market demand for the issuer's securities, we believe it is valuable for issuers to have the option to permit oversubscriptions. For example, permitting oversubscriptions will allow an issuer to raise more funds, while lowering compliance costs as a proportion of the amount raised, if the issuer discovers during the offering process that there is greater investor interest in the offering than initially anticipated or if the cost of capital is lower than initially anticipated. As an alternative, we could have limited the maximum oversubscription amount to a certain percentage of the target offering amount, as suggested by one commenter.[1466] However, such a restriction might reduce valuable flexibility and potentially limit capital formation without appreciably enhancing investor protection.

The final rules do not require issuers to set a fixed price, as suggested by one commenter.[1467] While such an alternative might reduce an investor's cost of evaluating the investment, it would reduce flexibility for issuers while providing only limited benefits to investors in light of other disclosures required in the final rules. Further, the required disclosure

[1465] *See* Rule 201(h) of Regulation Crowdfunding. *See also* Section II.B.6.a above.

[1466] *See* Joinvestor Letter; RFPIA Letter.

[1467] *See* RocketHub Letter.

of the pricing method used and the final prices for the securities before an offering closes,[1468] coupled with the investor's ability to cancel his or her investment commitment,[1469] can mitigate potential concerns that dynamic pricing can be used to provide preferential treatment to certain investors (*e.g.*, when an issuer offers better prices to relatives or insiders). We also believe that the cancellation rights afforded by the rules will help to address the concerns about time pressure on the investment decision because investors will have the opportunity to cancel their investment commitments if they decide to do so.

h. Types of Securities Offered and Valuation

The final rules do not limit the type of securities that may be offered in reliance on Section 4(a)(6). This provision gives issuers the flexibility to offer the types of securities that are most compatible with their desired capital structure and financing needs. Such flexibility may benefit issuers to the extent that capital structure decisions can be relevant for an issuer's firm value.

The final rules do not prescribe a method for valuing the securities but instead require issuers to describe the terms of the securities and the valuation method in their offering materials. The required disclosure of valuation method is intended to facilitate informed investment decisions. As an alternative, as suggested by commenters, we could have prescribed the use of particular valuation standards,[1470] required issuers to base the valuation of their securities on the price at which the issuer previously sold securities,[1471] or considered other standards designed to

1468 *See* Rule 201(l) of Regulation Crowdfunding.

1469 *See* Rule 201(j) of Regulation Crowdfunding.

1470 *See, e.g.*, 11 Wells Letter; Active Agenda Letter; Borrell Letter; Ellenbogen Letter; Greer Letter; Mountain Hardwear Letter; Moyer Letter; NaviGantt Letter; Vidal Letter.

1471 *See, e.g.*, Public Startup Letter 3; Wefunder Letter.

ensure that securities are fairly valued and that approaches to valuation that put investors at a disadvantage are prohibited.[1472] If we required a specific valuation methodology, such as one of the suggested alternatives, and it were appropriate for a particular issuer, it could mitigate the likelihood of inaccurate valuations and result in more informed decisions by investors. However, specific valuation requirements that do not accommodate inherent differences among companies, particularly in light of the uncertainty related to the valuation of early-stage companies, might result in inaccurate valuations and less informed investor decisions. Also, potential additional calculations and analysis that might be required to implement a prescribed valuation methodology could impose additional costs on issuers, compared to letting issuers select a valuation method that fits the particular circumstances of their offering.

i. Restrictions on Resales

The statute and the final rules include restrictions on the transfer of securities for one year, subject to limited exceptions (*e.g.*, for transfers to the issuer of the securities, in a registered offering, to an accredited investor or to certain family members).[1473] As we discussed in the proposal, we believe that including such proposed restrictions is important for investor protection. By restricting the transfer of securities for a one-year period, the final rules give investors in a business a defined period to observe the performance of the business and to potentially obtain more information about the potential success or failure of the business before trading occurs. The final rules permit transfers to trusts controlled by, or held for the benefit of, covered family members.[1474] In a change from the proposed rules, the restrictions apply to any purchasers and not

[1472] *See* Consumer Federation Letter.

[1473] *See* Section 4A(e). *See also* Rule 501(a) of Regulation Crowdfunding.

[1474] *See* Rule 501(a)(4) of Regulation Crowdfunding.

only to the initial purchasers, consistent with the suggestions of commenters.[1475] This change addresses the possibility of the initial purchaser selling securities to an eligible purchaser and such eligible purchaser reselling them to the public within the first year, resulting in the securities becoming widely traded within the first year.

We recognize that resale restrictions will impose costs. The one-year restriction on transfers of securities purchased in a transaction conducted in reliance on Section 4(a)(6) may impede price discovery, raise capital costs to issuers and limit investor participation, particularly among investors who are unable or unwilling to risk locking up their investments for this period. The illiquidity cost resulting from the resale restriction may be mitigated, in part, by provisions that allow investors to transfer the securities within one year of issuance by reselling the securities to accredited investors, back to the issuer or in a registered offering or transferring them to certain family members or trusts of those family members. The effect of resale restrictions on the extent to which investors make informed investment decisions is unclear. While resale restrictions may disincentivize investors from continuing to gather and analyze information about the issuer after investing while the resale restrictions are in effect, resale restrictions may also strengthen the incentive to conduct due diligence on the issuer and gather and analyze information before the initial investment. Nevertheless, at the investment amounts involved in these transactions, a typical purchaser's incentives to gather and analyze information before or after investing likely will remain limited, regardless of the presence of resale restrictions.

4. Intermediary Requirements

The statute and the final rules require that offerings in reliance on Section 4(a)(6) be conducted through an intermediary that is a registered broker-dealer or registered funding portal.

[1475] *See* CrowdCheck Letter 3; Moskowitz Letter.

The use of a registered intermediary to match issuers and investors will cause issuers to incur certain transaction costs associated with the intermediation activity[1476] but also will provide centralized venues for crowdfunding activities that are expected to lower investor and issuer search costs. As discussed earlier, existing lending-based, reward-based, and donation-based crowdfunding platforms already engage in a large volume of transactions in North America,[1477] demonstrating that the use of platforms for crowdfunding may be familiar to investors and issuers.

We believe that existing non-securities-based crowdfunding platforms will initially be the primary funding portals in the securities-based crowdfunding market. The entry of registered broker-dealers and new funding portals in the securities-based crowdfunding market will increase competition among existing non-securities-based crowdfunding intermediaries and potentially lower the cost of intermediation to issuers. One commenter stated that it has "a serious concern with Broker/Dealers having an unfair advantage in the market, by already being regulated and registered with the Commission as well as FINRA. Therefore, they may be able to service the market well ahead of Portals."[1478]

We acknowledge that, to the extent that it may take less time and cost for registered broker-dealers to comply with the requirements of Regulation Crowdfunding as compared to funding portals, registered broker-dealers may be at a competitive advantage compared to new entities that seek to register as funding portals and enter the crowdfunding market. However, as we discuss below, the registration requirements for funding portals are tailored to the more limited

[1476] *See* Section III.B.3.a above for a discussion of intermediary fees.

[1477] *See* Section III.A.3 above.

[1478] *See* RocketHub Letter. Several other commenters expressed concern about funding portals being at a competitive disadvantage to registered broker-dealers. *See, e.g.*, Joinvestor Letter; City First Letter; Seed&Spark Letter; Guzik Letter 1.

scope of funding portal activities and are thus expected to result in a lower compliance cost for these entities. Further, the effective dates of the final rules are expected to provide time for funding portals to register and comply with the other requirements of Regulation Crowdfunding before crowdfunding offerings can occur.[1479] We recognize, however, that registered broker-dealers can retain a competitive advantage relative to funding portals due to their ability to engage in a wider range of activities in the securities-based crowdfunding market.[1480] In this regard we note that the final rules permit funding portals to compensate a registered broker-dealer and to receive compensation from a registered broker-dealer for services in connection with the funding portal's offer or sale of securities in reliance on Section 4(a)(6),[1481] which may enable funding portals to partly mitigate the impact of restrictions on funding portal activities in the statute and final rules. Moreover, even if funding portals remain at a competitive disadvantage to registered broker-dealers in the securities-based crowdfunding market, overall the expected participation of multiple registered broker-dealers as intermediaries in offerings in reliance on Section 4(a)(6) may nevertheless result in a considerable level of competition in the securities-based crowdfunding marketplace.

Both existing non-securities-based crowdfunding platforms and registered broker-dealers will need to invest resources to comply with the requirements of the statute and final rules. In addition, registered broker-dealers will need to develop Internet-based crowdfunding platforms while existing non-securities-based crowdfunding platforms will need to register as funding

1479 The time period between the effective date of the final rules pertaining to funding portal registration as compared to the later effective date for rules governing crowdfunding offerings is expected to mitigate some of these effects. *See also* Section II.C.2.a above.

1480 *See also* note 607.

1481 *See* Rule 402(b)(7) and Rule 402(b)(8) of Regulation Crowdfunding. *See also* Section II.D.3.g.

portals or broker-dealers and modify their existing platforms to conform to the requirements of the statute and the final rules. Although the eventual extent of broker-dealer involvement in the securities-based crowdfunding market is difficult to estimate, we believe that some broker-dealers may acquire or form partnerships with funding portals to obtain access to a new and diverse investor base. In addition, some existing non-securities-based crowdfunding platforms may eventually form partnerships with registered broker-dealers or funding portals. It is challenging to exactly predict the future number of persons (or entities) who will register as either broker-dealers or funding portals to act as intermediaries in securities-based crowdfunding transactions. For purposes of the PRA,[1482] we estimate that intermediaries will number approximately 110, including approximately 10 intermediaries that will register as broker-dealers in order to engage in securities-based crowdfunding; approximately 50 intermediaries that are already registered as broker-dealers and that will choose to serve as crowdfunding intermediaries; and approximately 50 intermediaries that are not already registered as broker-dealers and that will register as funding portals.[1483] It is possible that the actual number of participants will deviate significantly from these estimates, and it is likely that there will be significant competition between existing crowdfunding venues and new entrants that may result in further changes in the number and types of intermediaries as the market develops and matures. It also is likely that there will be significant

[1482] *See* Section IV.B.2 and Section IV.B.3 below.

[1483] These estimates are based, in part, on recent indications of interest, which may change as the market develops. According to FINRA, as of October 3, 2013, approximately 36 entities have submitted the voluntary Interim Form for Funding Portals to FINRA to indicate their intention to act as funding portals under Title III of the JOBS Act. *See* Press Release, Financial Industry Regulatory Authority, FINRA Issues Voluntary Interim Form for Crowdfunding Portals (Jan. 10, 2013), *available at* http://www.finra.org/Newsroom/NewsReleases/2013/P197636; Financial Industry Regulatory Authority, *Crowdfunding Portals*, *available at* http://www.finra.org/industry/issues/crowdfunding. Based on these recent indications of interest, we expect that the number of funding portals that will ultimately register with the Commission will be approximately 50.

We note that these estimates are the same as the estimates of potential crowdfunding intermediaries set forth in the Proposing Release. We did not receive comments about these estimates.

developments in the types and ranges of crowdfunding products and services offered by intermediaries to potential issuers and investors, particularly as competitors gain additional experience in this new marketplace. Moreover, the business models of successful crowdfunding intermediaries are likely to change over time as they grow in size or market share or if they are forced to differentiate from other market participants in order to maintain their position in the market.

As a result of the uncertainty over how the market may develop, any estimates of the potential number of market participants, their services or fees charged are subject to significant estimation error. While we recognize that there are benefits as well as costs associated with the statutory requirements and the final rules pertaining to intermediaries, there are significant limitations to our ability to estimate these potential benefits and costs.

The statute requires that the offer or sale of securities in reliance on Securities Act Section 4(a)(6) be conducted through a broker-dealer or a funding portal that complies with the requirements of Securities Act Section 4A(a).[1484] Among other things, the intermediary must register with the Commission as a broker-dealer or a funding portal, and it also must register with a registered national securities association.[1485] The final rules implement these statutory requirements, including by requiring an intermediary to be a member of FINRA or any other applicable registered national securities association.

While the benefits and costs are described in further detail below, the following tables summarize the estimated direct costs to intermediaries, including broker-dealers and funding portals. Some of the direct costs of the rules will be incurred by all intermediaries, while others

1484 *See* Section 4(a)(6)(C).

1485 *See* Section 4A(a)(2).

are specific to whether the intermediary is a new entrant (registering as a broker-dealer or a funding portal) or is already registered as a broker-dealer.

Although we have attempted to estimate the direct costs of the statute and the final rules on intermediaries, we recognize that some costs can vary significantly across intermediaries, and within categories of intermediaries. For example, some intermediaries may choose to leverage existing platforms or systems and so may not need to incur significant additional expenses to develop a platform or comply with specific requirements of Regulation Crowdfunding. In the Proposing Release we provided cost estimates for the various intermediary requirements and requested comment on our estimates. Several commenters discussed the estimates of the costs associated with intermediaries or provided cost estimates of their own.[1486] Below we discuss the comments received on each of these costs and any revisions to our estimates made in response.

We estimate that the cost for an entity to register as a broker-dealer and become a member of a national securities association in order to engage in crowdfunding pursuant to Section 4(a)(6) will be approximately $275,000, with an ongoing annual cost of approximately $50,000 to maintain this registration and membership.[1487] In addition, we estimate that the cost to comply

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[1486] *See, e.g.*, ASSOB Letter (suggesting that the cost to establish a funding portal would run at least $480,000); Arctic Island Letter 8 (referring to the cost of establishing and managing escrow accounts); CapSchedule Letter (citing costs of managing securityholder records); Joinvestor Letter (suggesting in reference to records to be kept by funding portals that "[u]nder the expectation that crowdfunding portals will be online operations and will almost certainly retain records through digital methods, the burden of collection should be minimal" but not providing a specific estimate of the cost of compliance). Various commenters expressed concern with the cost imposed on intermediaries. *See, e.g.*, Heritage Letter (suggesting that the "costs incurred by the intermediary in dealing with an issuer, doing the required due diligence and background screening, establishing a web page describing the offering and so on do not vary linearly with the offering size"); Seed&Spark Letter; SBEC Letter (suggesting that there will be "extensive staff, technology and operational costs" in addition to the compliance costs estimated in the Proposing Release).

[1487] We recognize that the cost of registering and becoming a member of a national securities association varies significantly among broker-dealers, depending on facts and circumstances. The cost can vary, among other factors, based on the number of associated persons of the broker-dealer entity and their licensing requirements, the scope of the brokerage activities, and the means by which the broker-dealer administers the registration process (*e.g.*, it may choose to hire outside counsel to assist with the process). We also

with the various requirements that apply to registered broker-dealers engaging in transactions pursuant to Section 4(a)(6) for these new registrants will be approximately $245,000 initially and approximately $180,000 in each year thereafter. In making this estimate, we assume that broker-dealers acting as intermediaries in transactions pursuant to Section 4(a)(6) will provide a full range of brokerage services in connection with these transactions, including certain services such as providing investment advice and recommendations, soliciting investors, and managing and handling customer funds and securities, that funding portals cannot provide.[1488]

If instead an entity were to register as a funding portal and become a funding portal member of a national securities association, we estimate the initial registration and membership cost will be approximately $100,000, with an ongoing cost of approximately $10,000 in each year thereafter to maintain this registration and membership.[1489] We estimate that the initial cost for a

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recognize that the time required for a broker-dealer to become a member of a national securities association varies and can take six months to one year. We estimate the range of this cost to be between $50,000 and $500,000, and so we have chosen the average amount of $275,000 for purposes of this analysis.

1488 Among other things, a broker-dealer providing recommendations and investment advice is required to comply with FINRA rules on suitability. *See* FINRA Rule 2111. A broker-dealer soliciting through advertisements is required to comply with FINRA rules relating to communications with the public. *See* FINRA Rule 2210. Broker-dealers handling customer funds and securities also are required to maintain net capital, segregate customer funds and comply with Exchange Act Rule 15c2-4. *See* Exchange Act Rules 15c3-1, 15c3-3 and 15c2-4 [17 CFR 240.15c3-1, 15c3-3 and 15c2-4].

1489 In making these estimates, we assume that the membership process will take approximately sixty days and that there will be no related licensing requirement for associated persons of the funding portal. In the Proposing Release, we estimated that the membership process will take approximately one month. While it does not affect our estimate of direct costs, we note that a longer membership process can result in incremental indirect costs to funding portals (e.g., opportunity costs due to not being able to serve as an intermediary in crowdfunding offerings while registration requirements are not met and competitive costs due to requiring additional time to register compared to registered broker-dealers. The time period between the effective date of the final rules pertaining to funding portal registration as compared to the later effective date for rules governing crowdfunding offerings is expected to mitigate these effects.

We also only include domestic entities in these estimates, which do not need to comply with the requirements in Regulation Crowdfunding that apply to nonresident funding portals. Nonresident funding portals are subject to an additional cost of completing Schedule C to Form Funding Portal, hiring and maintaining an agent for service of process and providing the required opinion of counsel. *See* Section IV.C.2.a. below (discussing burden estimates of these additional requirements for purposes of the PRA).

registered funding portal to comply with the requirements of the final rules will be approximately $67,000, with an ongoing cost of approximately $40,000 in each year thereafter.

Finally, we estimate that the incremental initial cost for an intermediary that is already registered as a broker-dealer to comply with the requirements of the final rules will be approximately $45,000, with an ongoing cost of approximately $30,000 in each year thereafter.

These estimated costs are consistent with those set forth in the Proposing Release and are exclusive of the cost of establishing and maintaining a platform and related functionality. For purposes of the PRA, we estimate that for the average intermediary, the mid-range initial external platform development cost will be approximately $425,000 and the ongoing cost will be approximately $85,000 per year.[1490] However, we anticipate considerable variation among intermediaries depending on whether they already have in place platforms and systems that can be adapted to meet the requirements of the final rules. We expect that intermediaries (whether broker-dealers or funding portals) that already have in place platforms and related systems that will need only to tailor their existing platform and systems to comply with the requirements of Regulation Crowdfunding, resulting in a lower initial cost on average of $250,000. We expect the ongoing cost to remain approximately $85,000 per year for an intermediary that already has in place a platform and related systems. Commenters did not provide estimates of the cost of establishing a platform or tailoring an existing platform to comply with the requirements of Title III. One commenter suggested that the cost of operating a funding portal and regulatory

1490 These estimates are based on intermediaries that use a third party to develop the platform. Intermediaries that develop the platform in-house may incur lower costs. For purposes of the PRA, we estimate that intermediaries that develop the platform in-house instead of using a third-party provider will spend an average of 1,500 hours for initial planning, programming and implementation and 300 hours per year in ongoing internal burden. For purposes of the PRA we estimate that approximately half of the intermediaries will use a third party to develop the platform and the other half will develop their platforms in-house. *See* Section IV.C.2.b below.

compliance would be at least $480,000 per year but did not break out this estimate into separate cost components.[1491]

Estimated Costs of Final Rules for Intermediaries that Register as Broker-Dealers

	Estimated Costs	
	Initial Cost (Year 1)	**Ongoing Cost per Year**
Form BD Registration and National Securities Association Membership	$275,000	$50,000
Complying with Requirements to Act as an Intermediary in, and to Engage in Broker-Dealer Activities Related to, Transactions pursuant to Section 4(a)(6)[1492]	$245,000	$180,000
Platform Development[1493]	$425,000	$85,000
Total	*$945,000*	*$315,000*

Estimated Costs of Final Rules for Intermediaries that Register as Funding Portals

	Estimated Costs	
	Initial Cost (Year 1)	**Ongoing Cost per Year**
Form Funding Portal Registration and National Securities Association Membership[1494]	$100,000	$10,000
Complying with Requirements to Act as an Intermediary[1495] in Transactions pursuant to Section 4(a)(6)	$67,000	$40,000
Platform Development[1496]	$425,000	$85,000

1491 *See* ASSOB Letter.

1492 As discussed above, these costs include, among others, the costs to the broker-dealer of having associated persons who have licensing requirements, suitability requirements, requirements relating to advertisements, net capital requirements, and compliance with Exchange Act Rule 15c2-4 (17 CFR 240.15c2-4), as well as the costs of complying with Subpart C of Regulation Crowdfunding. *See* Section IV.C. 2 below for further detail on our estimates, for PRA purposes, of the costs associated with the requirements under Subpart C.

1493 *See* Section IV.C.2.b below for further detail on our estimates, for PRA purposes, of the costs of developing a platform.

1494 As described above, this estimate reflects a streamlined process of becoming a member of a national securities association, which we assume will take approximately sixty days and not involve application or licensing of associated persons.

1495 This includes the costs of complying with the requirements of Subparts C and D of Regulation Crowdfunding. *See* Section IV.C.2 below for further detail on our estimates, for PRA purposes, of these costs.

1496 *See* Section IV.C.2.b below for further detail on our estimates, for PRA purposes, of the costs of developing a platform.

	Estimated Costs	
	Initial Cost (Year 1)	Ongoing Cost per Year
Total	*$592,000*	*$135,000*

Estimated Incremental Costs of Final Rules for Intermediaries Already Registered as Broker-dealers

	Estimated Costs	
	Initial Cost (Year 1)	Ongoing Cost per Year
Complying with Requirements to Act as an Intermediary in Transactions pursuant to Section 4(a)(6)[1497]	$45,000	$30,000
Platform Development[1498]	$425,000	$85,000
Total	*$470,000*	*$115,000*

Commenters suggested that funding portals should not be required to register with the Commission or become FINRA members (or members of any other registered national securities association), because unlike broker-dealers, they serve only as an "information delivery service."[1499] One commenter stated that the Commission's estimates in initial costs of registration as a funding portal and for ongoing expenses create a significant burden given that potential funding portals operate on modest budgets and with thin margins.[1500] As we note above, however, registration is a statutory requirement under Securities Act Section 4A(a)(1).[1501] While the registration requirements will necessarily impose costs on intermediaries, we believe they also will be effective in providing investor protection for the crowdfunding market while taking into

[1497] This includes the incremental costs of complying with the requirements of Subpart C of Regulation Crowdfunding, but it excludes any registration or membership requirements. *See* Section IV.C.2 below for further detail on our estimates, for PRA purposes, of these costs.

[1498] *See* Section IV.C.2.b below for further detail on our estimates, for PRA purposes, of the costs of developing a platform.

[1499] *See* Perfect Circle Letter.

[1500] *See* Seed&Spark Letter.

[1501] *See* Section II.C.2.a above.

account the more limited activities of funding portals. Among other things, in addition to the Commission's oversight and rulemaking functions with regard to broker-dealers, FINRA currently is responsible for conducting most broker-dealer examinations, mandating certain disclosures by its members, writing rules governing the conduct of its members and associated persons, and informing and educating the investing public. Similarly, we believe that in addition to the benefits of the Commission's oversight with regard to funding portals, the regulatory framework that a registered national securities association – initially FINRA – will be required to create for funding portals will play an important role in the oversight of these entities.

The estimated costs in the tables above reflect the direct costs that intermediaries will incur in connection with registering as a broker-dealer on Form BD or as a funding portal on Form Funding Portal, submitting amendments to registrations and withdrawing registrations. For the purposes of the PRA, we estimate that approximately 50 intermediaries will be broker-dealers that have already registered with the Commission[1502] and, as such, these broker-dealers will not incur additional SEC registration costs associated with the final rules. Additionally, intermediaries that are not otherwise registered with FINRA or any other registered national securities association will need to register, and the estimated cost for such registration is included in the tables above. We anticipate that the cost for a funding portal to become a member of a registered national securities association will be lower than the cost for a broker-dealer to do so because of the more limited nature of a funding portal's permissible activities and the streamlined set of rules that an association is likely to impose on funding portals. In this regard, we note that FINRA has solicited

1502 *See* Section IV.C.2 below.

public comment on a set of proposed rules and related forms for registered funding portals that become FINRA members pursuant to the crowdfunding provisions of the JOBS Act.[1503]

The final rules also require that an intermediary execute transactions exclusively through its online platform. This requirement may lower the potential for abusive sales practices. However, it may also prevent investors who lack Internet access from investing through crowdfunding, as suggested by one commenter.[1504] We believe that the use of an online platform will enhance the ability of issuers and investors to communicate transparently as compared to the alternative of allowing transactions to occur offline. This requirement also is expected to help issuers gain exposure to a wide range of investors, who also may benefit from having numerous investment opportunities aggregated in one place, resulting in lower search costs or burdens related to identifying suitable investment opportunities.

The final rules further require that an issuer conduct an offering or concurrent offerings in reliance on Section 4(a)(6) using a single intermediary.[1505] We recognize that this requirement may impose costs by limiting the set of investors, as well as communication about a transaction, to the extent that some investors do not use a specific crowdfunding platform.[1506] However, it may also enhance communication between issuers and investors, as suggested by some commenters,[1507] and enable investors to access investor discussions about a particular transaction

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1503 *See* Proposed Funding Portal Rules, *available at* http://www.finra.org/sites/default/files/NoticeAttachment/p369763.pdf. *See also FINRA Requests Comment on Proposed Funding Portal Rules and Related Forms*, FINRA Regulatory Notice 13-34, *available* at http://www.finra.org/sites/default/files/NoticeDocument/p370743.pdf. ("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.")

1504 *See, e.g.*, Projecteureka Letter.

1505 *See* Instruction 1 to Rule 100(a)(3) of Regulation Crowdfunding. *See also* Section II.A.3.

1506 *See, e.g.*, Graves Letter.

1507 *See, e.g.*, CFA Institute Letter; RocketHub Letter.

on a single platform. This requirement may also reduce the risk of issuers circumventing the aggregate offering limit.

Some commenters suggested that the statutory and rule requirements for establishing a funding portal and ongoing maintenance and compliance expenses create a significant burden on funding portals.[1508] Among other concerns, commenters highlighted potential liability for intermediaries[1509] under Securities Act Section 4A(c) and the cost of conducting background checks[1510] pursuant to Rule 301(c) as particularly burdensome for funding portals. We are mindful of the potentially significant costs as a percentage of offering size incurred by intermediaries, especially funding portals, in securities-based crowdfunding offerings. However, intermediary requirements are designed to provide a measure of investor protection from the risk of fraud in small offerings by relatively unknown issuers. Concentration of certain due diligence tasks at the intermediary level may yield efficiency gains relative to having each small investor incur the cost to perform such tasks. In addition, although funding portals may be subject to issuer liability, the changes we have implemented in the final rules will give them greater ability to control which issuers conduct offerings on their platforms and thus to mitigate to some degree the risks of liability arising from such offerings.

a. Disclosure and Dissemination Requirements

The statute and final rules include disclosure and dissemination provisions designed to provide information to security-based crowdfunding investors. These provisions, together with

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1508 *See, e.g.*, ASSOB Letter (suggesting that the cost to establish a funding portal could be at least $480,000).

1509 *See, e.g.*, ABA Letter; AngelList Letter; BetterInvesting Letter; CFIRA Letter 10; City First Letter; EarlyShares Letter; EMKF Letter; FSI Letter; Graves Letter; Guzik Letter 1; IAC Recommendation; Inkshares Letter; Milken Institute Letter; PPA Letter; RocketHub Letter; SBA Office of Advocacy Letter; SBEC Letter; SeedInvest Letter 3; Seyfarth Letter; StartupValley Letter; Wefunder Letter; Winters Letter. *See also* Section II.E.5.

1510 *See, e.g.*, RocketHub Letter; Anonymous Letter 4; Zhang Letter. *See also* Section II.C.3.c above.

the issuer disclosure provisions discussed above, are expected to limit information asymmetries and promote the efficient allocation of capital amongst crowdfunding offerings. These provisions also will provide information intended to ensure that investors are aware of the risks associated with their investment, which can enhance investor protection. As discussed above, many of the costs and benefits of these provisions are difficult to quantify or estimate with any degree of certainty, especially considering that securities-based crowdfunding will constitute a new method for raising capital in the United States. Although we are not able to quantify the direct costs specifically associated with each of these requirements, these costs are reflected in our general estimates of the initial and ongoing costs for intermediaries to register, comply with their obligations under the final rules and develop a crowdfunding platform, as reflected in the tables above.

The final rules prohibit an intermediary or its associated persons from accepting an investment commitment until the investor has opened an account with the intermediary and the intermediary has obtained the investor's consent to electronic delivery of materials.[1511] This requirement will help ensure that certain basic information about the investor is on file with the intermediary and that all investors are on notice of the primary method of delivery for communications from the intermediary. To the extent that an intermediary uses a third party to establish account opening functionality, the costs relevant to this requirement will be incorporated into the cost to develop the platform.[1512]

The statute requires intermediaries to provide disclosures related to risks and other investor education materials. The final rules implement this statutory mandate by requiring intermediaries

[1511] *See* Rule 302(a) of Regulation Crowdfunding.

[1512] *See also* Section IV.C.2.d below.

to deliver educational materials that explain how the offering process works and the risks associated with investing in crowdfunding securities.[1513] The educational requirements will help make investors aware of the limits and risks associated with purchasing crowdfunding securities and facilitate the selection of investments suited to their level of risk tolerance. They also may help ensure that offerings proceed more efficiently as investors will be better informed by the time they decide to make their investment commitments and receive required notices. However, we recognize that the effectiveness of the educational materials in enhancing investor protection will vary depending upon the quality of the educational materials and the education and experience of retail investors.[1514] In addition, materials that highlight the risks of securities-based crowdfunding can discourage investor participation, which may limit potential capital formation.

Under the final rules, the educational materials can be in any electronic format, including video format, and the intermediary will have the flexibility to determine how best to communicate the contents of the educational material. Accordingly, the cost for intermediaries to develop educational materials is expected to vary widely. For purposes of the PRA, we estimate that the initial cost for an intermediary using a third-party firm to develop and produce educational materials will be approximately $10,000 to $30,000 and the ongoing cost will be approximately $5,000 to $15,000 per year.[1515]

1513 *See* Rule 302(b) of Regulation Crowdfunding.

1514 *See* Jennifer E. Bethel and Allen Ferrell, *Policy Issues Raised by Structured Products*, HARV. L. & ECON. Discussion Paper No. 560, 2007, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=941720.

1515 For the purposes of the PRA, we estimate that development of educational materials in-house will be associated with an average initial burden of approximately 20 hours and an average annual burden of approximately 10 hours. *See* Section IV.C.2.e below.

The final rules also require that intermediaries obtain representations from investors about their review of the investor education materials and their understanding of the risks.[1516] This requirement is expected to improve investors' understanding of investments in securities-based crowdfunding offerings. The direct costs of this requirement to an intermediary are reflected in the tables above as part of the costs of developing a crowdfunding platform, and we believe that the ongoing burden to comply will be minimal after the intermediary has systems in place to obtain such representations. This requirement also may limit capital formation to the extent that it deters investors from making investment commitments or otherwise participating in offerings made in reliance on Section 4(a)(6).

Under the final rules, an intermediary must clearly disclose the manner in which the intermediary is compensated in connection with offers and sales of securities in reliance on Section 4(a)(6).[1517] As explained above, we believe that investors will benefit by having information about how intermediaries are compensated, such as through compensation arrangements with affiliates. We believe that the costs of complying with this requirement generally will be included in the overall cost for intermediaries to develop their platforms, as it will entail adding an item of disclosure to the functionality of their platforms.[1518] While the requirement to disclose compensation arrangements may give rise to indirect costs due to the intermediary's competitors learning about the compensation arrangements, we do not expect such indirect costs to be significant since the intermediary's competitors can generally infer information about the intermediary's compensation arrangements from other sources.

[1516] *See* Rule 303(b)(2) of Regulation Crowdfunding.

[1517] *See* Rule 302(d) of Regulation Crowdfunding.

[1518] *See also* Section IV.C.2.f below.

The statute and the final rules further require that intermediaries make available certain issuer-provided information.[1519] We recognize that requiring intermediaries to provide prospective investors with information about the issuer will impose costs. We expect that intermediaries will incur costs to develop the functionality that will allow the uploading and downloading of issuer information. We believe that the direct costs of complying with this requirement will be included in the overall cost to intermediaries to develop their platforms and that this requirement will impose only nominal incremental costs on intermediaries on an ongoing basis, primarily because the functionality necessary to upload the required issuer disclosure information is a standard feature offered on many websites and would not require frequent updates.[1520]

The issuer disclosure requirements are expected to benefit investors by enabling them to better evaluate the issuer and the offering. Requiring intermediaries to make the issuer information publicly available and easily accessible on their platforms will reduce information asymmetries between issuers and investors and will enhance both transparency and efficiency of the crowdfunding market. Greater accessibility of issuer information may reduce incremental costs to investors of locating issuer information and may increase their willingness to participate in a securities-based crowdfunding offering, thereby enhancing capital formation.

The final rules also require an intermediary to provide communication channels on its platform, meeting certain conditions, which will allow investors who have opened accounts with intermediaries and representatives of the issuer to interact and exchange comments about the

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[1519] *See* Rule 303(a) of Regulation Crowdfunding.

[1520] *See also* Section IV.C.2.g below.

issuer's offering on that intermediary's platform, and which will be publicly available for viewing (i.e., by those who may not have opened accounts with the intermediary).[1521]

Compared with the alternative of not requiring intermediaries to provide communication channels, we believe this requirement will allow investors, particularly those who may be less familiar with online social media, to participate in online discussions about ongoing offerings without having to actively search for such discussions on external websites. Moreover, the requirement that promoters be clearly identified on these channels will enhance transparency, allowing those investors that draw information from an intermediary's online platform to make potentially better informed investment decisions. The direct costs of this requirement are reflected in the tables above as part of costs of developing a crowdfunding platform, and we believe that once the platform has been set up, the ongoing burden to comply will be minimal. We recognize, however, that this requirement will not assure that participants in online discussions on the intermediary's online platform convey accurate or relevant information in their postings, and it will not preclude investors from participating in discussions on external websites or other external social media.

The final rules also require intermediaries, upon receipt of an investment commitment from an investor, promptly to provide or send to the investor a notification of that investment commitment.[1522] This requirement will provide investors with key information about their investment commitments, including notice of the opportunity, as relevant, to cancel their investment commitments. Investors will benefit from these requirements because they will be provided with additional information with which to evaluate their investment commitments, their

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1521 *See* Rule 303(c) of Regulation Crowdfunding.

1522 *See* Rule 303(d) of Regulation Crowdfunding.

securities transactions and the intermediaries that are effecting those transactions. The direct costs of these requirements are reflected in the tables above as part of the costs of developing a crowdfunding platform.[1523]

The final rules implement the statutory requirement for intermediaries to allow investors to cancel their commitments to invest, by requiring investors to have until 48 hours prior to the deadline identified in the issuer's offering materials to cancel their investment commitments.[1524] If an issuer reaches its target offering amount prior to the target offering deadline, the final rules permit early closing of the offering under certain conditions, including a requirement that the intermediary send notices to investors informing them of the closing and the deadline for the opportunity to cancel.[1525] The final rules also set forth notice requirements and requirements related to the intermediary directing payments in the event of cancellations and material changes to offerings.[1526] Additionally, the final rules impose specific obligations on intermediaries related to informing investors about their right to cancel an investment commitment.[1527]

We believe that investors will benefit from receiving these notices because the notifications and accompanying information will keep investors informed about the status of the offering and thereby facilitate better investment decisions. This approach also will benefit investors by providing them with a specified period of time to review and assess information and communications about the issuer.

1523 *See also* Section IV.C.2.h below.

1524 *See* Rule 304(a) of Regulation Crowdfunding.

1525 *See* Rule 304(b) of Regulation Crowdfunding.

1526 *See* Rule 304(c) and Rule 304(d) of Regulation Crowdfunding.

1527 *See* Rule 302(b) of Regulation Crowdfunding.

We recognize that allowing investors to cancel their investment commitments up to 48 hours prior to the deadline identified in the issuer's offering materials may impose a cost on issuers who, because of investors cancelling commitments late in the offering period, may fall below the target offering amount and so decide to cancel the offering or to extend the offering period. Accordingly, we recognize that this requirement may reduce the overall amount of capital raised in offerings in reliance on Section 4(a)(6) and thus have an adverse effect on capital formation. Intermediaries are expected to incur direct costs in developing and maintaining systems to send the relevant notices to investors. These costs are reflected in the tables above as part of the cost of developing a crowdfunding platform.[1528]

b. Measures to Reduce the Risk of Fraud

The statute and final rules require intermediaries to have a reasonable basis for believing that an issuer seeking to offer and sell securities in reliance on Section 4(a)(6) through the intermediary's platform complies with the requirements in the final rules[1529] and has established means to keep accurate records of holders of the securities.[1530] Under the final rules, an intermediary must deny access to an issuer if it has a reasonable basis for believing that the issuer or the offering presents the potential for fraud or otherwise raises concerns about investor protection[1531] or that the issuer or any of its officers, directors (or any person occupying a similar status or performing a similar function) or 20 Percent Beneficial Owners was subject to a disqualification under the final rules.[1532] The intermediary also must conduct a background and

1528 *See also* Section IV.C.2.h below.

1529 *See* Rule 301(a) of Regulation Crowdfunding.

1530 *See* Rule 301(b) of Regulation Crowdfunding.

1531 *See* Rule 301(c)(2) of Regulation Crowdfunding.

1532 *See* Rule 301(c)(1) of Regulation Crowdfunding.

securities enforcement check on each of these persons.[1533] We believe that these requirements will increase investor protection in connection with the offering.[1534]

As noted above, the specific costs and benefits of these provisions are difficult to quantify or estimate with any degree of certainty. However, we have attempted to reflect the direct costs of these provisions in the tables above as part of our general estimates for the cost of complying with requirements to act as an intermediary in transactions pursuant to Section 4(a)(6). For purposes of the PRA, the cost for an intermediary to fulfill the required background checks and securities enforcement regulatory history checks is estimated to be approximately $13,818 to $34,546 in the first year and approximately the same in subsequent years.[1535]

Each of these requirements is intended to help reduce the risk of fraud in securities-based crowdfunding. As a result of these requirements, investors will be able to rely on the efforts of the intermediary that conducted a background and securities enforcement check, solving a collective action problem that would be prohibitively costly if left to individual investors. To the extent that these checks help prevent fraudulent activity, they may increase investor willingness to participate in crowdfunding offerings, thereby facilitating capital formation. We anticipate that most intermediaries will employ third parties to perform these background checks.

We received several suggestions from commenters aimed at reducing or scaling the costs of the proposed requirements. One commenter suggested that the checks be required only after an issuer has met its target offering amount, so as to prevent unnecessary expense to the

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1533 *Id.*

1534 *See also* Section II.C.3 above.

1535 *See* Section IV.C.2.c below.

intermediary.[1536] Requiring a background check only after an issuer has reached its target may reduce the total cost of performing background checks for intermediaries; however, it also may result in intermediaries having to cancel offerings by issuers who fail the background checks, resulting in additional transactional and reputational costs for the intermediary. Overall, relative to this alternative, we believe that an intermediary performing a background check on an issuer prior to the securities offering will improve investor confidence in using a given intermediary.

While intermediaries are required to take certain steps to reduce the risk of fraud, the final rules provide intermediaries with the flexibility to decide the specific steps to take, consistent with some of the commenters' suggestions.[1537] We believe this may reduce intermediary costs relative to establishing a more stringent or more specific standard for intermediaries. For example, deeming an intermediary to have satisfied the Rule 301(b) requirement if the issuer has engaged the services of a transfer agent that is registered under Section 17A of the Exchange Act will reduce the intermediary cost while at the same time potentially improving investor protection.[1538] In addition, intermediaries may rely on the representations of the issuer unless they have reason to question the reliability of those representations. Overall, a more rigorous review requirement represents a tradeoff between enhanced investor confidence in the portal and higher compliance costs for intermediaries. We recognize that permitting an intermediary to rely on an issuer's representations unless the intermediary has reason to question the reliability of the representations can potentially lessen the incentive for an intermediary to thoroughly investigate the issuers and

[1536] Anonymous Letter 4.

[1537] *See, e.g.,* StartupValley Letter; Vann Letter.

[1538] We note that while for purposes of this provision, the issuer is not required to continue to engage the services of a registered transfer agent on an ongoing basis, since the use of a registered transfer agent is a condition for the Section 12(g) exemption, issuers with a large number of shareholders of record are expected to have an incentive to continue to engage the services of a registered transfer agent. *See* Section III.B.8. below.

securities to be offered on its platform. Such an outcome may result in higher levels of fraud compared to a requirement that intermediaries perform an independent investigation to ensure that the issuer complied with all the requirements. A higher level of fraud will negatively affect both investors in crowdfunding offerings and non-fraudulent issuers. While we recognize this potential adverse effect, we note that intermediaries may be subject to liability as "issuers," and this liability, together with potential reputational harm, is expected to provide significant incentives for intermediaries to monitor and investigate the offerings on their platforms. We also note that the communication channels provided on these platforms can provide a potential source of information for intermediaries, further facilitating their evaluation of prospective issuers.

c. Other Limitations on Intermediaries

The statute and final rules place certain limitations on intermediaries. These limitations are expected to increase investor protection in the securities-based crowdfunding market.

The final rules require an intermediary before accepting an investment commitment to have a reasonable basis for believing that an investor has not exceeded the final rules' investment limits but permit an intermediary to rely on investor representations concerning compliance unless the intermediary has reason to question the reliability of the representations.[1539] While we realize that investors may make inaccurate representations, we believe that this provision represents a reasonable approach to implement the statutory requirement, appropriately considering the need for investors to adhere to investment limitations while mitigating the costs incurred by intermediaries. The cost to update the required functionality for processing issuer disclosure and investor acknowledgment information is reflected in the tables above as part of the costs to

[1539] *See* Rule 303(b)(1) of Regulation Crowdfunding. *See also* Section II.C.5.b above.

develop a crowdfunding platform, and we believe that the ongoing burden to comply would be minimal.

Under the final rules, intermediaries must require any person, when posting a comment in the communication channels, to clearly disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer or a compensated promoter[1540] We believe that these disclosure requirements will benefit investors by promoting a transparent information sharing process. We further believe that intermediaries are in an appropriate position to take such steps as part of designing communication channels on their platform.

Under the final rules, intermediaries will incur direct costs in complying with the requirements to disclose compensation to promoters, and certain additional costs from time to time to ensure continued compliance. These costs are reflected in the table above as part of the costs of complying with the requirements to act as an intermediary in a Section 4(a)(6) transaction. In addition, if this requirement discourages the use of promoters by issuers, it may limit the investor pool for an offering made in reliance on Section 4(a)(6), thus limiting the ability of an issuer to raise capital.[1541]

The statute prohibits the directors, officers or partners of an intermediary, or any person occupying a similar status or performing a similar function, from having any financial interest in an issuer that uses the services of the intermediary. The final rules implement this statutory requirement. In a change from the proposed rules, the final rules provide exceptions to the prohibition on an intermediary having a financial interest in a crowdfunding issuer. The

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1540 *See* Rule 303(c)(4) of Regulation Crowdfunding. *See also* Section II.C.5.c above.

1541 *See* Rule 300(b) of Regulation Crowdfunding and Section II.C.2.b.

intermediary may hold a financial interest in the crowdfunding issuer if the financial interest represents compensation for the services provided to or for the benefit of the issuer in connection with the offer or sale of securities in a crowdfunding offering and consists of securities of the same class and having the same terms, conditions and rights as the securities being offered or sold in the crowdfunding offering through the intermediary's platform. By not extending the prohibition from having any financial interest in an issuer to intermediaries in all instances, the final rules allow for more flexibility in the payment arrangements between issuers and intermediaries. This additional option by which the issuer may pay an intermediary for its services may be beneficial for issuers by allowing them to use more of the capital raised in an offering for future investments rather than paying a portion of it as a fee to the intermediaries. It also allows funding portals to share in the upside of successful issuers, generating potentially larger revenue than the offering fee. While allowing intermediaries to have a financial interest in issuers can align incentives between intermediaries and investors,[1542] it can alternatively lead to potential conflicts of interest between intermediaries and investors.[1543] While we believe that such conflicts of interest are possible and may reduce investor protection, they will be significantly mitigated by the requirement that an intermediary's financial interest in an issuer consist of securities of the same class and having the same terms, conditions and rights as the securities being offered or sold in the crowdfunding offering through the intermediary's platform. Such limitations on an intermediary's financial interest, combined with reputational concerns and the

[1542] *See, e.g.,* AngelList Letter ("So long as the program was consistently applied without judgment by the intermediary, the net effect would purely be to align the interests of the intermediary with the investor."). *See also* EMKF Letter; Hackers/Founders Letter; Heritage Letter; Milken Institute Letter; RoC Letter; RocketHub Letter; Thomas Letter 1.

[1543] *See* Jacobson Letter.

accompanying disclosure requirements, will likely curb the incentives of intermediaries to act in a way that harms the interests of crowdfunding investors.

The statute requires that intermediaries ensure that all offering proceeds are provided to the issuer only when the aggregate capital raised from all investors is equal to or greater than a target offering amount.[1544] The final rules implement this requirement by requiring intermediaries that are registered as broker-dealers to comply with the existing requirements of Exchange Act Rule 15c2-4 and by requiring intermediaries that are registered funding portals to direct investors to transmit the funds or other consideration directly to a qualified third party that has agreed in writing to hold the funds for the benefit of the investors and the issuer and to promptly transmit or return the funds to the persons entitled to such funds.[1545] Based on several commenters' suggestions,[1546] we modified the proposed definition of qualified third parties in Rule 303(e) also to include registered broker-dealers that carry customer or broker or dealer accounts and hold funds or securities for those persons and credit unions insured by the NCUA.[1547] The final rules also require a funding portal to direct the qualified third party to transmit funds to the issuer once the target offering amount is reached and the cancellation period has elapsed; to return funds to an investor when an investment commitment has been cancelled; and to return funds to investors when the offering has not been completed.

These requirements will benefit investors and issuers by helping ensure that funds are appropriately refunded or transmitted in accordance with the terms of the offering. In particular, the requirement that the account in which funds are deposited be exclusively for the benefit of

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1544 *See* Section 4A(a)(7).

1545 *See* Rule 303(e) of Regulation Crowdfunding.

1546 *See, e.g.,* Growthfountain Letter; Vann Letter; Ex24 Letter; FOLIOfn Letter.

1547 *See* Rule 303(e) of Regulation Crowdfunding. *See also* Section II.C.5.b above.

investors and the issuer will help prevent the intermediary or other parties from claiming or otherwise unlawfully appropriating funds from that account. Expanding the definition of "qualified third parties" will increase the number of third parties available to hold funds in an escrow or in an account for the benefit of investors and the issuer, potentially reducing the cost of the service due to increased competition. We do not expect any significant costs due to this change from the proposed rules because credit unions insured by the NCUA offer similar protections to banks while registered broker-dealers that carry customer or broker or dealer accounts and hold funds or securities for those persons are subject to various regulatory obligations, which are designed to provide protection of investor funds through the imposition of capital and other requirements.[1548]

Under the statute, intermediaries may not compensate promoters, finders or lead generators for providing broker-dealers or funding portals with the personally identifiable information of any potential investor. The final rules implement this statutory requirement by prohibiting an intermediary from compensating any person for providing the personally identifiable information of any crowdfunding investor to intermediaries.[1549] Investors will benefit from the privacy protection provided by this prohibition. Intermediaries will incur a cost because the rule will not allow them to use personally identifiable information to target and seek out specific investors, thus reducing the potential investor pool for certain offerings. However, subject to this restriction, the final rules permit an intermediary to compensate a person for directing issuers or investors to the intermediary's platform in certain situations.[1550] This provision will

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1548 *See* note 868.

1549 *See* Rule 305(a) of Regulation Crowdfunding.

1550 *See* Rule 305(b).

provide intermediaries with an alternative means to attract more investors to their crowdfunding platforms, thereby mitigating some of the costs associated with the restriction on paying for personally identifiable information.

5. Additional Funding Portal Requirements

Under the final rules, a funding portal must register with the Commission by filing a complete Form Funding Portal with information concerning the funding portal's operation.[1551] The final rules also include the statutory requirement that a funding portal be a member of a registered national securities association. In the table above, we estimate the costs that intermediaries will incur related to registering as a funding portal on Form Funding Portal and becoming a member of a national securities association to be approximately $100,000 in the initial year and $10,000 thereafter.

The requirement that funding portals register with the Commission and become a member of a national securities association will benefit investors by providing regulatory oversight for these new entities, which will help to reduce the risk for fraud. Although there are costs associated with this requirement, we believe that the protections deriving from this requirement will benefit investors, issuers and potentially intermediaries by helping to create a marketplace in which investors are more willing to participate and issuers are more comfortable using this method of capital formation.

The final rules also require that funding portals use Form Funding Portal to provide updates whenever information on file becomes inaccurate for any reason, to register successor funding portals and to withdraw from funding portal registration. Although funding portals would incur time and compliance costs to update Form Funding Portal, we expect funding portals will

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1551. *See* Rule 400(a) of Regulation Crowdfunding.

have experience with the filing process for Form Funding Portal from their registration and, as a result, will be familiar with the filing process by the time they update the form. In the tables above, this cost is reflected in the $10,000 annual compliance cost associated with registering on Form Funding Portal and becoming a member of a registered national securities association.

The final rules allow nonresident funding portals to register with the Commission, provided that certain conditions are met.[1552] The final rules require a nonresident funding portal to appoint an agent for service of process in the United States and to certify both that it can, as a matter of law, and will provide the Commission and any national securities association of which it becomes a member with prompt access to its books and records and submit to onsite inspection and examination by the Commission and the national securities association. The funding portal also must provide an opinion of counsel attesting to the funding portal's ability to comply with these requirements under home country law. As discussed above, the final rules condition nonresident funding portal registration on the presence of an information sharing arrangement between the Commission and the regulator in the funding portal's jurisdiction.[1553] This provision is expected to facilitate Commission oversight of registered nonresident funding portals, with the potential benefit of stronger protection of investors in offerings conducted on such portals. However, it may limit the ability of some nonresident funding portals to register, potentially resulting in adverse competitive effects on nonresident portals in jurisdictions without an information sharing agreement.

Compared to the alternative of not allowing nonresident entities to operate as funding portals in the U.S. crowdfunding market, the final rules may increase competition among

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[1552] *See* Rule 400(f) of Regulation Crowdfunding.

[1553] *See* Rule 400(f) of Regulation Crowdfunding.

crowdfunding intermediaries, which in turn may reduce the fees that intermediaries charge to issuers. Lower costs of raising capital can also attract more potential issuers to the crowdfunding market, thus enhancing capital formation. Due to lack of data, we are not able to estimate the magnitude of these potential effects.

Although the requirements with respect to the appointment of an agent for service of process, a certification and a legal opinion will impose costs on nonresident funding portals, these requirements are expected to enhance investor protection by requiring steps designed to ensure that the books and records of funding portals that are not based in the United States, or that are subject to laws other than those of the United States, nevertheless are accessible to the Commission and other relevant regulators for purposes of conducting examinations of, and enforcing U.S. laws and regulations against these entities. For PRA purposes, we estimate that nonresident intermediaries will face an additional cost for outside professional services of $25,179 per intermediary to retain an agent for service of process and provide an opinion of counsel to register as a nonresident funding portal.[1554]

The statute also provides an exemption from broker-dealer registration for funding portals. The final rules implement the statutory requirement by stating that a registered funding portal is exempt from the broker-dealer registration requirements of Exchange Act Section 15(a)(1) in connection with its activities as a funding portal.[1555] We believe this approach of exempting funding portals from broker-dealer registration and its accompanying regulations will benefit the market and its participants. The activities of funding portals will be more limited than those of

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1554 For the purposes of the PRA, we estimate that entities that register as nonresident funding portals also will incur an additional internal burden of half an hour to complete Schedule C, half an hour to hire an agent for the service of process, and one hour to provide an opinion of counsel. *See* Section IV.C.2.a.

1555 *See* Rule 401 of Regulation Crowdfunding.

broker-dealers. Thus, the final rules require funding portals to comply with registration requirements that are more appropriate for their limited, permissible activities, rather than the more extensive and higher cost requirements that accompany broker-dealer registration. Lower registration costs for funding portals may translate into lower fees charged to issuers that use these portals, thus possibly benefiting issuers of crowdfunding securities and potentially increasing capital formation. Due to lack of data, we are unable to quantify these potential benefits.

a. Safe Harbor for Certain Activities

Exchange Act Section 3(a)(80) prohibits funding portals from (1) offering investment advice or recommendations, (2) soliciting purchases, sales or offers to buy securities offered or displayed on the funding portal's platform, (3) compensating employees, agents or other such persons for solicitation or based on the sale of securities displayed or referenced on the funding portal's platform, or (4) holding, managing, possessing or otherwise handling investor funds or securities. The final rules give funding portals, their associated persons, affiliates and business associates, a measure of clarity on activities that are permissible without violating these statutory prohibitions, while also helping to protect investors from activities that create potential conflicts of interest.[1556] Thus, compared with the alternative that we could have chosen, that of not providing the safe harbor, the safe harbor provisions in the final rules may facilitate regulatory compliance for funding portals, potentially with corresponding benefits for both issuers and investors. Some safe harbor provisions have additional benefits and costs, which we discuss below. Other safe harbor provisions may facilitate the implementation of other provisions of the final rules in instances where the crowdfunding intermediary is a funding portal, in which case the benefits and costs of such safe harbor provisions will be inseparable from the benefits and costs of

[1556] *See* Rule 402 of Regulation Crowdfunding.

the other provisions of the final rules as applied to instances where the crowdfunding intermediary is a funding portal.

The safe harbor for a funding portal to provide communication channels on its platform[1557] will facilitate the realization of the benefits of the provision in the final rules that requires the intermediary to provide communication channels on its platform[1558] in instances where the crowdfunding intermediary is a funding portal. The provision of communication channels by the funding portal has the potential to attract a greater number of investors to crowdfunding transactions through funding portals than otherwise would be the case, thereby encouraging capital formation. The provision of communication channels may enhance information sharing among investors, although the relevance and accuracy of the information shared by investors on these communication channels will likely vary from offering to offering.

In a change from the proposal, the final rules include a conditional safe harbor that will permit funding portals, consistent with the prohibitions under Exchange Act Section 3(a)(80), to determine whether and under what circumstances to allow an issuer to offer and sell securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through their platforms.[1559] Allowing funding portals to decide which securities to offer through their platforms will potentially decrease compliance costs for funding portals because limiting the offerings available on their platform can help decrease the risk of statutory liability under Section 4A(c) of the Securities Act, consistent with the suggestions of some commenters.[1560] The ability to determine which issuers may offer and sell securities through their platforms may also make it easier for

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1557 *See* Rule 402(b)(4) of Regulation Crowdfunding.

1558 *See* Rule 303(c) of Regulation Crowdfunding.

1559 *See* Rule 402(b)(1) of Regulation Crowdfunding.

1560 *See e.g.*, CrowdCheck 2 Letter; Milken Institute Letter; RocketHub Letter. *See also* Section II.D.3.a.

funding portals to bar potentially fraudulent offerings from their platforms, thereby potentially enhancing investor protection, consistent with the suggestions of various commenters,[1561] as well as screen out offerings by issuers that are unprepared or not "crowdfund-ready."[1562] A reduction in the prevalence of potentially fraudulent offerings, in turn, may increase investor confidence and facilitate capital formation in the securities-based crowdfunding market. However, we recognize that, depending on the funding portal, the ability to exercise discretion with respect to which offerings to include on the platform may result in the exclusion of some issuers that do not pose a risk of fraud, potentially limiting capital formation and investor access to crowdfunding investment opportunities in those instances. This concern is expected to be mitigated, in part, by the reputational incentives of intermediaries and competition within the crowdfunding market. We also recognize that, while funding portals remain subject to more limitations concerning their activities in the crowdfunding market relative to registered broker-dealers, the ability to exercise discretion with respect to which offerings to include on their platforms is expected to partly mitigate the competitive disadvantage of funding portals relative to registered brokers, as suggested by several commenters.[1563]

The final rules also allow a funding portal to highlight particular issuers or offerings of securities made in reliance on Section 4(a)(6) on its platform based on objective criteria, for example: (1) the type of securities being offered (*e.g.*, common stock, preferred stock or debt securities); (2) the geographic location of the issuer; (3) the industry or business segment of the issuer; (4) the number or amount of investment commitments made; (5) the progress in meeting

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1561 *See e.g.*, ABA Letter; CrowdCheck 2 Letter; Graves Letter; Seyfarth Letter.

1562 *See* EMKF Letter; SBEC Letter.

1563 *See e.g.*, BetterInvesting Letter; EMKF Letter; SBA Office of Advocacy Letter; ABA Letter; CfPA Letter; CrowdCheck 2 Letter; Graves Letter; Seyfarth Letter; IAC Recommendation; CFIRA Letter 12.

the target offering amount or, if applicable, the maximum offering amount, and (6) the minimum or maximum investment amount.[1564] The final rules require that these criteria be objective and reasonably designed to highlight a broad selection of issuers and offerings and be applied consistently to all potential issuers and offerings. They also specify that such criteria may not be related to the advisability of investing in the issuer or offering and may not give the impression of an investment recommendation.[1565] Under the final rules, funding portals may provide search functions or other tools on its platform that users may use to search, sort or categorize available offerings according to objective criteria.[1566]

A funding portal may choose to categorize offerings into general subject areas or provide search functions that, for example, allowing an investor to sort through offerings based on a combination of different objective criteria. We believe that these safe harbor provisions will benefit investors by facilitating investor access to information about offerings characterized by certain broad, objective criteria, to the extent that funding portals provide such features and tools in reliance on the final rules. By enabling issuers to utilize technology to lower the costs of each investor to search for information about a particular category of offerings, these provisions also may enhance efficiency. To the extent that the availability of these features and tools encourages investor participation in crowdfunding offerings, these provisions may have a beneficial effect on capital formation in the crowdfunding market.

The final rules prohibit a funding portal from receiving any special or additional compensation for highlighting (or offering to highlight) one or more issuers or offerings on its

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[1564] *See* Rule 402(b)(2) of Regulation Crowdfunding.

[1565] *Id.*

[1566] *See* Rule 402(b)(3) Regulation Crowdfunding.

platform.[1567] This prohibition is expected to benefit investors by helping prevent conflicts of interest and incentives for funding portals to favor certain issuers over others. The final rules also make clear that such objective criteria may not include the advisability of investing in the issuer or its offering or an assessment of any characteristic of the issuer, its business plan, its management, or risks associated with an investment.[1568]

Under the final rules, funding portals are permitted to provide advice to an issuer on the structure and content of its offerings, including assistance to the issuer in preparing offering documentation.[1569] This will allow issuers to obtain guidance that may not typically be available to them and thereby help to lower funding costs. Many potential issuers seeking to offer and sell crowdfunding securities are unlikely to be familiar with how to structure offerings so as to raise capital in the most cost effective manner, and they may not have the capital, knowledge or resources to hire outside advisors. Given that an issuer will be required to conduct its securities-based crowdfunding offerings through an intermediary, we believe that permitting funding portals to provide these services to issuers will lower overall transaction costs for issuers, as they will not need to engage additional parties to provide these services. This effect will in turn help enhance market efficiency.

The final rules also provide a safe harbor for a funding portal to compensate a third party for referring a person to the funding portal in certain circumstances.[1570] This enables funding portals to realize the benefits of the provision in the final rules that permits an intermediary to compensate a person for directing issuers or investors to the intermediary's platform in certain

1567 *See* Rule 402(b)(2) of Regulation Crowdfunding.

1568 *See* Rule 402(b)(2) and Rule 402(b)(3) of Regulation Crowdfunding.

1569 *See* Rule 402(b)(5) of Regulation Crowdfunding.

1570 *See* Rule 402(b)(6) of Regulation Crowdfunding.

circumstances.[1571] This provision is expected to benefit intermediaries by providing them with a means to attract more investors to their crowdfunding platforms, thereby encouraging capital formation. Investors also will benefit from the condition of this safe harbor prohibiting transaction-based compensation (other than to registered broker-dealers), which is expected to reduce the incentive for abusive practices.

The final rules also provide a safe harbor for a funding portal to pay or offer to pay compensation to a registered broker-dealer for services provided in connection with the offer or sale of securities in reliance on Section 4(a)(6), subject to conditions set forth in the rule.[1572] Similarly, a funding portal can, subject to certain conditions, receive compensation from a registered broker-dealer for services provided in connection with the offer or sale of securities by the funding portal in reliance on Section 4(a)(6).[1573] We note that some commenters expressed concern that such relationships between funding portals and broker-dealers could create conflicts of interest.[1574] However, funding portals are expected to benefit from being able to enter into these types of arrangements with registered broker-dealers who can provide services that the funding portals otherwise are prohibited from providing, such as engaging a broker-dealer to serve as a qualified third party for the transmission of investor funds. Broker-dealers also will benefit from the additional business that funding portals may be able to attract through the funding portals' platforms, as well as from services, such as those related to technology, that funding portals can provide. We anticipate that these types of service arrangements will ultimately benefit investors.

[1571] *See* Rule 305(b) of Regulation Crowdfunding.

[1572] *See* Rule 402(b)(7) of Regulation Crowdfunding.

[1573] *See* Rule 402(b)(8) of Regulation Crowdfunding.

[1574] *See e.g.,* Commonwealth of Massachusetts Letter; RocketHub Letter.

The final rules permit a funding portal to advertise its existence and identify one or more issuers or offerings available through its platform subject to certain conditions.[1575] This provision will benefit funding portals by allowing them to potentially attract more investors to their crowdfunding platforms. This provision also may enhance market efficiency as investors become more aware of available offerings through advertisements by funding portals and are thus able to better match their investments with projects that are better suited to their risk preferences and investment strategies. The conditions on advertising by funding portals in the final rules aim to consider informational benefits and investor protection concerns. For instance, while a funding portal advertising its existence may also identify one or more issuers or offerings available on its platform, it must do so on the basis of objective criteria that are reasonably designed to identify a broad selection of issuers and offerings and are applied consistently to all potential issuers and offerings. In addition, advertisements sent by a funding portal must not suggest that it is a recommendation to purchase a security or advice as to the advisability in investing in any security.[1576] While we believe these conditions are appropriate to protect the integrity of the crowdfunding market, we recognize that they may impose costs on funding portals. For example these conditions may limit the utility of advertising for the funding portal while the prohibition on special or additional compensation for identifying the offering in an advertisement may reduce the funding portal's revenue.

As discussed above, the final rules require an intermediary to deny access to its platform to an issuer that the intermediary has a reasonable basis for believing presents the potential for fraud

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[1575] *See* Rule 402(b)(9) of Regulation Crowdfunding.

[1576] *See* Section II.D.3.h.

or otherwise raises concerns about investor protection.[1577] The final rules also provide a conditional safe harbor to intermediaries that are funding portals to deny access to the platform or cancel an offering in such instances.[1578] These provisions are expected to enhance investor protection by giving funding portals greater ability to deny potentially fraudulent offerings. Funding portals are expected to benefit from the ability to deny access to certain issuers to protect the integrity of the offering process and the market reputation of their crowdfunding platforms, without fear of violating the statutory prohibition on providing investment advice.

The final rules specify that a funding portal may accept, on behalf of an issuer, investment commitments for crowdfunding offerings from investors.[1579] Under the final rules funding portals also can direct investors where to transmit funds or remit payment in connection with the purchase of securities offered and sold in reliance on Section 4(a)(6).[1580] Similarly, a funding portal can direct a qualified third party to release proceeds of a successful offering to the issuer upon completion of the offering or to return investor proceeds when an investment commitment or offering is cancelled.[1581] These provisions will facilitate the implementation of the requirements of the final rules regarding the maintenance and transmission of investor funds[1582] for intermediaries that are funding portals and give both funding portals and entities with which they do business a measure of legal certainty that funding portals accepting investment commitments for crowdfunding offerings and providing direction for funds to and from qualified third parties in

1577 *See* Rule 301(c) of Regulation Crowdfunding.

1578 *See* Rule 402(b)(10) of Regulation Crowdfunding.

1579 *See* Rule 402(b)(11) of Regulation Crowdfunding.

1580 *See* Rule 402(b)(12) of Regulation Crowdfunding.

1581 *See* Rule 402(b)(13) of Regulation Crowdfunding.

1582 *See* Rule 303(e) of Regulation Crowdfunding.

compliance with the final rules will not be in violation of the statutory prohibitions on holding, managing, possessing or otherwise handling investor funds or securities. While we agree with the commenter that stated that the requirement to use a qualified third party to handle customer funds creates an additional cost,[1583] Section 3(a)(80)(D) of the Exchange Act explicitly prohibits funding portals from handling customer funds and securities.

b. Compliance Requirements

The final rules require that a funding portal implement written policies and procedures, reasonably designed to achieve compliance with the federal securities laws and the rules and regulations thereunder, relating to its business as a funding portal.[1584] This requirement will provide a benefit to investors and funding portals alike, as written policies and procedures will enhance compliance with the final rules. Funding portals will incur costs associated with the requirement to develop their own procedures and implement written policies and procedures, as well as to update and enforce them. These costs are reflected in the tables above as part of the costs to comply with requirements to act as an intermediary in transactions pursuant to Section 4(a)(6).

In contrast to the proposal, the final rules do not impose anti-money laundering (AML) obligations for funding portals. Some commenters generally suggested that since funding portals are prohibited from handling customer funds and securities, they should not be required to comply with AML provisions.[1585] As noted above, we believe it would be appropriate to work with other

1583 *See* Stephenson, *et al.*, Letter.

1584 *See* Rule 403(a) of Regulation Crowdfunding.

1585 *See, e.g.*, PeoplePowerFund Letter; Public Startup Letter 3; RFPIA Letter.

regulators to develop consistent and effective AML obligations for funding portals.[1586] By not imposing AML requirements in the final rules, we may avoid the possibility of conflicting or overlapping requirements. Registered broker-dealers that serve as intermediaries in securities-based crowdfunding transactions continue to have AML obligations, as do certain other parties involved in transactions conducted pursuant to Section 4(a)(6), such as a bank acting as a qualified third party to hold investor funds.[1587] To the extent that this difference in compliance obligations between funding portals and registered broker-dealers affects compliance costs and persists in the future, it may place funding portals at a relative competitive advantage. If this difference in compliance obligations between funding portals and registered broker-dealers persists in the future, it may also potentially expose investors in those securities-based crowdfunding offerings for which the intermediary is a funding portal to additional risks.

Additionally, the statute requires that intermediaries take such steps to protect the privacy of information collected from investors as we determine appropriate. In the final rules, we implement this statutory provision by requiring a funding portal to comply with Regulation S-P, S-ID and Regulation S-AM, as they apply to broker-dealers.[1588] We recognize that compliance with these privacy requirements will impose costs on funding portals. However, we believe that requiring a funding portal to comply with privacy obligations will help protect the personally identifiable information of investors, consistent with how it is required to be protected by other financial intermediaries. These privacy protections can give investors the confidence to participate in offerings made in reliance on Section 4(a)(6), which will facilitate capital formation

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[1586] *See* Section II.D.4.b.

[1587] *Id.*

[1588] *See* Rule 403(b) of Regulation Crowdfunding.

and benefit the markets generally. As an alternative, we could have developed a more limited privacy regime applicable only to funding portals. Such an alternative would result in inconsistent treatment of funding portals and broker-dealers with respect to privacy obligations and could reduce the willingness of investors to participate in securities-based crowdfunding offerings. This alternative might also affect competition between funding portals and registered broker-dealers in the market for securities-based crowdfunding offerings.

As a condition to exempting funding portals from the requirement to register as broker-dealers under Exchange Act Section 15(a)(1), Exchange Act Section 3(h)(1)(A) requires that registered funding portals remain subject to, among other things, the Commission's examination authority. Under the final rules, a funding portal is required to permit the examination and inspection of all its business and business operations relating to its activities as a funding portal, such as its premises, systems, platforms and records, by Commission representatives and by representatives of the registered national securities association of which it becomes a member.[1589] Although funding portals will face time and compliance costs in submitting to Commission and registered national securities association examinations, inspections or investigations, and potentially responding to any issues identified, funding portals, investors and issuers will benefit from the enhanced compliance with legal obligations due to this oversight, as well as the sanctions or other disciplinary actions that may follow upon findings of violations through such inspections, examinations or investigations.

Further, the final rules require a registered funding portal to maintain and preserve certain books and records relating to its business for a period of not less than five years and in an easily-

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1589 *See* Rule 403(c) of Regulation Crowdfunding.

accessible place for the first two years.[1590] Recordkeeping requirements can assist registrants with compliance. They are a well-established and important element of the approach to broker-dealer regulation, as well as the regulation of investment advisers and others, and are designed to maintain the effectiveness of our inspection program for regulated entities, facilitating our review of their compliance with statutory mandates and with our rules. These requirements will enable the Commission and registered national securities organizations to more effectively gather information about the activities in which a funding portal has been engaged to discern whether the funding portal and the other parties are in compliance with the requirements of Regulation Crowdfunding and other relevant regulatory requirements. Standardized recordkeeping practices for intermediaries will enable regulators to perform more efficient, targeted inspections and examinations and thereby increase the likelihood of identifying improper conduct at earlier stages of the inspection or examination, which ultimately will benefit investors and the marketplace as a whole. To the extent that these requirements result in better regulatory oversight, they may increase investor confidence in funding portals and may also benefit funding portals by promoting issuer reliance on funding portals in crowdfunding offerings.

Funding portals may incur costs in establishing the systems necessary to comply with the books and records requirements. We note that the records required to be made and preserved under the final rules are those that would ordinarily be made and preserved in the ordinary course of business by a regulated broker-dealer engaging in these activities. Entities that newly register as broker-dealers will be subject to the recordkeeping requirements of Rules 17a-3 and 17a-4.

[1590] *See* Rule 404(a) of Regulation Crowdfunding. We note that registered broker-dealers already are required to comply with Exchange Act Rules 17a-3 and 17a-4 pertaining to books and records (17 CFR 240.17a-3 and 17a-4). Thus, all intermediaries, whether registered as broker-dealers or as funding portals, are required to make and preserve books and records.

While these costs will constitute part of the cost of compliance for entities that choose to become intermediaries in crowdfunding transactions by registering as broker-dealers, the cost of broker-dealer compliance with recordkeeping requirements of Rules 17a-3 and 17a-4 is not by itself a result of the final rule. Entities solely intending to serve as intermediaries in crowdfunding transactions for which the cost of compliance with broker-dealer recordkeeping requirements is too high may elect to register as funding portals. Funding portals will be required to make and keep records related to their activities to facilitate transactions in reliance on Section 4(a)(6), which we estimate for the purposes of the PRA to result in an initial burden of 325 hours and an initial cost of $5,350 per funding portal. We estimate that ongoing recordkeeping burden and cost will be similar to the initial burden and cost.[1591] We also note that some commenters stated that the cost burden for a funding portal to maintain the proposed books and records would not be significant.[1592] We recognize that there may be a slight competitive advantage for funding portals over broker-dealers to the extent that the recordkeeping rule for funding portals is less burdensome for than the requirements applicable to broker-dealers. At the same time, we believe that the recordkeeping rule for funding portals is consistent with the narrow range of their permitted activities.

6. Insignificant Deviations

We are providing a safe harbor for issuers for certain insignificant deviations from a term, condition or requirement of Regulation Crowdfunding.[1593] This safe harbor will provide that insignificant deviations from a term, condition or requirement of Regulation Crowdfunding will

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[1591] *See* Section IV.C.2.n.

[1592] *See* CFIRA Letter 1; Joinvestor Letter.

[1593] *See* Rule 502(a) of Regulation Crowdfunding.

not result in a loss of the exemption, so long as the issuer relying on the exemption can show that: (1) the failure to comply was insignificant with respect to the offering as a whole; (2) the issuer made a good faith and reasonable attempt to comply with all applicable terms, conditions and requirements of Regulation Crowdfunding; and (3) the issuer did not know of the failure to comply, where the failure to comply with a term, condition or requirement was the result of the failure of the intermediary to comply with the requirements of Section 4A(a) and the related rules, or such failure by the intermediary occurred solely in offerings other than the issuer's offering.

The safe harbor is expected to decrease the costs incurred by issuers compared to the alternative of not providing a safe harbor. In the absence of a safe harbor, issuers might be hesitant to participate in this new marketplace for fear of inadvertently violating an applicable regulatory requirement, thereby reducing the benefits of Regulation Crowdfunding on efficiency, competition and capital formation. We recognize that providing a safe harbor can impose costs on investors, intermediaries and regulators, compared with the alternative of not providing a safe harbor, to the extent that issuers lessen the vigor with which they develop and implement systems and controls to achieve compliance with the requirements of Regulation Crowdfunding, which may result in a decrease in investor protection. Accordingly, we have designed the conditions of the safe harbor – specifically, the issuer must show that the failure to comply was insignificant with respect to the offering as a whole; it made a good faith and reasonable attempt to comply; and it did not know of the failure or such failure occurred solely in offerings other than the issuer's offering – to lessen the potential impact on investor protection.

Several commenters suggested that the safe harbor for insignificant deviations should not apply with respect to state regulatory enforcement actions.[1594] Adopting such an alternative could have significantly undermined the utility of the Section 4(a)(6) exemption by subjecting issuers to loss of state law preemption[1595] and potential state enforcement action for insignificant deviations from Regulation Crowdfunding's requirements.

7. Relationship with State Law

Section 305 of the JOBS Act amended Securities Act Section 18(b)(4)[1596] to preempt the ability of states to regulate certain aspects of crowdfunding conducted pursuant to Section 4(a)(6). This statutory amendment will benefit issuers by preempting any registration requirements in states in which they offer or sell securities in reliance on Section 4(a)(6), thereby reducing the costs for these transactions. It also can benefit investors because these cost savings ultimately may be passed on to investors. Absent preemption of state registration requirements, an offering made through the Internet in reliance on Section 4(a)(6) and the final rules could result in an issuer potentially violating state securities laws. Some evidence in donation-based and reward-based crowdfunding campaigns suggests that contributions are not exclusively local.[1597] The statutory preemption of state registration requirements will reduce issuer uncertainty about the necessity of state registration. On the other hand, state registration requirements may provide an additional layer of investor protection, and their preemption will remove a potential layer of

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1594 *See, e.g.,* Commonwealth of Massachusetts Letter; NASAA Letter.

1595 *See* Section III.B.7.

1596 15 U.S.C. 77r(b)(4).

1597 For example, in crowdfunding campaigns for early stage musical projects, the average distance between artist-entrepreneurs and contributors was 3,000 miles. *See* Ajay Agrawal, Christian Catalini and Avi Goldfarb, *The Geography of Crowdfunding*, NET Institute Working Paper No. 10-08 (Oct. 29, 2010), *available at* http://ssrn.com/abstract=1692661.

review that may help to deter fraud. This potential cost of state law preemption, however, may be offset by some of the statutory and final rule requirements that are designed to protect investors, such as public disclosure,[1598] investment limits,[1599] the use of a registered intermediary,[1600] provisions regarding measures to reduce the risk of fraud,[1601] and disqualification provisions.[1602] The requirement in the final rules that issuers file information on EDGAR also helps to ensure that information about issuers is available to individual state regulators, which retain the authority to bring enforcement actions for fraud.

8. Exemption from Section 12(g)

Rule 12g-6 provides that securities issued pursuant to an offering made under Section 4(a)(6) are exempted from the record holder count under Section 12(g) provided the issuer is current in its ongoing annual reports required pursuant to Rule 202 of Regulation Crowdfunding, has total assets as of the end of its last fiscal year not in excess of $25 million, and has engaged the services of a transfer agent registered with the Commission pursuant to Section 17A of the Exchange Act. The issuer size test is broadly consistent with some commenters' suggestions.[1603]

An issuer that exceeds the $25 million total asset threshold in addition to exceeding the thresholds in Section 12(g) will be granted a two-year transition period before it is required to register its class of securities pursuant to Section 12(g), provided it timely files all its ongoing reports due pursuant to Rule 202 of Regulation Crowdfunding during such period.[1604] Section

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[1598] *See* Rule 201 of Regulation Crowdfunding.

[1599] *See* Rule 100(a)(2) of Regulation Crowdfunding.

[1600] *See* Rule 100(a)(3) of Regulation Crowdfunding.

[1601] *See* Rule 301 of Regulation Crowdfunding.

[1602] *See* Rule 503 of Regulation Crowdfunding.

[1603] *See, e.g.*, ABA Letter ($25 million); PeoplePowerFund Letter.

[1604] *Id.*

12(g) registration will be required only if, on the last day of the fiscal year in which the company exceeded the $25 million total asset threshold, the company has total assets of more than $10 million and the class of equity securities is held by more than 2,000 persons or 500 persons who are not accredited investors.[1605] In such circumstances, an issuer that exceeds the thresholds in Section 12(g) and has total assets of $25 million or more is required to begin reporting under the Exchange Act the fiscal year immediately following the end of the two-year transition period.[1606] An issuer entering Exchange Act reporting will be considered an "emerging growth company" to the extent the issuer otherwise qualifies for such status.

The conditional 12(g) exemption will defer the more extensive Exchange Act reporting requirements until the issuer either sells securities in a registered transaction or registers a class of securities under the Exchange Act. Consequently, smaller issuers will not be required to become an Exchange Act reporting company as a result of a Section 4(a)(6) offering. These offerings may have a large number of investors due to the limits on the amount each investor may invest and the absence of investor eligibility restrictions, or as a result of secondary market transactions in crowdfunding securities after the expiration of resale restrictions. Given the $1 million offering limitation, the potential cost of becoming an Exchange Act reporting company could have made many offerings in reliance on Section 4(a)(6) prohibitively costly.

The condition that the issuer remain current in its ongoing reporting, as suggested by one commenter,[1607] is intended to provide sufficient disclosure to help investors make informed decisions. We believe that the ongoing disclosures required of crowdfunding issuers in the final

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1605 15 U.S.C. 78*l*(g).

1606 17 CFR 240.12g-6.

1607 *See* Joinvestor Letter.

rules accomplish this objective and provide an appropriate consideration of investor protection and capital formation. This condition is expected to increase the level of investor protection by strengthening the incentives of securities-based crowdfunding issuers that exceed the Section 12(g) thresholds related to issuer size and the number of shareholders of record to comply with the ongoing reporting requirements of Regulation Crowdfunding. The extent of additional investor protection benefits from this condition is difficult to estimate, given a separate provision in the final rules that conditions the use of the Section 4(a)(6) exemption for future offerings on compliance with Regulation Crowdfunding's ongoing reporting requirements.

The issuer size limit condition is designed to be broadly consistent with the crowdfunding exemption being tailored to facilitate small company capital formation and the likely small size of a typical issuer in the crowdfunding market. This condition is expected to strengthen investor protection by reducing the likelihood that an issuer will grow and accumulate a significant number of investors as a result of multiple offerings in reliance on Section 4(a)(6) while remaining permanently exempt from the more extensive reporting requirements of the Exchange Act that would otherwise be required pursuant to Section 12(g) (unless the issuer registers a class of securities). The size limit condition will require larger issuers to provide investors with the more extensive disclosures required by the Exchange Act for reporting companies. However, we recognize that this condition also may subject crowdfunding issuers that are larger than the size threshold or that have a higher rate of growth, and are thus more likely to exceed the size threshold in the future, to the costs of Section 12(g) registration and Exchange Act reporting, potentially placing them at a competitive disadvantage to issuers that are close to but below the size threshold. It may also discourage some high-growth issuers from relying on Section 4(a)(6)

or may lead issuers approaching the size threshold to divest assets to remain under the threshold, potentially resulting in inefficient investment decisions.

While the condition requiring an issuer to use a registered transfer agent to rely on the exemption will impose costs on issuers,[1608] it is designed to provide investor protection benefits by introducing a regulated entity with experience in maintaining accurate shareholder records, thus helping to ensure that security holder records and secondary trades will be handled accurately.

9. Disqualification

The statute and the final rules impose disqualification provisions under which an issuer is not eligible to offer securities pursuant to Section 4(a)(6) and an intermediary is not eligible to effect or participate in transactions pursuant to Section 4(a)(6).[1609] The disqualification provisions for issuers are substantially similar to those imposed under Rule 262 of Regulation A and Rule 506 of Regulation D,[1610] while the disqualification provisions for intermediaries under Section 3(a)(39), which is an established standard for broker-dealers, are substantially similar to the provisions of Rule 262.

1608 *See* STA Letter (stating that strong competition in the registered transfer agent industry may result in monthly fees of $75 - $300 for transfer agent services, depending on a number of factors). *See also* CapSchedule Letter (stating that there exist cost-effective ways to keep records of security holders, such as "Software-As-A-Service" products, that costs $0 to set up initial records regardless of the number of investors, then pricing from $5 per month for up to 100 investors, $15 per month up to 1,000 investors and $25 per month for over 1,000 investors).

1609 *See* Section 302(d) of the JOBS Act and Rule 503 of Regulation Crowdfunding. *See also* discussion in Section II.E.6 above.

1610 *See Disqualification Adopting Release*, note 1182. *See also Regulation A Adopting Release*, note 506.

a. **Issuers**

The final rules are expected to induce issuers to implement measures to restrict bad actor participation in offerings made in reliance on Section 4(a)(6). This will help reduce the potential for fraud in the market for such offerings, which in turn may reduce the cost of raising capital to issuers that rely on Section 4(a)(6), to the extent that disqualification standards lower the risk premium associated with the presence of bad actors in securities offerings. In addition, the requirement that issuers determine whether any covered persons are subject to disqualification may obviate the need for investors to do their own investigations and eliminate redundancies that may exist in otherwise separate investigations. This is expected to help reduce information-gathering costs to investors, to the extent that issuers are at an advantage in accessing much of the relevant information and to the extent that issuers can do so at a lower cost than investors.

The final rules will, however, impose costs on some issuers, other covered persons and investors. If issuers are disqualified from relying on Section 4(a)(6) to make their offerings, they may experience increased costs in raising capital through alternative methods that do not require bad actor disqualification, if available, or they may be precluded from raising capital altogether. This can result in negative effects on capital formation. In addition, issuers may incur costs in connection with internal personnel changes that issuers may make to avoid the participation of those covered persons who are subject to disqualifying events. Issuers also may incur costs associated with restructuring share ownership positions to avoid having 20 Percent Beneficial Owners who are subject to disqualifying events. Finally, issuers may incur costs in connection with seeking waivers of disqualification from the Commission or determinations by other authorities that existing orders do not give rise to disqualification.

The final rules provide a reasonable care exception whereby an issuer will not lose the benefit of the Section 4(a)(6) exemption if it is able to show that it did not know, and in the exercise of reasonable care could not have known, of the existence of a disqualification.[1611] A reasonable care exception may encourage capital formation by eliminating any hesitation issuers may otherwise experience under a strict liability standard. However, such an exception also may encourage issuers to take fewer steps to inquire about the existence of a disqualification than they would if a strict liability standard applied, increasing the potential for fraud in the market for offerings made in reliance on Section 4(a)(6). Nevertheless, some issuers, in exercising reasonable care, may incur costs associated with conducting and documenting their factual inquiry into possible disqualifications. The lack of specificity in the rule, while providing flexibility to the issuer to tailor its factual inquiry as appropriate to a particular offering, may increase these costs because uncertainty can drive issuers to do more than necessary under the rule.

The requirement under the final rules that issuers disclose matters that would have triggered disqualification, had they occurred after the effective date of Regulation Crowdfunding,[1612] also will impose costs and benefits. The disclosure requirement will reduce costs associated with covered persons who would be disqualified under the final rules but for the fact that the disqualifying event occurred prior to the effective date of the rules. However, this approach will allow the participation of past bad actors, whose disqualifying events occurred prior to the effective date of the final rules, which can expose investors to the risks that arise when bad actors are associated with an offering. Nevertheless, investors will benefit by having access to such information that can inform their investment decisions. Issuers also may incur costs

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1611 *See* Rule 503(b)(4) of Regulation Crowdfunding. *See also* Section II.E.6.a.iii.

1612 *See* Rule 201(u) of Regulation Crowdfunding. *See also* Section II.E.6.a.v.

associated with the factual inquiry, preparing the required disclosure and making any internal or share ownership changes to avoid the participation of covered persons that trigger the disclosure requirement. Disclosure of triggering events also may make it more difficult for issuers to attract investors, and issuers may experience some or all of the impact of disqualification as a result.

We believe the inclusion of Commission cease-and-desist orders in the list of disqualifying events will not impose a significant, incremental cost on issuers and other covered persons because many of these actors may already be subject to disqualifying orders issued by the states, federal banking regulators and the National Credit Union Administration.[1613]

Under the final rules, orders issued by the CFTC will trigger disqualification to the same extent as orders of the regulators enumerated in Section 302(d)(2)(B)(i) of the JOBS Act (*e.g.*, state securities, insurance and banking regulators, federal banking agencies and the National Credit Union Administration). We believe that including orders of the CFTC will result in the similar treatment, for disqualification purposes, of comparable sanctions. In this regard, we note that the conduct that will typically give rise to CFTC sanctions is similar to the type of conduct that will result in disqualification if it were the subject of sanctions by another financial services industry regulator. This is likely to enable the disqualification rules to more effectively screen out bad actors.

As discussed above, the baseline for our economic analysis of Regulation Crowdfunding, including the baseline for our consideration of the effects of the final rules on efficiency, competition and capital formation, is the situation in existence today, in which startups and small businesses seeking to raise capital through securities offerings must register the offer and sale of securities under the Securities Act unless they can comply with an existing exemption from

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1613 *See Disqualification Adopting Release*, note 1182.

registration under the federal securities laws. Relative to the current baseline, we believe that the disqualification provisions will not impose significant incremental costs on issuers and other covered persons because the final rules are substantially similar to the disqualification provisions under existing exemptions.

As an alternative, we could have specified that pre-existing events are subject to the disqualification rules, as suggested by some commenters.[1614] As another alternative, we could have expanded the list of covered persons to include transfer agents and lawyers, as suggested by one commenter.[1615] By expanding the range and categories of potentially disqualified persons, both of these alternatives could have the benefit of strengthening investor protection. At the same time, they would increase the compliance costs for issuers and disqualified persons described above. Overall, we believe that preserving consistency with the disqualification criteria of Rule 262 and Rule 506, as we do in the final rules, can potentially yield compliance cost savings for issuers that undertake multiple types of exempt offerings while still maintaining appropriate investor protections.

b. Intermediaries

With regard to intermediaries, the final rules apply the disqualification provisions under Section 3(a)(39) of the Exchange Act, rather than a standard based on Rule 262.[1616] The Section 3(a)(39) standard is an established one among broker-dealers and their regulators, and we believe that, despite the differences, Section 3(a)(39) and Rule 262 are substantially similar with regard to

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1614 *See, e.g.*, Guzik Letter 1; NASAA Letter.

1615 *See* Brown J. Letter (also recommending the Commission adopt similar bad actor provisions under Rule 504).

1616 *See* Rule 503(d) of Regulation Crowdfunding.

the persons and events they cover, their scope and their purpose.[1617] We believe that imposing any new or different standard, including one based on Rule 262, for those intermediaries that engage in crowdfunding transactions would likely create confusion and unnecessary burdens, as currently-registered broker-dealers and their associated persons would become subject to two distinct standards for disqualification. Moreover, adopting a more stringent disqualification standard may reduce the number of intermediaries eligible under the final rules and decrease competition among intermediaries in the securities-based crowdfunding market. By contrast, consistent standards for all broker-dealers and funding portals will assist a registered national securities association in monitoring compliance and enforcing its rules.

The final rules implement the statutory requirement for intermediaries by providing that a person subject to a statutory disqualification, as defined in Exchange Act Section 3(a)(39), may not act as, or be an associated person of, an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) unless so permitted by Commission rule or order. While this requirement will potentially reduce the number of intermediaries for Section 4(a)(6) transactions, we expect that it will strengthen investor protection by preventing bad actors from entering the securities-based crowdfunding market, thereby reducing the potential for fraud and other abuse.

As discussed above, the baseline for our economic analysis of Regulation Crowdfunding, including the baseline for our consideration of the effects of the final rules on efficiency, competition and capital formation, is the situation in existence today, in which intermediaries intending to facilitate securities transactions are required to register with the Commission as broker-dealers under Exchange Act Section 15(a). Relative to this baseline, we believe that the

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[1617] *See* discussion in Section II.E.6.b above.

disqualification provisions will not impose significant incremental costs to broker-dealers because the final rules include the same disqualification provisions that are already imposed on broker-dealers.

IV. PAPERWORK REDUCTION ACT

A. Background

Certain provisions of the final rules contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[1618] We published a notice requesting comment on the collection of information requirements in the Proposing Release, and we submitted the proposal to the Office of Management and Budget ("OMB") for review in accordance with the PRA.[1619]

In the Proposing Release, we solicited comment on the assumptions and estimates in our PRA analysis. We received no comments on our estimates of and assumptions about the number of issuers and intermediaries that will participate in securities-based crowdfunding transactions or the size and frequency of those transactions. We received several comments on our estimates of the time and expense required of issuers to meet their filing obligations.[1620] We also received several comments on our estimates of the costs incurred by intermediaries.[1621] One commenter recommended a lessened paperwork burden in general.[1622] These comments are discussed in further detail below, and where appropriate, we have revised our burden estimates in response to commenters' suggestions and to reflect changes in the final rules, as adopted.

[1618] 44 U.S.C. 3501 *et seq.*

[1619] 44 U.S.C. 3507(d); 5 CFR 1320.11.

[1620] *See, e.g.,* Angel Letter 1; Heritage Letter; SeedInvest Letter 1.

[1621] *See, e.g.,* Arctic Island Letter 8; CapSchedule Letter; Heritage Letter; Joinvestor Letter; SBEC Letter; Seed & Spark Letter; STA Letter.

[1622] Peers Letter.

The titles for the collections of information are:

(1) "Form ID" (OMB Control Number 3235-0328);

(2) "Form C" (OMB Control Number 3235-0716) (a new collection of information);

(3) "Form BD" (OMB Control Number 3235-0012); and

(4) "Crowdfunding Rules 300-304 – Intermediaries" (OMB Control Number 3235-0726)[1623] (a new collection of information) and

(5) "Crowdfunding Rules 400-404 – Funding Portals" (OMB Control Number 3235-0727)[1624] (a new collection of information).

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. We applied for OMB control numbers for the new collections of information in accordance with 44 U.S.C. 3507(j) and 5 CFR 1320.13, and as of the date of this release, OMB has assigned a control number to each new collection as specified above. Responses to these new collections of information will be mandatory for issuers raising capital under Regulation Crowdfunding and intermediaries participating in offerings under Regulation Crowdfunding.

The hours and costs associated with preparing disclosure, filing forms, and retaining records constitute reporting and cost burdens imposed by the collections of information. In deriving estimates of these hours and costs, we recognize that the burdens likely will vary among individual issuers and intermediaries based on a number of factors, including the stage of development of the business, the amount of capital an issuer seeks to raise, the number of

1623 This includes burdens for compliance with privacy rules (Reg. S-P, Reg. S-AM and Reg S-ID) as required by Rule 403(b).

1624 This includes burdens for Form Funding Portal.

offerings an intermediary hosts on its platform, and the number of years since inception of the business. We believe that some issuers and intermediaries will experience costs in excess of the average and some issuers and intermediaries may experience less than the average costs.

B. Estimate of Issuers and Intermediaries

1. Issuers

The number, type and size of the issuers that will participate in securities-based crowdfunding transactions are uncertain, but data on current market practices may help identify the number and characteristics of potential issuers that may offer and sell securities in reliance on Section 4(a)(6).[1625] While it is not possible to predict the number of future offerings made in reliance on Section 4(a)(6), particularly because rules governing securities-based crowdfunding are not yet in effect, for purposes of this analysis, we estimate that approximately 1,900 issuers will seek to offer and sell securities in reliance on Section 4(a)(6) per year. We base this estimate on the average number of issuers (excluding issuers that are pooled investment vehicles) per year that conducted a new Regulation D offering of up to $1 million from 2009 to 2014 and had no revenues or less than $1 million in revenues.[1626] We believe those issuers will be similar in size to the potential issuers that may participate in securities-based crowdfunding, and we assume that each issuer will conduct one offering per year.

We received no comments on our estimate of the number of issuers expected to participate in securities-based crowdfunding transactions or the number of offerings in reliance on Section

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[1625] *See* Section III.A.5.a for a discussion of the data regarding current market practices.

[1626] *Id.* This estimate differs from our estimate in the proposal. It uses more recent data than the proposal and is based on the average number of issuers per year rather than the average number of unique issuers. According to filings made with the Commission, an average of approximately 4,559 issuers per year conducted new Regulation D offerings of up to $1 million from 2009 to 2014. 22%, or 1,003, of those issuers reported having no revenues. (0.22 x 4,559 = 1,003). 19%, or 866, of those issuers reported having less than $1 million in revenues. (0.19 x 4,559 = 866). Therefore, the average number of issuers per year is 1,003 + 866 = 1,869, or approximately 1,900 issuers.

4(a)(6) we expect those issuers to conduct. In developing the estimate for the number of issuers in the final rule, we refined the methodology used in the Proposing Release and applied that methodology to more recent data, resulting in an updated estimate that we believe is reasonable and appropriate.

2. Intermediaries that are Registered Brokers

The final rules require intermediaries to register with us as either a broker-dealer or as a funding portal. Consistent with the Proposing Release, we estimate that the collection of information requirements in the final rules will apply to approximately 10 intermediaries per year that are not currently registered with the Commission and that will choose to register as brokers, rather than as funding portals, to act as intermediaries for offerings made in reliance on Section 4(a)(6). However, we believe that, given the cost that an unregistered entity will incur to register as a broker compared with the lower cost of becoming a funding portal, unregistered entities that choose to act as crowdfunding intermediaries will generally be more likely to register as funding portals than as brokers.

Consistent with the Proposing Release, we further estimate that approximately 50 intermediaries per year that are already registered as brokers with the Commission will choose to add to their current service offerings by also serving as crowdfunding intermediaries. These entities will not have to file a new application for registration with us, and if currently doing business with the public, they will already be members of FINRA (the applicable national securities association registered under Exchange Act Section 15A). We note, however, that given the nascent nature of the equity-based crowdfunding market, we do not have any data or other evidence indicating the number of currently-registered brokers that will be interested in becoming crowdfunding intermediaries. Therefore, we recognize that the number of brokers per year that

may engage in crowdfunding activities could differ significantly from our current estimate. We received no comments on our estimates of the number of broker-dealers that will act as intermediaries.

3. Funding Portals

Consistent with the Proposing Release, we estimate that on average approximately 50 intermediaries per year that are *not* already registered as brokers will choose to be registered as funding portals during the first three years following effectiveness of the final rules. This estimate assumes that, upon effectiveness of the final rules, about 15% of the approximately 200 U.S.-based crowdfunding portals[1627] currently in existence will participate in securities-based crowdfunding and that the number of crowdfunding portals will grow at 60% per year over the next three years.[1628] Therefore, we estimate that an average of approximately 50 respondents will be registered as funding portals annually.[1629] Of those 50 funding portals, we estimate that two will be nonresident funding portals. These estimates are based in part on indications of interest

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1627 This estimate is based in part on an industry estimate that, as of April 2012, there were approximately 200 non-securities-based crowdfunding portals operating in the United States. *See* Massolution 2012 at 16. We did not receive comment on these estimates and therefore continue to believe our estimates in the Proposing Release are appropriate. *See also* Massolution 2015 at 84 (estimating that, as of December 2014, there were approximately 375 crowdfunding portals operating in North America, not just the United States).

1628 A worldwide survey of crowdfunding portals indicated that, in 2011, approximately 14.8% of the surveyed crowdfunding portals (mostly based in Europe) participated in "equity-based" crowdfunding. *Id.* Also, the total number of crowdfunding portals worldwide grew by an estimated 60% from 2011 to 2012. *Id.* at 13. We did not receive comment on these estimates and therefore continue to believe our estimates in the Proposing Release are appropriate. *See also* Massolution 2015 at 82-83 (estimating that, as of December 2014, there were approximately 1250 crowdfunding portals worldwide compared to 813 worldwide in 2012, which represents an increase of approximately 54%).

1629 200 U.S.-based crowdfunding portals x 15% (estimated percentage of crowdfunding portals that will participate in securities-based crowdfunding) = 30 funding portals that will participate in securities-based crowdfunding. Assuming 60% growth over three years, the number of registered funding portals will be 30 during the first year, 48 during the second year and 77 during the third year. The average number of registered funding portals over three years is (30 + 48 + 77) / 3 = 52 funding portals (or approximately 50 funding portals per year).

expressed in responses to FINRA's voluntary interim form for funding portals. We received no comments on our estimates on the number of funding portals that will act as intermediaries

C. Estimate of Burdens

1. Issuers

a. Form C: Offering Statement and Progress Update

Under the final rules, an issuer conducting a transaction in reliance on Section 4(a)(6) will be required to file with us specified disclosures on a Form C: Offering Statement.[1630] An issuer also will be required to file with us amendments to Form C to disclose any material change in the offer terms or disclosure previously provided to investors.[1631] Form C is similar to the Form 1-A offering statement under Regulation A, but it requires fewer disclosure items (*e.g.*, it does not require disclosure about the plan of distribution, the compensation of officers and directors, litigation or a discussion of federal tax aspects). We note that offerings made in reliance on Regulation A allow issuers to offer up to $50 million, involve review by SEC staff and, in the case of Tier 1 offerings, require filings at the state level.[1632] In light of these factors, we expect that issuers seeking to raise capital pursuant to a Regulation A offering generally will be at a more advanced stage of development than issuers likely to raise capital pursuant to Section 4(a)(6), so the complexity of the required disclosure and, in turn, the burden of compliance with the requirements of Form C will be significantly less than for Form 1-A.[1633] In the Proposing Release we estimated that the burden to prepare and file Form C would be approximately 60 hours per

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1630 *See* Rule 203(a)(1) of Regulation Crowdfunding.

1631 *See* Rule 203(a)(2) of Regulation Crowdfunding.

1632 *See* Rule 256 of Regulation A; *Regulation A Adopting Release*, note 506.

1633 We currently estimate the average burden per response for preparing and filing a Form 1-A to be approximately 750 hours.

issuer, which represented approximately 10% of the burden to prepare then-existing Form 1-A.[1634] We estimated that 75% of the burden, or 45 hours, would be carried internally and the remaining 25% of the burden would be carried by outside professionals at a cost of $6,000 per issuer.

As discussed in more detail in the Economic Analysis, above, we received a number of comments concerning the burdens and costs of the proposed rules.[1635] Many of these commenters provided monetary estimates without distinguishing between internal burden hours and outside professional costs. Some commenters suggested that the Proposing Release underestimated the time and expense that would be required to prepare and file Form C.[1636] In contrast, one commenter stated that it was a third-party service provider that could prepare Form C at much lower costs than those estimated by the Commission.[1637] Another commenter suggested that the cost of preparing and filing these forms and the associated compliance costs would range from $3,000 to $9,000.[1638] Additionally, we received a number of comments about the costs of the audit and review of financial statements, as proposed. We believe that these costs would be a component of the outside professional costs associated with Form C. In the Economic Analysis, we have set forth our monetized estimates of the various cost components, grouped into categories

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[1634] *See* Proposing Release at 78 FR 66540.

[1635] *See* Section III.B.3.a.

[1636] *See, e.g.,* Heritage Letter (stating that the costs to prepare the required disclosures will likely exceed $10,500, except in cases of start-ups with no operating history); NSBA Letter (stating that issuers and intermediaries will likely incur higher attorney and accounting fees and financial and administrative burdens than estimated in the proposed rules but without providing estimates); SeedInvest Letter 2 (estimating upfront compliance costs to be "potentially hundreds of hours [in internal company time] and $20,000 to $50,000 [in outside professional costs]").

[1637] FundHub Letter 2 (stating that the commenter will prepare Form C and all disclosure documents, do all bad actor checks, verify investor status and perform all other necessary compliance measures for a $100,000 offering for $2,500 total, and that, in most cases, its services and associated legal fees will cost an issuer between $2,500 and $5,000 for an offering up to $500,000 and between $5,000 and $10,000 for an offering between $500,000 and $1,000,000).

[1638] *See* StartEngine Letter 2.

based on the size of the offering. Our Form C estimates range from $2,500 for the smallest offerings (up to $100,000); to a range of $2,500 to $5,000 for somewhat larger offerings (more than $100,000 but not more than $500,000) and a range of $5,000 and $20,000 for the largest offerings (more than $500,000). Additionally, our estimates of the cost of financial statement review or audit range from $0 for the smallest offerings; to between $1,500 and $18,000 for larger offerings and for first-time crowdfunding issuers conducting offerings between $500,000 and $1,000,000; and $2,500 to $30,000 for other issuers that are conducting an offering in the largest offering amount category. Accordingly, in our Economic Analysis we estimate a cost range estimate for Form C and the financial statement review of: $2,500 for the smallest offerings, $4,000 to $23,000 for the larger offerings, $6,500 to $38,000 for first-time crowdfunding issuers conducting offerings between $500,000 and $1,000,000, and $7,500 to $50,000 for other issuers conducting an offering in the largest offering amount category. For purposes of the PRA, however, we must provide a single estimate, comprised of both burden hours and outside professional costs, for an average issuer.

Based on these comments and our Economic Analysis, we have revised our estimate of the burden associated with the preparation and filing of Form C. We acknowledge that a number of commenters suggested that we underestimated the burdens of the proposed rule, but believe that changes in the final rule, particularly with respect to the financial statement requirements for first-time crowdfunding issuers, may mitigate the impact of those costs. Accordingly, we estimate that the average total burden to prepare and file the Form C, including any amendment to disclose any material change, will be approximately 100 hours, which, while higher than our proposed estimate, is still substantially less than the burden to prepare a Form 1-A for an offering under Regulation A, as recently amended. We continue to estimate that 75 percent of the burden of

preparation will be carried by the issuer internally and that 25 percent will be carried by outside professionals[1639] retained by the issuer at an average cost of $400 per hour.[1640] This reflects 75 internal burden hours per issuer and $10,000 in external professional costs. While for PRA purposes, we must present this estimate in terms of hours and costs, we believe that this estimate is consistent with the monetary ranges that we set forth in the Economic Analysis.

Under the final rules, the issuer also will be required to file with us regular updates on the progress of the issuer in meeting the target offering amount.[1641] In a change from the proposal, the rules permit issuers to satisfy the progress update requirement by relying on the relevant intermediary to make publicly available on the intermediary's platform frequent updates about the issuer's progress toward meeting the target offering amount. Nevertheless, an issuer relying on the intermediary's reports of progress must still file a progress update at the end of the offering to disclose the total amount of securities sold in the offering. The issuer is required to make the filing under cover of a Form C-U: Progress Update. Form C-U is similar to a Form D Notice of Exempt Offering of Securities under Regulation D.[1642] Form C-U will require significantly less disclosure than the Form D, however, as it will require disclosure only of the issuer's progress in meeting the target offering amount, rather than compensation and use of proceeds disclosures or other information about the issuer and the offering. Thus, the complexity of the required

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1639 For example, an issuer could retain an outside professional to assist in the preparation of the financial statements, but could decide to address the remaining disclosure requirements internally.

1640 We estimate the average external cost of preparing Form C to be 0.25 x 100 hours x $400 per hour = $10,000.

We recognize that the costs of retaining outside professionals may vary depending on the nature of the professional services, but for purposes of this PRA analysis, we estimate that such costs would be an average of $400 per hour. This is the rate we typically estimate for outside legal services used in connection with public company reporting.

1641 *See* Rule 203(a)(3) of Regulation Crowdfunding.

1642 We currently estimate the burden per response for preparing and filing a Form D to be 4.00 hours.

disclosure and the burden to prepare and file Form C-U will be significantly less than for Form D. We continue to estimate that the burden to prepare and file each progress update will be 0.50 hours. In light of the change from the proposal, we expect most issuers will rely on the relevant intermediary to provide interim progress updates and therefore will be required to file an average of one progress update during each offering rather than the two progress updates that we estimated in the Proposing Release.[1643] As in the Proposing Release, we estimate that the entirety of this burden will be borne internally by the registrant.

Overall, we estimate that compliance with the requirements of a Form C filed in connection with offerings made in reliance on Section 4(a)(6) will require 190,000 burden hours (1,900 offering statements x 100 hours/offering statement) in aggregate each year, which corresponds to 142,500 hours carried by the issuer internally (1,900 offering statements x 100 hours/offering statement x 0.75) and costs of $19,000,000 (1,900 offering statements x 100 hours/offering statement x 0.25 x $400) for the services of outside professionals. We also estimate that compliance with the requirements of Form C-U filed during an offering will require 950 burden hours (1,900 offering statements x 1 progress update per offering x 0.50 hours per progress update) in aggregate each year.

b. Form C-AR: Annual Report

Under the final rules, unless the reporting has been terminated, any issuer that sells securities in a transaction made pursuant to Section 4(a)(6) will be required to file annually with us an annual report on Form C-AR: Annual Report.[1644] Form C-AR will require disclosure substantially similar to the disclosure provided in the Form C: Offering Statement, except that

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[1643] *See* Rule 203(a)(3) of Regulation Crowdfunding.

[1644] *See* Rule 202 of Regulation Crowdfunding.

offering-specific disclosure will not be required and the issuer may be able to update disclosure previously provided in the Form C. In addition, in a change from the proposal, instead of requiring financial statements in the annual report that meet the highest standard of review previously provided (either reviewed or audited), the final rules require financial statements of the issuer certified by the principal executive officer of the issuer to be true and complete in all material respects.[1645] Therefore, we estimate that the burden to prepare and file Form C-AR will be less than that required to prepare and file Form C.

As discussed in the Economic Analysis, we received some comments on the costs of Form C-AR.[1646] One commenter that submitted comments concerning both Form C and Form C-AR provided several cost estimates or ranges for Form C-AR that varied but were ranges or amounts that were lower than the commenter's estimates for Form C.[1647] Our analysis of the cost of Form C-AR in our Economic Analysis reflects these comments, and in that analysis, we estimate that the cost of Form C-AR represents two-thirds of the cost of Form C (exclusive of the financial statement review).

Additionally, in light of the change to the final rules for Form C-AR to require financial statements that are certified by the principal executive officer of the issuer to be true and complete in all material respects, rather than requiring financial statements that meet the highest level of review previously provided, we estimate that for Form C-AR there will be a further reduction of PRA burden compared with the burden of Form C. Accordingly, we estimate that compliance

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1645 *See* Rule 202(a) of Regulation Crowdfunding. However, issuers that have available financial statements that have been reviewed or audited by an independent certified public accountant because they prepare them for other purposes shall provide them and will not be required to have the principal executive officer certification. *Id.*

1646 *See* Section III.B.3.a.

1647 *See* SeedInvest Letter 1; SeedInvest Letter 4

with Form C-AR will be approximately one-half of the burden of Form C, resulting in a burden of 50 hours per response. We further estimate that 75 percent of the burden of preparation will be carried by the issuer internally and that 25 percent will be carried by outside professionals[1648] retained by the issuer at an average cost of $400 per hour.[1649]

We estimate that compliance with the requirements of Form C-AR in the first year after issuers sell securities pursuant to Section 4(a)(6) will require 95,000 burden hours (1,900 issuers x 50 hours/issuer) in the aggregate, which corresponds to 71,250 hours carried by the issuer internally (1,900 issuers x 50 hours/issuer x 0.75) and costs of $9,500,000 (1,900 issuers x 50 hours/issuer x 0.25 x $400) for the services of outside professionals.

c. Form C-TR: Termination of Reporting

Under the final rules, any issuer terminating its annual reporting obligations will be required to file a notice under cover of Form C-TR: Termination of Reporting to notify investors and the Commission that it no longer will file and provide annual reports pursuant to the requirements of Regulation Crowdfunding.[1650] We estimate that eight percent of the issuers that sell securities pursuant to Section 4(a)(6) will file a notice under cover of Form C-TR during the first year.[1651] The Form C-TR will be similar to the Form 15 that issuers file to provide notice of termination of the registration of a class of securities under Exchange Act Section 12(g) or to provide notice of the suspension of the duty to file reports required by Exchange Act Sections

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1648 *See* note 1639.

1649 *See* note 1640.

1650 *See* Rule 203(b)(2) of Regulation Crowdfunding.

1651 For purposes of this PRA analysis, we estimate that eight percent of issuers will not survive past their first year, based on a recent study that found that of a random sample of 4,022 new high-technology businesses started in 2004, 92.3% survived past their first year. *See* Kauffman Firm Survey, note 1302 at 13.

13(a) or 15(d).[1652] Therefore, we estimate that compliance with the Form C-TR will result in a similar burden as compliance with Form 15, that is, a burden of 1.50 hours per response. We estimate that compliance with Form C-TR will result in a burden of 228 hours (1,900 issuers x 0.08 issuers filing Form C-TR x 1.50 hours/issuer) in the aggregate during the first year for issuers terminating their reporting obligations. As in the Proposing Release, we estimate that the entirety of this burden will be borne internally by the registrant. We received no comments on our estimates with respect to Form C-TR and continue to believe that these estimates are reasonable.

d. Form ID Filings

Under the final rules, an issuer will be required to file specified disclosures with us on EDGAR.[1653] We anticipate that the majority of first-time issuers seeking to offer and sell securities in reliance on Section 4(a)(6) will not previously have filed an electronic submission with us and so will need to file a Form ID. Form ID is the application form for access codes to permit filing on EDGAR. The final rules will not change the form itself, but we anticipate that the number of Form ID filings will increase due to new issuers seeking to offer and sell securities in reliance on Section 4(a)(6). One commenter stated that it would take approximately 70 minutes to complete a Form ID, considerably more time than the estimated 0.15 hours.[1654] However, the information required by Form ID is very limited, primarily the name and address of the filer, so we continue to believe the estimated 0.15 hours per response is appropriate. For purposes of this PRA analysis, we estimate that all of the issuers who will seek to offer and sell securities in reliance on Section 4(a)(6) will not have filed an electronic submission with us previously and

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1652 We currently estimate the burden per response for preparing and filing a Form 15 to be 1.50 hours.

1653 *See* Rules 201-203 of Regulation Crowdfunding.

1654 Angel Letter 1.

will, therefore, be required to file a Form ID. As noted above, we estimate that approximately 1,900 issuers per year will seek to offer and sell securities in reliance on Section 4(a)(6), which will correspond to 1,900 additional Form ID filings. As a result, we estimate the additional annual burden associated with this form will be approximately 285 hours (1,900 filings x 0.15 hours/filing).[1655]

2. Brokers and Funding Portals

Below, we discuss our estimates of the internal burdens and professional costs associated with the collections of information required under the final rules as they relate to intermediaries. Where relevant, we discuss any comments received on these estimates and any changes to estimates, including changes made in response to comments on them.

a. Registration Requirements

(1) Time Burden

The final rules will require intermediaries to register with us as either a broker or as a funding portal. As noted above, we believe that some intermediaries for transactions made in reliance on Section 4(a)(6) and Regulation Crowdfunding will already be registered as brokers. Therefore, this registration requirement will impose no new requirement on these entities and no additional burden for purposes of this PRA analysis. Entities that are not already registered as brokers may decide to register either as brokers or as funding portals and to become members of a registered national securities association (if they are not already a member) pursuant to the final rules. We estimate that each year, on average, approximately 10 entities may decide to be registered as brokers and approximately 50 entities may decide to be registered as funding portals

[1655] We currently estimate the burden per response for preparing and filing with Form ID to be 0.15 hours.

by filing Form Funding Portal.[1656] In addition, we estimate that of those 50 entities that register as funding portals, two will be nonresident funding portals and subject to the additional requirements under Rule 400(f) of completing Schedule C (including the required certifications), requirements related to the agent for service of process in the United States, and obtaining an opinion of counsel.

We estimate the burden for registering with the Commission as a broker based upon the existing burdens for completing and filing Form BD, currently estimated as 2.75 hours.[1657] Consequently, we estimate that the total annual burden hours required for all crowdfunding intermediaries, including brokers and funding portals, to register with us under the final rules will be approximately 165 hours (2.75 hours/respondent x (10 brokers + 50 funding portals)). In addition, those entities that register as nonresident funding portals will face an additional burden of half an hour to complete Schedule C and make the required certifications, half an hour to document the appointment of an agent for the service of process, and one hour to obtain an opinion of counsel. Consequently, we estimate that, of the 50 registered funding portals, two will each face an additional burden of two hours to register, for a total additional annual burden of four hours.

We have taken into consideration that brokers that register to engage in crowdfunding transactions conducted in reliance on Section 4(a)(6) may eventually decide to withdraw their

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1656 As noted above, funding portals will have to complete and file Form ID in order to obtain access codes to file on EDGAR. Based on our estimates, 50 funding portals per year will newly register through EDGAR, which will correspond to 50 additional Form ID filings. As a result, we estimate the additional annual burden associated with this form will be approximately 7.5 hours (50 filings x 0.15 hours/filing).

1657 While it is likely that the time necessary to complete Form BD varies depending on the nature and complexity of the entity's securities business, we currently estimate the average time necessary for a broker-dealer to complete and file an application for broker-dealer registration on Form BD to be approximately 2.75 hours. We also estimate that the time burden to register as a funding portal on Form Funding Portal will be, for purposes of this PRA analysis, the same as the time required to complete and file Form BD because the information required for that form is similar.

registration. Withdrawal requires an entity to complete and file with us a Form BDW.[1658] We further estimate that approximately 430 broker-dealers withdraw from Commission registration annually[1659] and, therefore, file a Form BDW. Of them, we estimate that approximately one broker who had registered in order to facilitate crowdfunding offerings made in reliance on Section 4(a)(6) will decide to withdraw in each year following adoption of the rules.[1660] Therefore, the one broker-dealer that withdraws from registration by filing Form BDW will incur an aggregate annual reporting burden of approximately 0.25 hours (0.25 hours/respondent x 1 broker). Similarly, we estimate that approximately five funding portals will choose to withdraw from registration each year[1661] and that each withdrawal, as with Form BDW, will take approximately 0.25 hours. This will result in an aggregate annual reporting burden of approximately 1.25 hours (0.25 hours/respondent x 5 funding portals).

1658 The time necessary to complete Form BDW varies depending on the nature and complexity of the applicant's securities business. We currently estimate that it takes a broker-dealer approximately 0.25 burden hours to complete and file a Form BDW to withdraw from Commission registration, as required by Exchange Act Rule 15b6-1 (17 CFR 240.15b6-1).

1659 This estimate is based on Form BDW data collected over the past five years and may be high as a result of the impact of the financial crisis on broker-dealers. For the past five fiscal years (from 10/1 through 9/30), the number of broker-dealers that withdrew from registration was as follows: 524 in 2011 and 428 in 2012, 434 in 2013, 454 in 2014 and 306 by September 15, 2015. We thus estimate the number of broker-dealers that withdraw from the Commission annually to be 430 ((524+428+434+454+306) / 5).

1660 As of September 2015, there were 4,213 broker-dealers registered with the Commission. An average of 430 broker-dealers per year withdraw from registration, or 10% of the number of registered broker-dealers (430 withdrawing broker-dealers / 4,213 registered broker-dealers). We assume that the same percentage of broker-dealers that withdraw from registration will apply to the population of registered broker-dealers participating in offerings in reliance on Section 4(a)(6). Of our estimate of 10 registered broker-dealers per year registering to participate in crowdfunding transactions in reliance on Section 4(a)(6), we estimate that approximately one broker-dealer per year (10 registered broker-dealers x 0.10) will withdraw from registration.

1661 We estimate that the percentage of registered funding portals participating in crowdfunding transactions in reliance on Section 4(a)(6) that will withdraw from registration annually would be the same as the percentage of broker dealers that withdraw from registration annually because of the similarity of these entities' businesses. Of our estimate of 50 registered funding portals participating in crowdfunding transactions in reliance on Section 4(a)(6), we estimate that approximately five funding portals per year (50 registered funding portals x 0.10) will withdraw from registration. For funding portals, a decision to withdraw registration will be required to be reported to us in the same way as an amendment; however, for brokers, withdrawal requires the filing of Form BDW.

In the Proposing Release, we also included an estimate of PRA burdens and costs for newly-registered intermediaries to become members of FINRA or any other registered national securities association. Specifically, the Proposing Release included a discussion of an estimate of the paperwork burdens and costs that would be incurred by an intermediary to register with a national securities association as well as an estimate of the ongoing fees (e.g., FINRA annual assessment fees) that would be incurred by an intermediary to remain registered with a national securities association. However, after further consideration, we do not believe the hour burdens and costs associated with FINRA's membership constitute paperwork burdens and costs attributable to the Commission's rules. Accordingly, we are not providing estimates of burdens and costs resulting from membership in a registered national securities association in this PRA analysis. We have, however, considered the costs of such membership, both initial and ongoing, in our Economic Analysis above.[1662]

Once registered, a broker must promptly file an amended Form BD when information originally reported on Form BD changes or becomes inaccurate. Similarly, a registered funding portal must file amendments relating to changes in information filed in a Form Funding Portal filing.[1663] Based on the number of amended Forms BD that we received from October 1, 2011 through September 15, 2015, we estimate that the total number of amendments that we will receive on Form BD from the 10 brokers that register under Regulation Crowdfunding will be approximately 32.[1664] Therefore, we estimate that the total additional annual burden hours

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[1662] *See* Section III.B.4.

[1663] We currently estimate that the average time necessary to complete an amended Form BD to be approximately 20 minutes, or 0.33 hours. We estimate that an amendment to Form Funding Portal will take the same amount of time as an amendment to Form BD because the forms are similar.

[1664] We received 15,491, 13,271, 12,902, 14,330 and 10,848 amended Forms BD during the fiscal years ending 2011, 2012, 2013, 2014 and 2015, respectively, reflecting an average of 13,368 amendment filings per year

necessary for broker-dealers to complete and file amended Forms BD will be approximately 10.6 hours (32 amended Forms BD per year x 0.33 hours). Using the same ratios, we estimate that the total annual burden hours for funding portals to complete and file amended Forms Funding Portal will be approximately 52.8 hours (50 funding portals x 3.2 amendments per year x 0.33 hours per amendment).

(2) Cost

We estimate that two intermediaries will face a cost per intermediary of $25,179 to retain an agent for service of process and provide an opinion of counsel to register as a nonresident funding portal.[1665]

b. Development of Intermediary Platform

(1) Time Burden

The final rules envision that intermediaries will develop electronic platforms to offer securities to the public in reliance on Section 4(a)(6). We anticipate that an intermediary's platform will incorporate related systems functionality to comply with our final rules (including the collection of information associated with, for example, the requirements of Rules 302, 303 and 304) as well as execute other platform capabilities and system operations. The estimated time burdens and costs for platform development discussed in this section include the estimated time

(15,491 + 13,271+12,902+ 14,330+10,848) / 5 years). As of September 15, 2015, there were 4,213 broker-dealers registered with the Commission. Therefore, we estimate that there are approximately 3.17 amendments (13,368 amended Forms BD / 4,213 broker-dealers) per registered broker-dealer per year. We therefore estimate that the 10 broker-dealers who register under Regulation Crowdfunding will file, on aggregate, approximately 32 amendments per year.

1665 We have altered our cost estimates slightly from the Proposing Release (from $25,130 to $25,179) and note that the amended estimates are consistent with our recent estimates of what it would cost other types of nonresident entities to retain an agent for service of process and provide an opinion of counsel. *See* Registration Process for Security-Based Swap Dealers and Major Security-Based Swap Participants, Exchange Act Release No. 34-75611, 80 FR 48964, 48994 (Aug. 14, 2015). We inadvertently included the costs to non-resident funding portals of completing Schedule C in the Proposing Release. We anticipate, however, that nonresident funding portals will incur a time burden rather than a cost burden to complete Schedule C.

burdens and costs for the functionalities that will allow funding portals to comply with their disclosure, communication channel, and investor notification requirements.[1666]

Intermediaries that develop their platforms in-house will incur an initial time burden associated with setting up their systems. Based on our discussions with potential intermediaries prior to the publication of our proposed rules, we estimate that intermediaries creating the initial platform in-house will typically have a team of approximately four to six developers that will work on all aspects of platform development, including, but not limited to, front-end programming, data management, systems analysis, communication channels, document delivery, and Internet security.[1667] We estimate, based on our discussions with potential intermediaries prior to the publication of our proposed rules, that in developing a platform in-house, intermediaries will spend an average of 1,500 hours for planning, programming, and implementation.[1668]

It is difficult to estimate the number of intermediaries that will develop their initial platforms in-house, but assuming that half of the 110 newly-registered intermediaries[1669] do so, the total initial time burden on those intermediaries will be 82,500 hours (55 intermediaries x 1,500 hours = 82,500 hours).

We estimate that annually updating the features and functionality of an intermediary's platform will require approximately 20% of the hours required to initially develop the platform, for an average burden of 300 hours per year. If we assume that half of the 110 crowdfunding

1666 *See* Sections IV.C.2.g. and IV.C.2.h.

1667 *See* Sections IV.C.2.g. and IV.C.2.h.

1668 This average takes into account intermediaries that will develop a brand new platform and those that will modify an existing platform to function in accordance with Regulation Crowdfunding.

1669 As discussed above, we anticipate that 10 intermediaries will newly register as brokers, 50 intermediaries will be brokers that are already registered, and 50 intermediaries will register as funding portals.

intermediaries update their systems accordingly each year, the total ongoing time burden will be 16,500 hours per year (55 intermediaries x 300 hours = 16,500 hours).

(2) Cost

There will be a cost associated with developing a platform for an intermediary that hires a third-party to develop its platform rather than developing it in-house. Based on our discussions with potential intermediaries prior to the publication of our proposed rules, we estimate that it will cost an intermediary approximately $250,000 to $600,000[1670] to build a new Internet-based crowdfunding portal and all of its basic functionality.[1671] Assuming that half of the 110 newly-registered intermediaries hire outside developers to build or to tailor their platforms, the total initial cost will range from $13,750,000 to $33,000,000 (55 intermediaries x $250,000 = $13,750,000; 55 intermediaries x $600,000 = $33,000,000). For purposes of this PRA analysis, we estimate the cost to be $23,375,000 (the average of $13,750,000 and $33,000,000).

We estimate that it will typically cost an intermediary approximately one-fifth of the initial development cost per year to use a third-party developer to provide annual maintenance on an Internet-based crowdfunding portal, including updating and basic functionality, or $85,000 per year on average.[1672] If we assume that half of the 110 crowdfunding intermediaries updated their

[1670] *See, e.g.*, ASSOB Letter (suggesting that the cost to establish a funding portal would run at least $480,000, which is within the range of our estimate).

[1671] We anticipate that some percentage of intermediaries will already have in place platforms and related systems that will need to be tailored to comply with the requirements of Title III of the JOBS Act and Regulation Crowdfunding. We anticipate that these intermediaries will hire outside developers to tailor their platforms. We estimate an average cost of approximately $250,000 in the first year in order to tailor the current systems for an intermediary that already has in place a platform and related systems. Thus, this amount is already covered in our range of costs above -- $250,000 to $600,000.

[1672] Our estimate of the average initial external cost per intermediary to develop a crowdfunding platform is the average of the cited range of $250,000 to $600,000, or $425,000 (($250,000 + $600,000)/ 2). One-fifth of the cost of $425,000 is $85,000.

systems accordingly, the total ongoing cost will be $4,675,000 per year (55 intermediaries x $85,000 = $4,675,000).

c. Measures to Reduce the Risk of Fraud

(1) Time Burden

The final rules will require intermediaries to have a reasonable basis for believing that an issuer seeking to offer and sell securities in reliance on Section 4(a)(6) through the intermediary's platform complies with the requirements in Section 4A(b) and the related requirements in Regulation Crowdfunding.[1673] The final rules will also require intermediaries to have a reasonable basis for believing that an issuer has established means to keep accurate records of the holders of the securities it will offer and sell through the intermediary's platform.[1674] For both requirements, an intermediary may reasonably rely on the representations of the issuer, unless the intermediary has reason to question the reliability of those representations. For the purposes of this PRA analysis, we expect that 100% of intermediaries will rely on the representations of issuers. Based on our industry knowledge and discussions with participants prior to the publication of our proposed rules, we calculate that this requirement will impose a time burden in the first year of five hours per intermediary to establish standard representations it will request from issuers, and six minutes per intermediary per issuer to obtain the issuer representation, which is consistent with estimates we have used for other regulated entities to obtain similar documentation, such as consents, from customers.

Based on our estimate that there will be approximately 1,900 offerings per year, that each issuer will conduct one offering per year, and that there will be 110 intermediaries, we estimate

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1673 *See* Rule 301(a) of Regulation Crowdfunding.

1674 *See* Rule 301(b) of Regulation Crowdfunding.

that each intermediary will facilitate an average of approximately 17 offerings per year (1,900 offerings/(10 newly registered broker-dealers + 50 previously registered broker-dealers + 50 funding portals)). Therefore, we estimate that the total initial burden hours will be approximately 740 hours ((5 hours/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)) + (0.1 hours/issuer x 17 offerings x 110 intermediaries).

We believe that the ongoing time burdens for this requirement will be approximately one hour per intermediary per year to review and confirm that the standard representations it requests from issuers remain appropriate, and six minutes (0.1 hours) per intermediary per issuer to obtain an issuer's representation. Therefore, we estimate that the ongoing total burden hours necessary for intermediaries to rely on the representations of the issuers will be approximately 300 hours per year ((1 hour/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)) + (0.1 hours/issuer x 17 offerings x 110 intermediaries).

(2) Cost

The final rules will require intermediaries to conduct a background and securities enforcement regulatory history check on each issuer and each officer, director or 20 Percent Beneficial Owner of an issuer to determine whether the issuer or such person is subject to a disqualification. We anticipate that most intermediaries will employ third parties to perform background and securities enforcement regulatory history checks in light of the costs of developing an in-house capability to conduct such checks. Therefore, for the purposes of this PRA analysis, we assume that 100% of intermediaries will use these third-party service providers.

The cost for a third party to perform a background check is estimated to be between $200 and $500, depending on the nature and extent of the information provided.[1675] We recognize that some issuers will require more than one background check (*e.g.*, for officers or directors of the issuer), and we estimate that intermediaries will perform four background checks per issuer, on average. We base this number on the assumption that most crowdfunding issuers will be startups and small businesses with small management teams and few owners. Assuming an average of approximately 1,900 offerings made in reliance on Section 4(a)(6) per year, the total estimated initial cost for all intermediaries to fulfill the required background and securities enforcement regulatory history checks will range from approximately $1,520,000 to $3,800,000 per year,[1676] or approximately $13,818 to $34,546 per intermediary per year.[1677] For purposes of this PRA analysis, we average this cost to $24,182 per intermediary per year.

One commenter noted, as a general matter, that the "costs incurred by the intermediary in dealing with an issuer, doing the required due diligence and background screening, establishing a web page describing the offering and so on do not vary linearly with the offering size. As a percentage of the offering amount, they will be disproportionately high for smaller offerings."[1678] This commenter did not, however, question our underlying assumptions or our estimates of these costs. For purposes of this PRA analysis and as discussed above, we believe that these cost

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1675 *See, e.g.*, A Matter of Fact, *Background Check FAQ: Frequently Asked Questions*, *available at* http://www.amof.info/faq.htm (Matter of Fact is a background check provider accredited by the National Association of Professional Background Screeners and the Background Screening Credentialing Council. This source states that the cost for a comprehensive background check is $200 to $500).

1676 1,900 securities-based offerings made in reliance on Section 4(a)(6) per year x ($200 to $500 per background and securities enforcement regulatory history check) x 4 checks per offering = $1,520,000 to $3,800,000 per year.

1677 $1,520,000/110 intermediaries = approximately $13,818 per intermediary; $3,800,000/110 intermediaries = approximately $34,546 per intermediary.

1678 Heritage Letter.

estimates are reasonable. We also believe that intermediaries are in a better position to make their own business decisions as to whether such costs would be disproportionately high for smaller offerings.[1679]

We believe that, on an ongoing basis, intermediaries will continue to use third-party services to conduct background and securities enforcement regulatory history checks. We also believe that the total estimated ongoing cost for all intermediaries to fulfill the required background and securities enforcement regulatory history checks will be the same as the estimated initial cost, or on average $24,182 per intermediary per year.

d. Account Opening: Accounts and Electronic Delivery

The final rules provide that no intermediary or associated person of an intermediary may accept an investment commitment in a transaction involving the offer or sale of securities made in reliance on Section 4(a)(6) until an investor has opened an account with the intermediary and consented to electronic delivery of materials.[1680] This requirement will impose certain information gathering and recordkeeping burdens on intermediaries. For the purposes of this PRA analysis, we expect that the functionality required to allow an investor to open an account with an intermediary and obtain consents will result in an initial time burden of approximately 10 hours per intermediary in the first year. Therefore, we estimate that the total initial burden hours resulting from this functionality will be approximately 1,100 hours (10 hours/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)).

1679 As noted above, we agree with the commenter's suggestion that there is likely to be a fixed component to these costs that reflects a certain necessary level of due diligence and background screening, which will result in these costs, as a percentage of offering size, being higher for smaller offerings.

1680 *See* Rule 302(a) of Regulation Crowdfunding.

We believe that the ongoing time burdens for this requirement will be significantly less than the initial time burden, and thus we estimate approximately two hours per intermediary per year to review and assess the related processes. Therefore, we estimate that the ongoing total burden hours necessary for this functionality will be approximately 220 hours per year (2 hours/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)).

e. Account Opening: Educational Materials

(1) Time Burden

The final rules require intermediaries to provide educational materials to investors,[1681] about the risks and costs of investing in securities offered and sold in reliance on Section 4(a)(6). Because the intermediary will determine what electronic format will prove most effective in communicating the requisite contents of the educational material, the expected costs for intermediaries to develop the educational material are expected to vary widely and are difficult to estimate. For the purposes of this PRA analysis, we assume that half of the intermediaries will develop their educational materials in-house, potentially including online presentations and written documents, and that the other half will employ third parties to produce educational materials, such as professional-quality online video presentations. We estimate that to develop their educational materials in-house, each intermediary will incur an initial time burden of approximately 20 hours. Therefore, the total initial burden will be approximately 1,100 hours (55 intermediaries x 20 hours/intermediary).[1682]

[1681] *See* Rule 302(b) of Regulation Crowdfunding.

[1682] In the Proposing Release we did not take into account in our estimated time burden and cost calculations our assumption that half of the intermediaries would develop educational materials in-house. Therefore, we have

Assuming that half of the intermediaries will develop their educational materials in-house, we also expect that these intermediaries will update their educational materials in-house, as needed. We estimate that to update their educational materials in-house, each intermediary will incur an ongoing time burden of approximately 10 hours per year. Therefore, the total ongoing burden will be approximately 550 hours per year (55 intermediaries x 10 hours/intermediary).

(2) Cost

As stated above, for the purposes of this PRA analysis, we assume that half of the intermediaries will employ third-party firms to produce educational materials, such as professional-quality online video presentations, instead of developing materials in-house. Public sources indicate that the typical cost to produce a professional corporate training video ranges from approximately $1,000 to $3,000 per production minute.[1683] Based on discussions with industry participants prior to the publication of our proposed rules, we assume that, on average, each intermediary will produce a series of short educational videos that will cover all of the requirements of the final rules and that the video material will be 10 minutes long in total. Based on this assumption, we estimate that the average initial cost for an intermediary to develop and produce educational materials will range from approximately $10,000 to $30,000. The total initial cost across all intermediaries estimated to employ a third party per year will be $550,000 to $1,650,000.[1684] For purposes of this PRA analysis, we average the cost to $20,000 per intermediary per year. We note that the estimated initial cost may be significantly lower, because

re-calculated the estimated total initial and ongoing time burdens and costs for the development of in-house materials in this release based on 55 (rather than 110) intermediaries.

1683 *See, e.g.*, Lee W. Frederiksen, *What Is the Cost of Video Production for the Web?*, Hinge Marketing, *available at* http://www.hingemarketing.com/library/article/what-is-the-cost-of-video-production-for-the-web.

1684 55 intermediaries x $10,000 production cost = $550,000. 55 intermediaries x $30,000 production cost = $1,650,000.

not all intermediaries that outsource the development of educational materials may choose to produce professional-quality online video presentations; others may produce videos of shorter length or use other types of educational materials.

We estimate that, on an ongoing basis, when using a third-party company to update their video educational materials, each intermediary will spend approximately half of the initial average cost. We estimate, therefore, that the average ongoing annual cost for an intermediary to update its video educational materials will range from approximately $5,000 to $15,000 and that the total ongoing annual cost across all intermediaries will range from approximately $275,000 to $825,000 per year.[1685] For purposes of this PRA analysis, we average the cost to $10,000 per intermediary per year.

f. Account Opening: Promoters

The final rules require an intermediary, at the account opening stage, to disclose to users of its platform that any person who receives compensation to promote an issuer's offering, or who is a founder or employee of an issuer engaging in promotional activities on behalf of the issuer, must clearly disclose the receipt of compensation and his or her engagement in promotional activities on the platform.[1686] We expect that this requirement will result in an estimated time burden of five hours per intermediary in the first year, to prepare this particular disclosure and incorporate it into the account opening process. Therefore, we estimate that the total initial burden hours necessary for intermediaries to comply with this requirement will be approximately 550 hours (5 hours/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)).

1685 $550,000 total cost x 0.50 = $275,000. $1,650,000 total cost x 0.50 = $825,000.

1686 *See* Rule 302(c) of Regulation Crowdfunding.

We believe that the ongoing time burdens for this requirement will be approximately one hour per intermediary per year to review and check that the disclosures remain appropriate. Therefore, we estimate that the ongoing total burden hours necessary for intermediaries to comply with this requirement will be approximately 110 hours per year (1 hour/intermediary x (10 newly-registered broker-dealers + 50 previously-registered broker-dealers + 50 funding portals)).

g. Issuer Disclosures to be Made Available

(1) Time Burden

The final rules require an intermediary to make publicly available on its platform the information that an issuer of crowdfunding securities is required to provide to investors, in a manner that reasonably permits a person accessing the platform to save, download or otherwise store the information, until the offer and sale of securities is completed or cancelled.[1687]

For purposes of the PRA, our estimate of the hourly burdens related to the public availability of the issuer information is included in our estimate of the hourly burdens associated with overall platform development, discussed above in Section IV.C.2.b. We note that the platform functionality will include not only the ability to display, upload and download issuer information as required under the final rules, but also the ability to provide users with required online disclosures

We recognize that, over time, intermediaries may need to update their systems that allow issuer information to be uploaded to their platforms. We do not expect a significant ongoing burden related to the requirement for providing issuer disclosures, primarily because the

1687 *See* Rule 303(a) of Regulation Crowdfunding.

functionality required for required issuer disclosure information to be uploaded is a standard feature offered on many websites and will not require frequent or significant updates.

(2) **Cost**

We do not expect a significant ongoing cost for providing issuer disclosures, primarily because the functionality required to upload required issuer disclosure information is a standard feature offered on many websites and will not require frequent updates. To the extent an intermediary uses a third party to develop the functionality for this requirement, the initial costs relevant to this requirement will be incorporated into the cost of hiring a third party to develop the platform, discussed above in subsection IV.C.2.b.2.

h. Other Disclosures to Investors

(1) Time Burden

Intermediaries will be required to implement and maintain systems to comply with the information disclosure, communication channels, and investor notification requirements of Regulation Crowdfunding, including providing disclosure about compensation at account opening, obtaining investor acknowledgments to confirm investor qualifications and review of educational materials, providing investor questionnaires, maintaining communication channels with third parties and among investors, notifying investors of investment commitments, confirming completed transactions and confirming or reconfirming offering cancellations.

For purposes of the PRA analysis, our estimate of the hourly burdens related to these information disclosure, communication channel and investor notification requirements of Regulation Crowdfunding is included in our estimate of the hourly burdens associated with overall platform development, discussed above in Section IV.C.2.b. Based on our discussions with industry participants, we expect that these functionalities will generally be part of the overall

platform development process and costs. We discuss the burdens of platform development above, and note that these will include developing the functionality that will allow intermediaries to comply with disclosure and notification requirements.[1688]

We do not expect a significant ongoing burden for providing disclosures, as required by the final rules, because the functionality required to provide information and communication channels will likely not require frequent updates. We incorporate the total burden to update the required functionality for processing investor disclosures and investor acknowledgment information in the total burden estimates relating to platform development discussed above.[1689]

(2) Cost

We recognize that some intermediaries may implement the required functionality for processing investor disclosures and investor acknowledgments by using a third-party developer. The total cost for issuers to use third-party developers to add the required functionality for processing investor disclosures and investor acknowledgments, as well as to update the required functionality for processing investor disclosures and investor acknowledgments, is incorporated into our discussion of the total cost estimates relating to platform development in Section IV.C.2.b.

We also do not expect there to be a significant ongoing cost for developing the functionality to process these disclosures and acknowledgments, primarily because this functionality will likely not require frequent updates by third-party developers.

1688 *See* Section IV.C.2.b.1.

1689 *See* Section IV.C.2.b.1.

i. Maintenance and Transmission of Funds

The final rules contain requirements related to the maintenance and transmission of funds. A registered broker will be required to comply with the requirements of Rule 15c2-4 of the Exchange Act (Transmission or Maintenance of Payments Received in Connection with Underwritings).[1690] A registered funding portal will be required to enter into a written agreement with a qualified third party that has agreed in writing to hold the client funds.[1691] It also will be required to send directions to the qualified third party depending on whether an investing target is met or if an investment commitment or offering is cancelled. For purposes of the PRA, we are providing an estimate for the hour burden that a funding portal will incur to enter into a written agreement with the qualified third party on an initial basis, and to review and update that agreement on an ongoing basis.

Based on discussion with industry participants, we estimate that funding portals will incur an initial burden of approximately 20 hours each to comply with these requirements, for a total burden of 1,000 hours (20 hours per funding portal x 50 funding portals). We expect that the burden associated with the website functionality required to send directions to third parties will be included as part of the platform development discussed above.[1692]

We expect that, on an ongoing basis, a registered funding portal will have to periodically review and update its written agreement with the qualified third party to hold its client funds. A registered funding portal will also be required to send directions on an ongoing basis to a qualified

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1690 *See* Rule 303(e)(1) of Regulation Crowdfunding. *See also* 17 CFR 240.15c2-4. For purposes of this PRA discussion, any burdens associated with Rule 15c2-4, as well as for any other rule to which brokers are subject regardless of whether they engage in transactions pursuant to Section 4(a)(6), are not addressed here; rather, they are included in any OMB approvals for the relevant rules.

1691 *See* Rule 303(e)(2) of Regulation Crowdfunding.

1692 *See* Section IV.C.2.b.

third party depending on whether an investing target is met or an investment commitment or offering is cancelled. Based on discussion with industry participants, we estimate that funding portals will incur an ongoing annual burden of approximately 5 hours each to comply with these requirements, or 250 hours total (5 hours per funding portal x 50 funding portals).

j. Compliance: Policies and Procedures

The final rules require a funding portal to implement written policies and procedures reasonably designed to achieve compliance with the federal securities laws and the rules and regulations thereunder, relating to its business as a funding portal. We anticipate that funding portals will comply with this requirement by using internal personnel and internal information technology resources integrated into their platforms. Based on discussion with industry participants, we estimate that a funding portal will spend approximately 40 hours to establish written policies and procedures to achieve compliance with these requirements. This will result in a total aggregate initial recordkeeping burden of 2,000 hours (40 hours x 50 funding portals).

We estimate that, on an ongoing basis, funding portals will spend approximately 5 hours per year updating, as necessary, the policies and procedures required by the final rules. This will result in an aggregate ongoing recordkeeping burden of 250 hours (5 hours x 50 funding portals).

k. Compliance: Privacy

Funding portals will be required to comply with the Privacy Rules as they apply to broker-dealers, including Regulation S-P, S-AM and S-ID.[1693]

Under Rule 403(b), a funding portal will be required to comply with Regulation S-P, which will require the funding portal to provide notice to investors about its privacy policies and practices; describe the conditions under which a broker may disclose nonpublic personal

[1693] *See* Rule 403(b) of Regulation Crowdfunding.

information about investors to nonaffiliated third parties; and provide a method for investors to prevent a funding portal from disclosing that information to most nonaffiliated third parties by "opting out" of that disclosure, subject to certain exceptions. For funding portals, we expect that the privacy and opt-out notices will be delivered electronically, thereby reducing the delivery burden as compared to paper delivery.

We estimate that under the final rules all 50 funding portals will be subject to the requirements of Regulation S-P pursuant to Rule 403(b). In developing an estimate of the burden relating to the Regulation S-P requirements under Rule 403(b), we have considered: (1) the minimal recordkeeping burden imposed by Regulation S-P;[1694] (2) the summary fashion in which information must be provided to investors in the privacy and opt-out notices required by Regulation S-P;[1695] and (3) the availability of the model privacy form and online model privacy form builder. Given these considerations, we estimate that each funding portal will spend, on an ongoing basis, an average of approximately 12 hours per year complying with the information collection requirement of Regulation S-P, for a total of approximately 600 annual burden-hours (12 hours/respondent x 50 funding portals).

Funding portals will be required to comply with Regulation S-AM, which will require funding portals to provide notice to each affected individual informing the individual of his or her right to prohibit such marketing before a receiving affiliate may make marketing solicitations based on the communication of certain consumer financial information from the broker. Based on our discussions with industry participants, we estimate that approximately 20 funding portals will

1694 Regulation S-P has no recordkeeping requirement, and records relating to customer communications already must be made and retained by broker-dealers pursuant to other Commission rules. The estimates of the burdens relating to recordkeeping requirements for funding portals are discussed below in Section IV.C.2.l.

1695 The model privacy form adopted by the Commission and the other agencies in 2009, designed to serve as both a privacy notice and an opt-out notice, is only two pages.

have affiliations that will subject them to the requirements of Regulation S-AM under the final rules, and that they will incur an average one-time burden of one hour to review affiliate marketing practices, for a total of 20 burden hours (1 hour/respondent x 20 funding portals).

We estimate that these 20 funding portals will be required to provide notice and opt-out opportunities to consumers pursuant to the requirements of Regulation S-AM, as imposed by Rule 403(b), and that they will incur an average initial burden of 18 hours to do so, for a total estimated initial burden of 360 hours (18 hours/respondent x 20 funding portals). We also estimate that funding portals will incur an ongoing burden related to Regulation S-AM's requirements for providing notice and opt-out opportunities of approximately four hours per respondent per year. This burden will cover the creation and delivery of notices to new investors and the recording of any opt-outs that are received on an ongoing basis, for a total of approximately 80 annual burden-hours (4 hours/respondent x 20 funding portals).

Funding portals will be required to comply with rule S-ID, which will require funding portals to develop and implement a written identity theft prevention program that is designed to detect, prevent and mitigate identity theft in connection with certain existing accounts or the opening of new accounts. We estimate that the initial burden for funding portals to comply with the applicable portions of Regulation S-ID, as imposed by Rule 403(b), will be (1) 25 hours to develop and obtain board approval of a program; (2) four hours to train staff; and (3) two hours to conduct an initial assessment of relevant accounts, for a total of 31 hours per funding portal. We estimate that all 50 funding portals will incur these initial burdens, resulting in an aggregate time burden of 1,550 hours ((25 + 4 + 2 hours / respondent) x 50 funding portals).

With respect to the requirements of Rule 403(b) relating to Regulation S-ID, we estimate that the ongoing burden per year will include: (1) two hours to periodically review and update the

program, review and preserve contracts with service providers and review and preserve any documentation received from service providers; (2) four hours to prepare and present an annual report to a compliance director; and (3) two hours to conduct periodic assessments to determine if the entity offers or maintains covered accounts, for a total of eight hours, of which we estimate 7 seven hours will be spent by internal counsel and 1 one hour will be spent by a compliance director. We estimate that all 50 funding portals will incur these ongoing burdens, for a total ongoing burden 400 hours (8 hours/respondent x 50 funding portals).

l. Records to be Made and Kept by Funding Portals

(1) Time Burden

All funding portals will be required to make and keep records related to their activities to facilitate transactions in reliance on Section 4(a)(6) and the related rules.[1696] These books and records requirements are based generally on Exchange Act Rules 17a-3 and 17a-4, which apply to broker-dealers. To estimate the initial burden for funding portals, we base our analysis upon the current annual burdens of Rules 17a-3 and 17a-4.

We currently estimate the annual recordkeeping burden for broker-dealer compliance with Rule 17a-3 to be 394.16 hours per respondent, and the most recently approved annual recordkeeping burden for broker-dealer compliance with Rule 17a-4 to be 249 hours per respondent.

Given the more limited scope of a funding portal's business as compared to that of a broker, the more targeted scope of the books and records rules, and the fact that funding portals will be required to make, deliver and store records electronically, we expect the burden of the final rules will likely be less than that of Rules 17a-3 and 17a-4. For the purposes of the PRA, we

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[1696] *See* Rule 404 of Regulation Crowdfunding.

assume that the recordkeeping burden, on average, for a funding portal to comply with the final rules will be 50% of the burdens of a broker-dealer to comply with Rules 17a-3 and 17a-4. Therefore, we estimate the initial burden to be approximately 325 hours per respondent,[1697] or 16,250 hours total (325 hours/respondent x 50 respondents). We expect the ongoing recordkeeping burden for funding portals will be the same as the initial burden because the requirements regarding maintaining such records will be consistent each year.

(2) **Cost**

We currently estimate the annual recordkeeping cost for broker-dealer compliance with Rule 17a-3 to be $5,706.67 per respondent. These ongoing recordkeeping costs reflect the costs of systems and equipment development. We currently estimate the annual recordkeeping cost for broker-dealer compliance with Rule 17a-4 to be $5,000 per respondent.

Given the more limited scope of a funding portal's business as compared to that of a broker, the more targeted scope of the books and records rules, and the fact that funding portals will be required to make, deliver and store records electronically, we expect the annual recordkeeping cost of the final rule requirements will likely be less than that of Rules 17a-3 and 17a-4. For purposes of the PRA, we assume that the annual recordkeeping cost on average for a funding portal to comply with the requirements that records be made and kept will be about 50% less than burdens of a broker-dealer to comply with Rules 17a-3 and 17a-4. We expect the initial recordkeeping cost for funding portals, therefore, to be approximately $5,350 per respondent,[1698] or $267,500 total ($5,350 per respondent x 50 respondents). We expect the ongoing

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[1697] 394.16 hours (recordkeeping burden for Rule 17a-3) + 249 hours (recordkeeping burden for Rule 17a-4) = 643.16 hours. 638.16 hours/2 = 321.58 hours.

[1698] $5,706.67 (recordkeeping cost for Rule 17a-3) + $5,000 (recordkeeping cost for Rule 17a-4) = $10,706.67. $10,706.67 / 2 = $5,353.34.

recordkeeping cost burden for funding portals will be the same as the initial burden because the requirements regarding maintaining such records will be consistent each year.

One commenter stated that "[u]nder the expectation that crowdfunding portals will be online operations and will almost certainly retain records through digital methods, the burden of collection should be minimal."[1699] We agree that digital recordkeeping can help to minimize costs, and our estimates reflect this assessment.

D. Collections of Information are Mandatory

The collections of information required under Rules 201 through 203 will be mandatory for all issuers. The collections of information required under Rules 300 through 304 will be mandatory for all intermediaries. The collections of information required under Rules 400 through 404 will be mandatory for all funding portals.

E. Confidentiality

Responses on Form C, Form C-A, Form C-U, Form C-AR and Form C-TR will not be kept confidential. Responses on Form ID will be kept confidential by the Commission, subject to a request under the Freedom of Information Act.[1700] Responses on Forms BD and Forms Funding Portal will not be kept confidential.

F. Retention Period of Recordkeeping Requirements

Issuers are not subject to recordkeeping requirements under Regulation Crowdfunding. Intermediaries that are brokers will be required to retain records and information relating to Regulation Crowdfunding for the required retention periods specified in Exchange Act Rule 17a-

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1699 Joinvestor Letter.

1700 5 U.S.C. 552. The Commission's regulations that implement the Freedom of Information Act are at 17 CFR 200.80 *et seq.*

4. Intermediaries that are funding portals will be required to retain records and information under Regulation Crowdfunding for the required retention periods specified in Rule 404.[1701]

V. FINAL REGULATORY FLEXIBILITY ACT ANALYSIS

The Commission has prepared the following Final Regulatory Flexibility Analysis ("FRFA"), in accordance with the provisions of the Regulatory Flexibility Act,[1702] regarding Regulation Crowdfunding. It relates to the rules for securities-based crowdfunding being adopted today. An Initial Regulatory Flexibility Analysis ("IRFA") was prepared in accordance with the Regulatory Flexibility Act and included in the Proposing Release.

A. Need for the Rule

The regulation is designed to implement the requirements of Title III of the JOBS Act. Title III added Securities Act Section 4(a)(6), which provides a new exemption from the registration requirements of Securities Act Section 5 for securities-based crowdfunding transactions, provided the transactions are conducted in the manner set forth in new Securities Act Section 4A. Section 4A includes requirements for issuers that offer or sell securities in reliance on the crowdfunding exemption, as well as for persons acting as intermediaries in those transactions. The rules prescribe requirements governing the offer and sale of securities in reliance on Section 4(a)(6) and provide a framework for the regulation of registered funding portals and brokers that act as intermediaries in the offer and sale of securities in reliance on Section 4(a)(6).

As discussed above, the crowdfunding provisions of the JOBS Act, which we implement through this regulation, are intended to help alleviate the funding gap and accompanying

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1701 *See* Rule 404 of Regulation Crowdfunding.

1702 5 U.S.C. 603.

regulatory concerns faced by small businesses by making relatively low dollar offerings of securities less costly and by providing crowdfunding platforms a means by which to facilitate the offer and sale of securities without registering as brokers, with a framework for regulatory oversight to protect investors.

B. Significant Issues Raised by Public Comments

In the Proposing Release, we requested comment on every aspect of the IRFA, including the number of small entities that would be affected by the proposed amendments, the existence or nature of the potential impact of the proposals on small entities discussed in the analysis, and how to quantify the impact of the proposed rules.

Some commenters expressed concern that the IRFA did not comply with the Regulatory Flexibility Act because it did not, in their view, adequately describe the costs of the proposed rule on small entities, and did not set forth significant alternatives which accomplish the rule's objectives and which minimize the significant economic impact of the proposal on small entities.[1703] These commenters recommended that the Commission republish for public comment a supplemental IRFA to address these concerns. One commenter stated that the IRFA did not set forth significant alternatives which accomplish the Commission's stated objectives because the IRFA only considered alternatives related to exempting small business from the proposed rules.[1704] One commenter believed that the Commission should exercise its discretion and

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[1703] *See* SBA Office of Advocacy Letter; NAHB Letter; Graves Letter.

[1704] *See* SBA Office of Advocacy Letter.

eliminate the need for two years of audited financial statements,[1705] whereas another commenter viewed the audit requirement as a "heavy-handed" regulatory approach.[1706]

Commenters suggested several alternatives which in their view could reduce costs while accomplishing the rule's objectives.[1707] Commenters suggested that the Commission use its discretion to raise the threshold amount above which issuers would be required to provide audited financial statements,[1708] with one commenter specifically recommending a threshold of $900,000.[1709] One commenter also suggested that the Commission adopt a "question and answer" format for nonfinancial disclosures similar to the format used in Regulation A offerings.[1710] This same commenter also recommended that the Commission could develop "standard, boilerplate disclosures" for some of the "more complicated" nonfinancial disclosures such as risk factors. This commenter stated that the nonfinancial disclosures are not required under the JOBS Act and encouraged the Commission to develop alternatives that would be less burdensome for small issuers. One commenter recommended that the Commission revise the ongoing financial reporting requirements for small issuers to require the disclosure of reviewed rather than audited financial statements, even if such issuers were previously required to disclose audited financial statements pursuant to Section 4A(b)(1)(D).[1711] This commenter also supported a requirement that issuers submit annually an updated statement of financial condition, similar in nature to an abbreviated management's discussion and analysis of financial condition and results of

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[1705] *See* Guzik Letter.

[1706] *See* Rockethub Letter.

[1707] *See* Graves Letter; SBA Office of Advocacy Letter.

[1708] *Id.*

[1709] *See* Graves Letter.

[1710] *See* SBA Office of Advocacy Letter.

[1711] *See* Graves Letter.

operations.[1712] This commenter also suggested that issuers with total revenue below $5 million should be permitted to use either cash-based or accrual-based methods of accounting, so that businesses using cash accounting will not be required to create two sets of accounting records in order to access crowdfunding.[1713]

One commenter suggested that smaller entities tend to be more volatile and more illiquid than larger entities.[1714] This commenter explained that this illiquidity needs to be considered when crafting regulations for small entity intermediaries and small entity issuers. This commenter also stated that, regardless of whether an intermediary has internal compliance personnel, or uses a third party, these compliance costs ultimately will have to be borne by the investors and issuers using the intermediary service. Another commenter expressed concern that the statutory liability standard of Section 4A(c) will be particularly burdensome for funding portals and noted that the IRFA does not account for the large expense statutory liability will impose on intermediaries.[1715] Similarly, one commenter thought it was appropriate to apply the same level of liability that is reserved for issuers to broker-dealers, but not funding portals.[1716] This commenter urged the Commission to either eliminate liability for funding portals, or create regulatory alternatives for funding portals such as allowing them to limit the offerings on their platforms.[1717] One

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1712 *See Id.*

1713 *See Id.*

1714 *See* RocketHub Letter.

1715 *See* SBA Office of Advocacy Letter (stating that the liability standard is especially burdensome for funding portals because broker-dealers already have procedures in place for conducting due diligence on issuers in order to meet FINRA requirements, and funding portals will have to establish these procedures anew).

1716 *See* Graves Letter (stating that the Commission should recognize the difference in the ability of funding portals and registered broker-dealers to use discretion in selecting or curating offerings, and apply liability to each as appropriate).

1717 *Id.* (suggesting that funding portals should be allowed the discretion to exclude offerings from their platforms if they deem them to be overly risky, or if they view the offerings as having shortcomings that could be detrimental to investors).

commenter stated that the IRFA did not account for the cost of prohibiting funding portals from limiting the offerings on their platforms on the basis of subjective factors and suggested that the Commission create a safe harbor for funding portals that allows them to limit such offerings.[1718]

C. Small Entities Subject to the Rules

For purposes of the Regulatory Flexibility Act, under our rules, an issuer (other than an investment company) is a "small business" or "small organization" if it has total assets of $5 million or less as of the end of its most recently completed fiscal year and is engaged or proposing to engage in an offering of securities which does not exceed $5 million.[1719] We believe that many issuers seeking to offer and sell securities in reliance on Section 4(a)(6) will be at a very early stage of their business development and will likely have total assets of $5 million or less. Also, to qualify for the exemption under Section 4(a)(6), the amount raised by an issuer must not exceed $1 million in a 12-month period. Therefore, we estimate that all issuers who offer or sell securities in reliance on the exemption will be classified as a "small business" or "small organization."

For purposes of the Regulatory Flexibility Act when used with reference to a broker or dealer, the Commission has defined the term "small entity" to mean a broker-dealer that: (1) had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d) or, if not required to file such statements, a broker or dealer that had total capital (net worth plus subordinated debt) of less than $500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business if shorter); and (2) is not affiliated with any person (other

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1718 *See* SBA Office of Advocacy Letter.

1719 17 CFR 230.157.

than a natural person) that is not a small business or small organization as defined in this release."[1720] Currently, based on FOCUS Report[1721] data, there are 871 broker-dealers that are classified as "small" entities for purposes of the Regulatory Flexibility Act.[1722] Because of some overlap in permitted functions of funding portals and brokers, we look to the definition of a small broker-dealer to quantify the estimated numbers of small funding portals that will likely register under the new regulation. Based on discussions with industry participants prior to the publication of the proposed rules, we estimate that, of the anticipated 50 funding portals we expect to register under the new regulation, 30 will be classified as "small" entities for purposes of the Regulatory Flexibility Act.

D. Projected Reporting, Recordkeeping and other Compliance Requirements

As discussed above, the final rules include reporting, recordkeeping and other compliance requirements. In particular, the final rules impose certain disclosure requirements on issuers offering and selling securities in a transaction relying on the exemption provided by Section 4(a)(6). The final rules require that issuers relying on the exemption provided by Section 4(a)(6) file with the Commission certain specified information about the issuer and the offering, including information about the issuer's contact information; directors, officers and certain beneficial owners; business and business plan; current number of employees; financial condition; target offering amount and the deadline to reach the target offering amount; use of proceeds from the offering and price or method for calculating the price of the securities being offered; ownership

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[1720] 17 CFR 240.0-10(c).

[1721] FOCUS Reports, or "Financial and Operational Combined Uniform Single" Reports, are monthly, quarterly, and annual reports that broker-dealers generally are required to file with the Commission and/or self-regulatory organizations pursuant to Exchange Act Rule 17a-5 (17 CFR 240.17a-5).

[1722] *See* 17 CFR 240.0-10(a).

and capital structure; material factors that make an investment in the issuer speculative or risky; indebtedness; description of other offerings of securities; and transactions with related parties. Issuers also will be required to file updates with the Commission to describe the progress of the issuer in meeting the target offering amount, unless the issuer relies on the intermediary to include this information on its platform, and to disclose the total amount of securities sold in the offering. In addition, any issuer that sells securities in reliance on Section 4(a)(6) also will be required to file with the Commission an annual report to update the previously provided disclosure about the issuer's contact information; directors, officers and certain beneficial owners; business and business plan; current number of employees; financial condition; ownership and capital structure; material factors that make an investment in the issuer speculative or risky; indebtedness; description of other offerings of securities; and transactions with related parties.

Intermediaries will be required to register with the Commission as either brokers or as funding portals. Intermediaries also will be required to provide quarterly reports to the Commission. Funding portals will be required to make and keep certain records in accordance with the rules. Registered broker-dealers are already required to make and keep certain records in accordance with existing Exchange Act Rules 17a-3 and 17a-4. In addition, the final rules impose specific compliance requirements on intermediaries, such as the maintenance of written policies and procedures.

In adopting this regulation, we took into account that the regulation, as mandated by the JOBS Act, aimed to address difficulties encountered by small entities. Accordingly, we designed the final rules for intermediaries, to the extent possible in light of investor protection concerns, with the needs and constraints of small entities in mind, including small intermediaries. We believe that the reporting, recordkeeping and other compliance requirements of the final rules

applicable to intermediaries will impact, in particular, small entities that decide to register as funding portals. We believe that most of these requirements will be performed by internal compliance personnel of the broker or funding portal, but we expect that at least some funding portals may decide to hire outside counsel and third-party service providers to assist in meeting the compliance requirements. Given the statutory limitations on crowdfunding, we believe that the potential impact of the final rules on larger brokers and funding portals will be proportionally less than on small brokers and small intermediaries.

E. Agency Action to Minimize Effect on Small Entities

In response to comments, the final rules include a number of changes from the proposal, many of which were made to minimize the effect of the rules on small entities. These changes are outlined in detail above in the discussions of the rules adopted.

1. Issuers

To address commenters' concerns about the cost of the rules to small issuers, we have considered the alternatives suggested by commenters and are adopting final rules which implement certain alternatives we believe will minimize the cost of the final rules to small issuers while also preserving necessary investor protection measures.

First, the final rules include an accommodation for issuers conducting an offering for the first time in reliance on Regulation Crowdfunding. Under the final rules, issuers conducting an offering of more than $500,000 but not more than $1,000,000 that have not previously sold securities in reliance on Section 4(a)(6) will not be required to provide audited financial statements, unless audited financial statements are otherwise available. Instead, the final rules permit these issuers to provide reviewed financial statements. As discussed above, this is a change from the proposal that is responsive to concerns raised by many commenters about the

expense of obtaining audited financial statements, especially for start-up issuers without a track record of successfully raising capital.[1723] We believe that requiring reviewed financial statements for issuers using Regulation Crowdfunding for the first time to raise more than $500,000 but not more than $1 million, rather than audited financial statements, will minimize costs for issuers while providing sufficient investor protection by maintaining the benefit of an independent review.

As suggested by one commenter,[1724] and as discussed above, the final Form C includes an optional question-and-answer format that issuers may elect to use to provide the disclosures that are not required to be filed in XML format. Issuers opting to use this format would prepare their disclosures by answering the questions provided and filing that disclosure as an exhibit to the Form C. Given our expectation that issuers engaged in offerings in reliance on Section 4(a)(6) will encompass a wide variety of industries at different stages of business development, we do not believe it would be practical or useful to develop standard, predetermined disclosure, as suggested by one commenter, for such a variety of issuers. Also, as discussed above, we do not believe that financial statements prepared in accordance with other comprehensive bases of accounting, such as cash or accrual-based accounting, as suggested by one commenter, provide investors with a fair representation of a company's financial position and results of operations, and it may be difficult for investors to determine whether the issuer complied with such basis. Although we acknowledge, as some commenters observed, that other bases of accounting may be less expensive than U.S. GAAP, we believe the benefit of a single standard that will facilitate comparison among securities-based crowdfunding issuers justifies any incremental expenses

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1723 *See, e.g.*, SBA Office of Advocacy Letter.

1724 *Id.*

associated with U.S. GAAP. We also note that financial statements prepared in accordance with U.S. GAAP are generally self-scaling to the size and complexity of the issuer, which we expect to reduce the burden of preparing financial statements for many early stage issuers, including small issuers.

The final rules also maintain the progress update requirement, but with a significant modification from the proposed rule which is intended to reduce duplicative disclosure and minimize the burden on small issuers. The final rules will require an issuer to file a Form C-U at the end of the offering to disclosure the total amount of securities sold in the offering, but the rules permit issuers to satisfy the 50% and 100% progress update requirements by relying on the relevant intermediary to make publicly available on the intermediary's platform frequent updates about the issuer's progress toward meeting the target offering amount.

With respect to ongoing reporting requirements, rather than requiring an issuer to provide financial statements in the annual report that meet the highest standard previously provided, as proposed, the final rules require financial statements of the issuer certified by the principal executive officer of the issuer to be true and complete in all material respects. We expect that reducing the required level of public accountant involvement will minimize the costs and burdens for all issuers, including small issuers, associated with preparing reviewed and audited financial statements on an ongoing basis.

In addition, the final rules provide for termination of the ongoing reporting obligation in two additional circumstances: (1) the issuer has filed at least one annual report and has fewer than 300 holders of record, or (2) the issuer has filed the annual reports for at least the three most recent years and has total assets not exceeding $10,000,000. We believe the addition of these

termination events should help reduce related costs for issuers that may not have achieved a level of financial success that would sustain an ongoing reporting obligation.

Overall, we considered whether to establish different compliance or reporting requirements or timetables or to clarify, consolidate or simplify compliance and reporting requirements for small issuers. As noted above, we have made significant revisions to the final rules to address commenters' concerns about compliance and reporting burdens faced by issuers, especially small issuers. With respect to using performance rather than design standards, we used performance standards to the extent appropriate under the statute. For example, issuers have the flexibility to customize the presentation of certain disclosures in their offering statements.[1725] We also considered whether there should be an exemption from coverage of the rule, or any part of the rule, for small issuers. However, because the rules have been designed to implement crowdfunding, which focuses on capital formation by issuers that are small entities, while at the same time provide appropriate investor protections, we do not believe that small issuers should be exempt, in whole or in part, from the proposed rules.

2. Intermediaries

In response to comments, we have made a number of changes from the proposal with respect to intermediaries that will help to alleviate the compliance burdens faced by small entities. Most significantly, and in response to commenters' concerns about the application of Section 4A(c) liability,[1726] as discussed above, Rule 402(b)(1) has been modified from the proposal to include a safe harbor that provides a funding portal the ability to determine whether and under what terms to allow an issuer to offer and sell securities in reliance on Section 4(a)(6) of the

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[1725] *See* Section II.B.3.

[1726] *See, e.g.*, SBA Office of Advocacy Letter.

Securities Act through its platform; provided that a funding portal otherwise complies with Regulation Crowdfunding. This change is expected to allow intermediaries, including small entities, to reduce their exposure to such liability by denying access to issuers that present risk of fraud or other investor protection concerns. In addition, in a change from the proposed rules, we are not requiring a fidelity bond for intermediaries and also are expanding the definition of qualified third party. These changes should reduce costs for all intermediaries, including small entities.

The final rules have been tailored to the more limited role intermediaries will play in offerings made pursuant to Securities Act Section 4(a)(6) (as compared to the wide range of services that a traditional broker-dealer may provide). Registered brokers and funding portals will engage in similar activities related to crowdfunding and must comply with the adopted rules. The effective date for the registration provisions for funding portals will allow funding portals to be in a position to engage in crowdfunding at the same time as registered brokers once the rest of the rules become effective. These effective dates are designed to accommodate competitiveness concerns related to funding portals' and registered broker dealers' abilities to begin crowdfunding concurrently. While registered broker-dealers may perform services that a funding portal is prohibited from performing, the Exchange Act and rules thereunder, as well as SRO rules, already govern those activities. Therefore, we believe that the adopted rules are appropriate and properly tailored for the permissible activities of all brokers and funding portals.

We also considered whether, for small brokers or small funding portals, to establish different compliance, reporting or timing requirements, or whether to clarify, consolidate or simplify those requirements in our rules. While the final rules are based in large part on existing compliance requirements applicable to registered brokers to the extent they are applicable to

activities permitted for funding portals, we do not believe we should establish different requirements for small entities (whether registered brokers or funding portals) that engage in crowdfunding because such activities are limited in scope and, as such, the adopted rules are tailored to that more limited activity.

VI. STATUTORY AUTHORITY AND TEXT OF PROPOSED REGULATION

We are adopting the rules and forms contained in this document under the authority set forth in the Securities Act (15 U.S.C. 77a *et seq.*), particularly, Sections 4(a)(6), 4A, 19 and 28 thereof; the Exchange Act (15 U.S.C. 78a *et seq.*), particularly, Sections 3(b), 3(h), 10(b), 15, 17, 23(a) and 36 thereof; and Pub. L. No. 112-106, §301-305, 126 Stat. 306 (2012).

List of Subjects

17 CFR Part 200

Administrative practice and procedure, Authority delegations (Government agencies), Organization and functions (Government agencies).

Reporting and recordkeeping requirements.

17 CFR Part 227

Crowdfunding, Funding Portals, Intermediaries, Reporting and recordkeeping requirements, Securities.

17 CFR Parts 232 and 239

Reporting and recordkeeping requirements, Securities.

17 CFR Part 240

Brokers, Confidential business information, Fraud, Reporting and recordkeeping requirements, Securities.

17 CFR Part 249

Brokers, Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, title 17, chapter II of the Code of Federal Regulations is amended as follows:

PART 200 – ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

SUBPART A – Organization and Program Management

1. The authority citation for Part 200, Subpart A, continues to read, in part as follows:

Authority: 15 U.S.C. 77c, 77o, 77s, 77z-3, 77sss, 78d, 78d-1, 78d-2, 78o-4, 78w, 78ll(d), 78mm, 80a-37, 80b-11, 7202, and 7211 et seq., unless otherwise noted.

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2. Amend § 200.30-1 by:

a. Redesignating paragraphs (d), (e), (f), (g), (h), (i), (j) and (k) as paragraphs (e), (f), (g), (h), (i), (j), (k) and (*l*), respectively; and

b. Adding new paragraph (d).

The addition reads as follows:

§ 200.30-1 Delegation of authority to Director of Division of Corporation Finance.

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(d) With respect to the Securities Act of 1933 (15 U.S.C. 77a *et seq.*) and §§ 227.100 through 227.503 of this chapter, to authorize the granting of applications under § 227.503(b)(2) of this chapter upon the showing of good cause that it is not necessary under the circumstances that the exemption under Regulation Crowdfunding be denied.

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PART 227—REGULATION CROWDFUNDING, GENERAL RULES AND REGULATIONS

3. The authority citation for Part 227 reads as follows:

Authority: 15 U.S.C. 77d, 77d-1, 77s, 78c, 78o, 78q, 78w, 78mm, and Pub. L. No. 112-106, §301-305, 126 Stat. 306 (2012).

4. Part 227 is added to read as follows:

Sec.

REGULATION CROWDFUNDING

Subpart A General

227.100 Crowdfunding exemption and requirements.

Subpart B Requirements for Issuers

227.201 Disclosure requirements.

227.202 Ongoing reporting requirements.

227.203 Filing requirements and form.

227.204 Advertising.

227.205 Promoter compensation.

Subpart C Requirements for Intermediaries

227.300 Intermediaries.

227.301 Measures to reduce risk of fraud.

227.302 Account opening.

227.303 Requirements with respect to transactions.

227.304 Completion of offerings, cancellations and reconfirmations.

227.305 Payments to third parties.

Subpart D Funding Portal Regulation

227.400 Registration of funding portals.

227.401 Exemption.

227.402 Conditional safe harbor.

227.403 Compliance.

227.404 Records to be made and kept by funding portals.

Subpart E Miscellaneous Provisions

227.501 Restrictions on resales.

227.502 Insignificant deviations from a term, condition or requirement of Regulation Crowdfunding.

227.503 Disqualification provisions.

SUBPART A – General

§ 227.100 Crowdfunding exemption and requirements.

(a) *Exemption.* An issuer may offer or sell securities in reliance on Section 4(a)(6) of the Securities Act of 1933 (the "Securities Act") (15 U.S.C. 77d(a)(6)), provided that:

(1) The aggregate amount of securities sold to all investors by the issuer in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) during the 12-month period preceding the date of such offer or sale, including the securities offered in such transaction, shall not exceed $1,000,000;

(2) The aggregate amount of securities sold to any investor across all issuers in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) during the 12-month period preceding the date of such transaction, including the securities sold to such investor in such transaction, shall not exceed:

(i) The greater of $2,000 or 5 percent of the lesser of the investor's annual income or net

worth if either the investor's annual income or net worth is less than $100,000; or

(ii) 10 percent of the lesser of the investor's annual income or net worth, not to exceed an amount sold of $100,000, if both the investor's annual income and net worth are equal to or more than $100,000;

Instruction 1 to paragraph (a)(2). To determine the investment limit for a natural person, the person's annual income and net worth shall be calculated as those values are calculated for purposes of determining accredited investor status in accordance with § 230.501 of this chapter.

Instruction 2 to paragraph (a)(2). A person's annual income and net worth may be calculated jointly with that person's spouse; however, when such a joint calculation is used, the aggregate investment of the investor spouses may not exceed the limit that would apply to an individual investor at that income or net worth level.

Instruction 3 to paragraph (a)(2). An issuer offering and selling securities in reliance on Section 4(a)(6) of the Sccurities Act (15 U.S.C. 77d(a)(6)) may rely on the efforts of an intermediary required by § 227.303(b) to ensure that the aggregate amount of securities purchased by an investor in offerings pursuant to Section 4(a)(6) of the Securities Act will not cause the investor to exceed the limit set forth in Section 4(a)(6) of the Securities Act and § 227.100(a)(2), *provided that* the issuer does not know that the investor has exceeded the investor limits or would exceed the investor limits as a result of purchasing securities in the issuer's offering.

(3) The transaction is conducted through an intermediary that complies with the requirements in Section 4A(a) of the Securities Act (15 U.S.C. 77d-1(a)) and the related requirements in this part, and the transaction is conducted exclusively through the intermediary's platform; and

Instruction to paragraph (a)(3). An issuer shall not conduct an offering or concurrent

offerings in reliance on Section 4(a)(6) of the Securities Act of 1933 (15 U.S.C. 77d(a)(6)) using more than one intermediary.

(4) The issuer complies with the requirements in Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)) and the related requirements in this part; *provided, however,* that the failure to comply with §§ 227.202, 227.203(a)(3) and 227.203(b) shall not prevent an issuer from relying on the exemption provided by Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

(b) *Applicability.* The crowdfunding exemption shall not apply to transactions involving the offer or sale of securities by any issuer that:

(1) Is not organized under, and subject to, the laws of a State or territory of the United States or the District of Columbia;

(2) Is subject to the requirement to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act") (15 U.S.C. 78m or 78o(d));

(3) Is an investment company, as defined in Section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), or is excluded from the definition of investment company by Section 3(b) or Section 3(c) of that Act (15 U.S.C. 80a-3(b) or 80a-3(c));

(4) Is not eligible to offer or sell securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) as a result of a disqualification as specified in § 227.503(a);

(5) Has sold securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) and has not filed with the Commission and provided to investors, to the extent required, the ongoing annual reports required by this part during the two years immediately preceding the filing of the required offering statement; or

Instruction to paragraph (b)(5). An issuer delinquent in its ongoing reports can again rely on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) once it has filed with the

Commission and provided to investors both of the annual reports required during the two years immediately preceding the filing of the required offering statement.

(6) Has no specific business plan or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies.

(c) *Issuer*. For purposes of §227.201(r), calculating aggregate amounts offered and sold in §227.100(a) and §227.201(t), and determining whether an issuer has previously sold securities in §227.201(t)(3), *issuer* includes all entities controlled by or under common control with the issuer and any predecessors of the issuer.

Instruction to paragraph (c). The term *control* means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of the entity, whether through the ownership of voting securities, by contract or otherwise.

(d) *Investor.* For purposes of this part, *investor* means any investor or any potential investor, as the context requires.

SUBPART B – Requirements for Issuers

§ 227.201 Disclosure requirements.

An issuer offering or selling securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) and in accordance with Section 4A of the Securities Act (15 U.S.C. 77d-1) and this part must file with the Commission and provide to investors and the relevant intermediary the following information:

(a) The name, legal status (including its form of organization, jurisdiction in which it is organized and date of organization), physical address and website of the issuer;

(b) The names of the directors and officers (and any persons occupying a similar status or performing a similar function) of the issuer, all positions and offices with the issuer held by such

persons, the period of time in which such persons served in the position or office and their business experience during the past three years, including:

(1) Each person's principal occupation and employment, including whether any officer is employed by another employer; and

(2) The name and principal business of any corporation or other organization in which such occupation and employment took place.

Instruction to paragraph (b). For purposes of this paragraph (b), the term *officer* means a president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, and any person routinely performing similar functions.

(c) The name of each person, as of the most recent practicable date but no earlier than 120 days prior to the date the offering statement or report is filed, who is a beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power;

(d) A description of the business of the issuer and the anticipated business plan of the issuer;

(e) The current number of employees of the issuer;

(f) A discussion of the material factors that make an investment in the issuer speculative or risky;

(g) The target offering amount and the deadline to reach the target offering amount, including a statement that if the sum of the investment commitments does not equal or exceed the target offering amount at the offering deadline, no securities will be sold in the offering, investment commitments will be cancelled and committed funds will be returned;

(h) Whether the issuer will accept investments in excess of the target offering amount and, if so, the maximum amount that the issuer will accept and how oversubscriptions will be allocated, such as on a pro-rata, first come-first served, or other basis;

(i) A description of the purpose and intended use of the offering proceeds;

Instruction to paragraph (i). An issuer must provide a reasonably detailed description of any intended use of proceeds, such that investors are provided with enough information to understand how the offering proceeds will be used. If an issuer has identified a range of possible uses, the issuer should identify and describe each probable use and the factors the issuer may consider in allocating proceeds among the potential uses. If the issuer will accept proceeds in excess of the target offering amount, the issuer must describe the purpose, method for allocating oversubscriptions, and intended use of the excess proceeds with similar specificity.

(j) A description of the process to complete the transaction or cancel an investment commitment, including a statement that:

(1) Investors may cancel an investment commitment until 48 hours prior to the deadline identified in the issuer's offering materials;

(2) The intermediary will notify investors when the target offering amount has been met;

(3) If an issuer reaches the target offering amount prior to the deadline identified in its offering materials, it may close the offering early if it provides notice about the new offering deadline at least five business days prior to such new offering deadline (absent a material change that would require an extension of the offering and reconfirmation of the investment commitment); and

(4) If an investor does not cancel an investment commitment before the 48-hour period prior to the offering deadline, the funds will be released to the issuer upon closing of the offering and the investor will receive securities in exchange for his or her investment;

(k) A statement that if an investor does not reconfirm his or her investment commitment after a material change is made to the offering, the investor's investment commitment will be cancelled and the committed funds will be returned;

(l) The price to the public of the securities or the method for determining the price, provided that, prior to any sale of securities, each investor shall be provided in writing the final price and all required disclosures;

(m) A description of the ownership and capital structure of the issuer, including:

(1) The terms of the securities being offered and each other class of security of the issuer, including the number of securities being offered and/or outstanding, whether or not such securities have voting rights, any limitations on such voting rights, how the terms of the securities being offered may be modified and a summary of the differences between such securities and each other class of security of the issuer, and how the rights of the securities being offered may be materially limited, diluted or qualified by the rights of any other class of security of the issuer;

(2) A description of how the exercise of rights held by the principal shareholders of the issuer could affect the purchasers of the securities being offered;

(3) The name and ownership level of each person, as of the most recent practicable date but no earlier than 120 days prior to the date the offering statement or report is filed, who is the beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power;

(4) How the securities being offered are being valued, and examples of methods for how such securities may be valued by the issuer in the future, including during subsequent corporate actions;

(5) The risks to purchasers of the securities relating to minority ownership in the issuer and the risks associated with corporate actions including additional issuances of securities, issuer repurchases of securities, a sale of the issuer or of assets of the issuer or transactions with related parties; and

(6) A description of the restrictions on transfer of the securities, as set forth in § 227.501;

(n) The name, SEC file number and Central Registration Depository (CRD) number (as applicable) of the intermediary through which the offering is being conducted;

(o) A description of the intermediary's financial interests in the issuer's transaction and in the issuer, including:

(1) The amount of compensation to be paid to the intermediary, whether as a dollar amount or a percentage of the offering amount, or a good faith estimate if the exact amount is not available at the time of the filing, for conducting the offering, including the amount of referral and any other fees associated with the offering, and

(2) Any other direct or indirect interest in the issuer held by the intermediary, or any arrangement for the intermediary to acquire such an interest;

(p) A description of the material terms of any indebtedness of the issuer, including the amount, interest rate, maturity date and any other material terms;

(q) A description of exempt offerings conducted within the past three years;

Instruction to paragraph (q). In providing a description of any prior exempt offerings, disclose:

(1) The date of the offering;

(2) The offering exemption relied upon;

(3) The type of securities offered; and

(4) The amount of securities sold and the use of proceeds;

(r) A description of any transaction since the beginning of the issuer's last fiscal year, or any currently proposed transaction, to which the issuer was or is to be a party and the amount involved exceeds five percent of the aggregate amount of capital raised by the issuer in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) during the preceding 12-month period, inclusive of the amount the issuer seeks to raise in the current offering under Section 4(a)(6) of the Securities Act, in which any of the following persons had or is to have a direct or indirect material interest:

(1) Any director or officer of the issuer;

(2) Any person who is, as of the most recent practicable date but no earlier than 120 days prior to the date the offering statement or report is filed, the beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power;

(3) If the issuer was incorporated or organized within the past three years, any promoter of the issuer; or

(4) Any member of the family of any of the foregoing persons, which includes a child, stepchild, grandchild, parent, stepparent, grandparent, spouse or spousal equivalent, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, and shall include adoptive relationships. The term *spousal equivalent* means a cohabitant occupying a relationship generally equivalent to that of a spouse.

Instruction 1 to paragraph (r). For each transaction identified, disclose the name of the specified person and state his or her relationship to the issuer, and the nature and, where practicable, the approximate amount of his or her interest in the transaction. The amount of such interest shall be computed without regard to the amount of the profit or loss involved in the transaction. Where it is not practicable to state the approximate amount of the interest, the approximate amount involved in the transaction shall be disclosed.

Instruction 2 to paragraph (r). For purposes of paragraph (r), a transaction includes, but is not limited to, any financial transaction, arrangement or relationship (including any indebtedness or guarantee of indebtedness) or any series of similar transactions, arrangements or relationships.

(s) A discussion of the issuer's financial condition, including, to the extent material, liquidity, capital resources and historical results of operations;

Instruction 1 to paragraph (s).

The discussion must cover each period for which financial statements of the issuer are provided. An issuer also must include a discussion of any material changes or trends known to management in the financial condition and results of operations of the issuer subsequent to the period for which financial statements are provided.

Instruction 2 to paragraph (s). For issuers with no prior operating history, the discussion should focus on financial milestones and operational, liquidity and other challenges. For issuers with an operating history, the discussion should focus on whether historical results and cash flows are representative of what investors should expect in the future. Issuers should take into account the proceeds of the offering and any other known or pending sources of capital. Issuers also should discuss how the proceeds from the offering will affect the issuer's liquidity, whether receiving these funds and any other additional funds is necessary to the viability of the business,

and how quickly the issuer anticipates using its available cash. In addition, issuers should describe the other available sources of capital to the business, such as lines of credit or required contributions by shareholders.

Instruction 3 to paragraph (s). References to the issuer in this paragraph and its instructions refer to the issuer and its predecessors, if any.

(t) For offerings that, together with all other amounts sold under Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) within the preceding 12-month period, have, in the aggregate, the following target offering amounts:

(1) $100,000 or less, the amount of total income, taxable income and total tax, or the equivalent line items, as reported on the federal income tax returns filed by the issuer for the most recently completed year (if any), which shall be certified by the principal executive officer of the issuer to reflect accurately the information reported on the issuer's federal income tax returns, and financial statements of the issuer, which shall be certified by the principal executive officer of the issuer to be true and complete in all material respects. If financial statements of the issuer are available that have either been reviewed or audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead and need not include the information reported on the federal income tax returns or the certifications of the principal executive officer;

(2) More than $100,000, but not more than $500,000, financial statements of the issuer reviewed by a public accountant that is independent of the issuer. If financial statements of the issuer are available that have been audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead and need not include the reviewed financial statements; and

(3) More than $500,000, financial statements of the issuer audited by a public accountant that is independent of the issuer; *provided, however*, that for issuers that have not previously sold securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), offerings that have a target offering amount of more than $500,000, but not more than $1,000,000, financial statements of the issuer reviewed by a public accountant that is independent of the issuer. If financial statements of the issuer are available that have been audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead and need not include the reviewed financial statements.

Instruction 1 to paragraph (t).

To determine the financial statements required under this paragraph (t), an issuer must aggregate amounts sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) within the preceding 12-month period and the offering amount in the offering for which disclosure is being provided. If the issuer will accept proceeds in excess of the target offering amount, the issuer must include the maximum offering amount that the issuer will accept in the calculation to determine the financial statements required under this paragraph (t).

Instruction 2 to paragraph (t). An issuer may voluntarily meet the requirements of this paragraph (t) for a higher aggregate target offering amount.

Instruction 3 to paragraph (t). The financial statements must be prepared in accordance with U.S. generally accepted accounting principles and include balance sheets, statements of comprehensive income, statements of cash flows, statements of changes in stockholders' equity and notes to the financial statements. If the financial statements are not audited, they must be labeled as "unaudited." The financial statements must cover the two most recently completed fiscal years or the period(s) since inception, if shorter.

Instruction 4 to paragraph (t). For an offering conducted in the first 120 days of a fiscal year, the financial statements provided may be for the two fiscal years prior to the issuer's most recently completed fiscal year; however, financial statements for the two most recently completed fiscal years must be provided if they are otherwise available. If more than 120 days have passed since the end of the issuer's most recently completed fiscal year, the financial statements provided must be for the issuer's two most recently completed fiscal years. If the 120th day falls on a Saturday, Sunday, or holiday, the next business day shall be considered the 120th day for purposes of determining the age of the financial statements.

Instruction 5 to paragraph (t). An issuer may elect to delay complying with any new or revised financial accounting standard that applies to companies that are not issuers (as defined under section 2(a) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201(a)) until the date that such companies are required to comply with such new or revised accounting standard. Issuers electing this accommodation must disclose it at the time the issuer files its offering statement and apply the election to all standards. Issuers electing not to use this accommodation must forgo this accommodation for all financial accounting standards and may not elect to rely on this accommodation in any future filings.

Instruction 6 to paragraph (t). An issuer required to provide information from a tax return under paragraph (t)(1) of this section before filing a tax return with the U.S. Internal Revenue Service for the most recently completed fiscal year may provide information from its tax return for the prior year (if any), provided that the issuer provides information from the tax return for the most recently completed fiscal year when it is filed with the U.S. Internal Revenue Service (if the tax return is filed during the offering period). An issuer that requested an extension from the U.S. Internal Revenue Service would not be required to provide information from the tax return until

the date the return is filed, if filed during the offering period. If an issuer has not yet filed a tax return and is not required to file a tax return before the end of the offering period, then the tax return information does not need to be provided.

Instruction 7 to paragraph (t). An issuer providing financial statements that are not audited or reviewed and tax information as specified under paragraph (t)(1) of this section must have its principal executive officer provide the following certification:

I, [identify the certifying individual], certify that:

(1) the financial statements of [identify the issuer] included in this Form are true and complete in all material respects; and

(2) the tax return information of [identify the issuer] included in this Form reflects accurately the information reported on the tax return for [identify the issuer] filed for the fiscal year ended [date of most recent tax return].

[Signature and title].

Instruction 8 to paragraph (t). Financial statement reviews shall be conducted in accordance with the Statements on Standards for Accounting and Review Services issued by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants. A signed review report must accompany the reviewed financial statements, and an issuer must notify the public accountant of the issuer's intended use of the review report in the offering. An issuer will not be in compliance with the requirement to provide reviewed financial statements if the review report includes modifications.

Instruction 9 to paragraph (t). Financial statement audits shall be conducted in accordance with either auditing standards issued by the American Institute of Certified Public Accountants (referred to as U.S. Generally Accepted Auditing Standards) or the standards of the

Public Company Accounting Oversight Board. A signed audit report must accompany audited financial statements, and an issuer must notify the public accountant of the issuer's intended use of the audit report in the offering. An issuer will not be in compliance with the requirement to provide audited financial statements if the audit report includes a qualified opinion, an adverse opinion, or a disclaimer of opinion.

Instruction 10 to paragraph (t). To qualify as a public accountant that is independent of the issuer for purposes of this part, the accountant must satisfy the independence standards of either:

(i) 17 CFR 210.2-01 of this chapter, or

(ii) The American Institute of Certified Public Accountants. The public accountant that audits or reviews the financial statements provided by an issuer must be:

(a) Duly registered and in good standing as a certified public accountant under the laws of the place of his or her residence or principal office; or

(b) In good standing and entitled to practice as a public accountant under the laws of his or her place of residence or principal office.

Instruction 11 to paragraph (t). Except as set forth in § 227.100(c), references to the issuer in this paragraph (t) and its instructions (2) through (10) refer to the issuer and its predecessors, if any.

(u) Any matters that would have triggered disqualification under § 227.503(a) but occurred before [INSERT DATE 180 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]. The failure to provide such disclosure shall not prevent an issuer from continuing to rely on the exemption provided by Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) if the issuer

establishes that it did not know and, in the exercise of reasonable care, could not have known of the existence of the undisclosed matter or matters;

Instruction to paragraph (u). An issuer will not be able to establish that it could not have known of a disqualification unless it has made factual inquiry into whether any disqualifications exist. The nature and scope of the factual inquiry will vary based on the facts and circumstances concerning, among other things, the issuer and the other offering participants.

(v) Updates regarding the progress of the issuer in meeting the target offering amount, to be provided in accordance with § 227.203;

(w) Where on the issuer's website investors will be able to find the issuer's annual report, and the date by which such report will be available on the issuer's website;

(x) Whether the issuer or any of its predecessors previously failed to comply with the ongoing reporting requirements of § 227.202; and

(y) Any material information necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

Instruction to §227.201. If disclosure provided pursuant to any paragraph of this section also satisfies the requirements of one or more other paragraphs of this section, it is not necessary to repeat the disclosure. Instead of repeating information, an issuer may include a cross-reference to disclosure contained elsewhere in the offering statement or report, including to information in the financial statements.

§ 227.202 Ongoing reporting requirements.

(a) An issuer that has offered and sold securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) and in accordance with Section 4A of the Securities Act (15 U.S.C. 77d-1) and this part must file with the Commission and post on the issuer's website an

annual report along with the financial statements of the issuer certified by the principal executive officer of the issuer to be true and complete in all material respects and a description of the financial condition of the issuer as described in § 227.201(s). If, however, an issuer has available financial statements that have either been reviewed or audited by a public accountant that is independent of the issuer, those financial statements must be provided and the certification by the principal executive officer will not be required. The annual report also must include the disclosure required by paragraphs (a), (b), (c), (d), (e), (f), (m), (p), (q), (r), and (x) of § 227.201. The report must be filed in accordance with the requirements of § 227.203 and Form C (§ 239.900 of this chapter) and no later than 120 days after the end of the fiscal year covered by the report.

Instruction 1 to paragraph (a). Instructions (3), (8), (9), (10), and (11) to paragraph (t) of § 227.201 shall apply for purposes of this section.

Instruction 2 to paragraph (a). An issuer providing financial statements that are not audited or reviewed must have its principal executive officer provide the following certification:

I, [identify the certifying individual], certify that the financial statements of [identify the issuer] included in this Form are true and complete in all material respects.

[Signature and title]. (b) An issuer must continue to comply with the ongoing reporting requirements until one of the following occurs:

(1) The issuer is required to file reports under Section 13(a) or Section 15(d) of the Exchange Act (15 U.S.C. 78m(a) or 78o(d));

(2) The issuer has filed, since its most recent sale of securities pursuant to this part, at least one annual report pursuant to this section and has fewer than 300 holders of record;

(3) The issuer has filed, since its most recent sale of securities pursuant to this part, the annual reports required pursuant to this section for at least the three most recent years and has total assets that do not exceed $10,000,000;

(4) The issuer or another party repurchases all of the securities issued in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), including any payment in full of debt securities or any complete redemption of redeemable securities; or

(5) The issuer liquidates or dissolves its business in accordance with state law.

§ 227.203 Filing requirements and form.

(a) Form C – Offering Statement and Amendments (§ 239.900 of this chapter).

(1) *Offering Statement.* An issuer offering or selling securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) and in accordance with Section 4A of the Securities Act (15 U.S.C. 77d-1) and this part must file with the Commission and provide to investors and the relevant intermediary a Form C: Offering Statement (Form C) (§ 239.900 of this chapter) prior to the commencement of the offering of securities. The Form C must include the information required by § 227.201.

(2) *Amendments to Offering Statement.* An issuer must file with the Commission and provide to investors and the relevant intermediary an amendment to the offering statement filed on Form C (§ 239.900 of this chapter) to disclose any material changes, additions or updates to information that it provides to investors through the intermediary's platform, for any offering that has not yet been completed or terminated. The amendment must be filed on Form C: Amendment (Form C/A) (§ 239.900 of this chapter), and if the amendment reflects material changes, additions or updates, the issuer shall check the box indicating that investors must reconfirm an investment commitment within five business days or the investor's commitment will be considered cancelled.

(3) *Progress Updates.*

(i) An issuer must file with the Commission and provide to investors and the relevant intermediary a Form C: Progress Update (Form C-U) (§ 239.900 of this chapter) to disclose its progress in meeting the target offering amount no later than five business days after each of the dates when the issuer reaches 50 percent and 100 percent of the target offering amount.

(ii) If the issuer will accept proceeds in excess of the target offering amount, the issuer must file with the Commission and provide to investors and the relevant intermediary, no later than five business days after the offering deadline, a final Form C-U (§ 239.900 of this chapter) to disclose the total amount of securities sold in the offering.

(iii) The requirements of paragraphs (a)(3)(i) and (ii) of this section shall not apply to an issuer if the relevant intermediary makes publicly available on the intermediary's platform frequent updates regarding the progress of the issuer in meeting the target offering amount; however, the issuer must still file a Form C-U (§ 239.900 of this chapter) to disclose the total amount of securities sold in the offering no later than five business days after the offering deadline.

Instruction to paragraph (a)(3). If multiple Forms C-U (§ 239.900 of this chapter) are triggered within the same five business day period, the issuer may consolidate such progress updates into one Form C-U, so long as the Form C-U discloses the most recent threshold that was met and the Form C-U is filed with the Commission and provided to investors and the relevant intermediary by the day on which the first progress update is due.

Instruction 1 to paragraph (a). An issuer would satisfy the requirement to provide to the relevant intermediary the information required by this paragraph (a) if it provides to the relevant intermediary a copy of the disclosures filed with the Commission.

Instruction 2 to paragraph (a). An issuer would satisfy the requirement to provide to investors the information required by this paragraph (a) if the issuer refers investors to the information on the intermediary's platform by means of a posting on the issuer's website or by e-mail.

(b) Form C: Annual Report and Termination of Reporting (§ 239.900 of this chapter).

(1) *Annual Reports.* An issuer that has sold securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) and in accordance with Section 4A of the Securities Act (15 U.S.C. 77d-1) and this part must file an annual report on Form C: Annual Report (Form C-AR) (§ 239.900 of this chapter) with the Commission no later than 120 days after the end of the fiscal year covered by the report. The annual report shall include the information required by § 227.202(a).

(2) *Amendments to Annual Report.* An issuer must file with the Commission an amendment to the annual report filed on Form C: Annual Report (Form C-AR) (§ 239.900 of this chapter) to make a material change to the previously filed annual report as soon as practicable after discovery of the need for the material change. The amendment must be filed on Form C: Amendment to Annual Report (Form C-AR/A) (§ 239.900 of this chapter).

(3) *Termination of Reporting.* An issuer eligible to terminate its obligation to file annual reports with the Commission pursuant to § 227.202(b) must file with the Commission, within five business days from the date on which the issuer becomes eligible to terminate its reporting obligation, Form C: Termination of Reporting (Form C-TR) (§ 239.900 of this chapter) to advise investors that the issuer will cease reporting pursuant to this part.

§ 227.204 Advertising.

(a) An issuer may not, directly or indirectly, advertise the terms of an offering made in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), except for notices that meet the requirements of paragraph (b) of this section.

Instruction to § 227.204(a). For purposes of this paragraph (a), *issuer* includes persons acting on behalf of the issuer.

(b) A notice may advertise any of the terms of an issuer's offering made in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) if it directs investors to the intermediary's platform and includes no more than the following information:

(1) A statement that the issuer is conducting an offering pursuant to Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), the name of the intermediary through which the offering is being conducted and a link directing the potential investor to the intermediary's platform;

(2) The terms of the offering; and

(3) Factual information about the legal identity and business location of the issuer, limited to the name of the issuer of the security, the address, phone number and website of the issuer, the e-mail address of a representative of the issuer and a brief description of the business of the issuer.

(c) Notwithstanding the prohibition on advertising any of the terms of the offering, an issuer, and persons acting on behalf of the issuer, may communicate with investors and potential investors about the terms of the offering through communication channels provided by the intermediary on the intermediary's platform, provided that an issuer identifies itself as the issuer in all communications. Persons acting on behalf of the issuer must identify their affiliation with the issuer in all communications on the intermediary's platform.

Instruction to § 227.204. For purposes of this section, *terms of the offering* means the amount of

securities offered, the nature of the securities, the price of the securities and the closing date of the offering period.

§ 227.205 Promoter compensation.

(a) An issuer, or person acting on behalf of the issuer, shall be permitted to compensate or commit to compensate, directly or indirectly, any person to promote the issuer's offerings made in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through communication channels provided by an intermediary on the intermediary's platform, but only if the issuer or person acting on behalf of the issuer, takes reasonable steps to ensure that the person promoting the offering clearly discloses the receipt, past or prospective, of such compensation with any such communication.

Instruction to paragraph (a). The disclosure required by this paragraph is required, with each communication, for persons engaging in promotional activities on behalf of the issuer through the communication channels provided by the intermediary, regardless of whether or not the compensation they receive is specifically for the promotional activities. This includes persons hired specifically to promote the offering as well as to persons who are otherwise employed by the issuer or who undertake promotional activities on behalf of the issuer.

(b) Other than as set forth in paragraph (a) of this section, an issuer or person acting on behalf of the issuer shall not compensate or commit to compensate, directly or indirectly, any person to promote the issuer's offerings made in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), unless such promotion is limited to notices permitted by, and in compliance with, § 227.204.

SUBPART C – Requirements for Intermediaries

§ 227.300 Intermediaries.

(a) Requirements. A person acting as an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) must:

(1) Be registered with the Commission as a broker under Section 15(b) of the Exchange Act (15 U.S.C. 78*o*(b)) or as a funding portal in accordance with the requirements of § 227.400; and

(2) Be a member a national securities association registered under Section 15A of the Exchange Act (15 U.S.C. 78*o*-3).

(b) Financial Interests. Any director, officer or partner of an intermediary, or any person occupying a similar status or performing a similar function, may not have a financial interest in an issuer that is offering or selling securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through the intermediary's platform, or receive a financial interest in an issuer as compensation for the services provided to or for the benefit of the issuer in connection with the offer or sale of such securities. An intermediary may not have a financial interest in an issuer that is offering or selling securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through the intermediary's platform unless:

(1) the intermediary receives the financial interest from the issuer as compensation for the services provided to, or for the benefit of, the issuer in connection with the offer or sale of the securities being offered or sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through the intermediary's platform; and

(2) the financial interest consists of securities of the same class and having the same terms, conditions and rights as the securities being offered or sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through the intermediary's platform. For purposes of this paragraph, a *financial interest in an issuer* means a direct or indirect ownership of, or economic interest in, any class of the issuer's securities.

(c) Definitions. For purposes of this part:

(1) *Associated person of a funding portal* or *person associated with a funding portal* means any partner, officer, director or manager of a funding portal (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling or controlled by such funding portal, or any employee of a funding portal, except that any person associated with a funding portal whose functions are solely clerical or ministerial shall not be included in the meaning of such term for purposes of Section 15(b) of the Exchange Act (15 U.S.C. 78*o*(b)) (other than paragraphs (4) and (6) of Section 15(b) of the Exchange Act).

(2) *Funding portal* means a broker acting as an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), that does not:

(i) Offer investment advice or recommendations;

(ii) Solicit purchases, sales or offers to buy the securities displayed on its platform;

(iii) Compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its platform; or

(iv) Hold, manage, possess, or otherwise handle investor funds or securities.

(3) *Intermediary* means a broker registered under Section 15(b) of the Exchange Act (15 U.S.C. 78*o*(b)) or a funding portal registered under § 227.400 and includes, where relevant, an associated person of the registered broker or registered funding portal.

(4) *Platform* means a program or application accessible via the Internet or other similar electronic communication medium through which a registered broker or a registered funding portal acts as an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

Instruction to paragraph (c)(4). An intermediary through which a crowdfunding transaction is conducted may engage in back office or other administrative functions other than on the intermediary's platform.

§ 227.301 Measures to reduce risk of fraud.

An intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) must:

(a) Have a reasonable basis for believing that an issuer seeking to offer and sell securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through the intermediary's platform complies with the requirements in Section 4A(b) of the Act (15 U.S.C. 77d-1(b)) and the related requirements in this part. In satisfying this requirement, an intermediary may rely on the representations of the issuer concerning compliance with these requirements unless the intermediary has reason to question the reliability of those representations;

(b) Have a reasonable basis for believing that the issuer has established means to keep accurate records of the holders of the securities it would offer and sell through the intermediary's platform, provided that an intermediary may rely on the representations of the issuer concerning its means of recordkeeping unless the intermediary has reason to question the reliability of those

representations. An intermediary will be deemed to have satisfied this requirement if the issuer has engaged the services of a transfer agent that is registered under Section 17A of the Exchange Act (15 U.S.C. 78q-1(c)).

(c) Deny access to its platform to an issuer if the intermediary:

(1) Has a reasonable basis for believing that the issuer or any of its officers, directors (or any person occupying a similar status or performing a similar function) or beneficial owners of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power, is subject to a disqualification under § 227.503. In satisfying this requirement, an intermediary must, at a minimum, conduct a background and securities enforcement regulatory history check on each issuer whose securities are to be offered by the intermediary and on each officer, director or beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power.

(2) Has a reasonable basis for believing that the issuer or the offering presents the potential for fraud or otherwise raises concerns about investor protection. In satisfying this requirement, an intermediary must deny access if it reasonably believes that it is unable to adequately or effectively assess the risk of fraud of the issuer or its potential offering. In addition, if an intermediary becomes aware of information after it has granted access that causes it to reasonably believe that the issuer or the offering presents the potential for fraud or otherwise raises concerns about investor protection, the intermediary must promptly remove the offering from its platform, cancel the offering, and return (or, for funding portals, direct the return of) any funds that have been committed by investors in the offering.

§ 227.302 Account opening.

(a) Accounts and Electronic Delivery.

(1) No intermediary or associated person of an intermediary may accept an investment commitment in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) until the investor has opened an account with the intermediary and the intermediary has obtained from the investor consent to electronic delivery of materials.

(2) An intermediary must provide all information that is required to be provided by the intermediary under Subpart C (§§ 227.300 through 305), including, but not limited to, educational materials, notices and confirmations, through electronic means. Unless otherwise indicated in the relevant rule of Subpart C, in satisfying this requirement, an intermediary must provide the information through an electronic message that contains the information, through an electronic message that includes a specific link to the information as posted on intermediary's platform, or through an electronic message that provides notice of what the information is and that it is located on the intermediary's platform or on the issuer's website. Electronic messages include, but are not limited to, e-mail, social media messages, instant messages or other electronic media messages.

(b) Educational Materials. (1) In connection with establishing an account for an investor, an intermediary must deliver educational materials to such investor that explain in plain language and are otherwise designed to communicate effectively and accurately:

(i) The process for the offer, purchase and issuance of securities through the intermediary and the risks associated with purchasing securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6));

(ii) The types of securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) available for purchase on the intermediary's platform and the risks

associated with each type of security, including the risk of having limited voting power as a result of dilution;

(iii) The restrictions on the resale of a security offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6));

(iv) The types of information that an issuer is required to provide under § 227.202, the frequency of the delivery of that information and the possibility that those obligations may terminate in the future;

(v) The limitations on the amounts an investor may invest pursuant to § 227.100(a)(2);

(vi) The limitations on an investor's right to cancel an investment commitment and the circumstances in which an investment commitment may be cancelled by the issuer;

(vii) The need for the investor to consider whether investing in a security offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) is appropriate for that investor;

(viii) That following completion of an offering conducted through the intermediary, there may or may not be any ongoing relationship between the issuer and intermediary; and

(ix) That under certain circumstances an issuer may cease to publish annual reports and, therefore, an investor may not continually have current financial information about the issuer.

(2) An intermediary must make the most current version of its educational material available on its platform at all times and, if at any time, the intermediary makes a material revision to its educational materials, it must make the revised educational materials available to all investors before accepting any additional investment commitments or effecting any further transactions in securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

(c) Promoters. In connection with establishing an account for an investor, an intermediary must inform the investor that any person who promotes an issuer's offering for compensation, whether past or prospective, or who is a founder or an employee of an issuer that engages in promotional activities on behalf of the issuer on the intermediary's platform, must clearly disclose in all communications on the intermediary's platform, respectively, the receipt of the compensation and that he or she is engaging in promotional activities on behalf of the issuer.

(d) Compensation Disclosure. When establishing an account for an investor, an intermediary must clearly disclose the manner in which the intermediary is compensated in connection with offerings and sales of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

§ 227.303 Requirements with respect to transactions.

(a) Issuer Information. An intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) must make available to the Commission and to investors any information required to be provided by the issuer of the securities under §§ 227.201 and 203(a).

(1) This information must be made publicly available on the intermediary's platform, in a manner that reasonably permits a person accessing the platform to save, download, or otherwise store the information;

(2) This information must be made publicly available on the intermediary's platform for a minimum of 21 days before any securities are sold in the offering, during which time the intermediary may accept investment commitments;

(3) This information, including any additional information provided by the issuer, must remain publicly available on the intermediary's platform until the offer and sale of securities in

reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) is completed or cancelled; and

(4) An intermediary may not require any person to establish an account with the intermediary to access this information.

(b) Investor Qualification. Each time before accepting any investment commitment (including any additional investment commitment from the same person), an intermediary must:

(1) Have a reasonable basis for believing that the investor satisfies the investment limitations established by Section 4(a)(6)(B) of the Act (15 U.S.C. 77d(a)(6)(B)) and this part. An intermediary may rely on an investor's representations concerning compliance with the investment limitation requirements concerning the investor's annual income, net worth, and the amount of the investor's other investments made pursuant to Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) unless the intermediary has reason to question the reliability of the representation.

(2) Obtain from the investor:

(i) A representation that the investor has reviewed the intermediary's educational materials delivered pursuant to § 227.302(b), understands that the entire amount of his or her investment may be lost, and is in a financial condition to bear the loss of the investment; and

(ii) A questionnaire completed by the investor demonstrating the investor's understanding that:

(A) There are restrictions on the investor's ability to cancel an investment commitment and obtain a return of his or her investment;

(B) It may be difficult for the investor to resell securities acquired in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)); and

(C) Investing in securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) involves risk, and the investor should not invest any funds in an offering made in reliance on Section 4(a)(6) of the Securities Act unless he or she can afford to lose the entire amount of his or her investment.

(c) Communication Channels. An intermediary must provide on its platform communication channels by which persons can communicate with one another and with representatives of the issuer about offerings made available on the intermediary's platform, provided:

(1) If the intermediary is a funding portal, it does not participate in these communications other than to establish guidelines for communication and remove abusive or potentially fraudulent communications;

(2) The intermediary permits public access to view the discussions made in the communication channels;

(3) The intermediary restricts posting of comments in the communication channels to those persons who have opened an account with the intermediary on its platform; and

(4) The intermediary requires that any person posting a comment in the communication channels clearly and prominently disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or is otherwise compensated, whether in the past or prospectively, to promote the issuer's offering.

(d) Notice of Investment Commitment. An intermediary must promptly, upon receipt of an investment commitment from an investor, give or send to the investor a notification disclosing:

(1) The dollar amount of the investment commitment;

(2) The price of the securities, if known;

(3) The name of the issuer; and

(4) The date and time by which the investor may cancel the investment commitment.

(e) Maintenance and Transmission of Funds.

(1) An intermediary that is a registered broker must comply with the requirements of 17 CFR 240.15c2-4.

(2) An intermediary that is a funding portal must direct investors to transmit the money or other consideration directly to a qualified third party that has agreed in writing to hold the funds for the benefit of, and to promptly transmit or return the funds to, the persons entitled thereto in accordance with paragraph (e)(3) of this section. For purposes of this Subpart C (§§ 227.300 through 305), a qualified third party means a:

(i) Registered broker or dealer that carries customer or broker or dealer accounts and holds funds or securities for those persons; or

(ii) Bank or credit union (where such credit union is insured by National Credit Union Administration) that has agreed in writing either to hold the funds in escrow for the persons who have the beneficial interests therein and to transmit or return such funds directly to the persons entitled thereto when so directed by the funding portal as described in paragraph (e)(3) of this section, or to maintain a bank or credit union account (or accounts) for the exclusive benefit of investors and the issuer.

(3) A funding portal that is an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) shall promptly direct the qualified third party to:

(i) Transmit funds from the qualified third party to the issuer when the aggregate amount of investment commitments from all investors is equal to or greater than the target amount of the

offering and the cancellation period as set forth in § 227.304 has elapsed, *provided that* in no event may the funding portal direct this transmission of funds earlier than 21 days after the date on which the intermediary makes publicly available on its platform the information required to be provided by the issuer under §§ 227.201 and 203(a);

(ii) Return funds to an investor when an investment commitment has been cancelled in accordance with § 227.304 (including for failure to obtain effective reconfirmation as required under § 227.304(c)); and

(iii) Return funds to investors when an issuer does not complete the offering.

(f) Confirmation of Transaction. (1) An intermediary must, at or before the completion of a transaction in a security in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), give or send to each investor a notification disclosing:

(i) The date of the transaction;

(ii) The type of security that the investor is purchasing;

(iii) The identity, price, and number of securities purchased by the investor, as well as the number of securities sold by the issuer in the transaction and the price(s) at which the securities were sold;

(iv) If a debt security, the interest rate and the yield to maturity calculated from the price paid and the maturity date;

(v) If a callable security, the first date that the security can be called by the issuer; and

(vi) The source, form and amount of any remuneration received or to be received by the intermediary in connection with the transaction, including any remuneration received or to be received by the intermediary from persons other than the issuer.

(2) An intermediary satisfying the requirements of paragraph (f)(1) of this section is exempt from the requirements of §240.10b-10 of this chapter with respect to a transaction in a security offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

§ 227.304 Completion of offerings, cancellations and reconfirmations.

(a) Generally. An investor may cancel an investment commitment for any reason until 48 hours prior to the deadline identified in the issuer's offering materials. During the 48 hours prior to such deadline, an investment commitment may not be cancelled except as provided in paragraph (c) of this section.

(b) Early Completion of Offering. If an issuer reaches the target offering amount prior to the deadline identified in its offering materials pursuant to § 227.201(g), the issuer may close the offering on a date earlier than the deadline identified in its offering materials pursuant to § 227.201(g), *provided that:*

(1) The offering remains open for a minimum of 21 days pursuant to § 227.303(a);

(2) The intermediary provides notice to any potential investors, and gives or sends notice to investors that have made investment commitments in the offering, of:

(i) The new, anticipated deadline of the offering;

(ii) The right of investors to cancel investment commitments for any reason until 48 hours prior to the new offering deadline; and

(iii) Whether the issuer will continue to accept investment commitments during the 48-hour period prior to the new offering deadline.

(3) The new offering deadline is scheduled for and occurs at least five business days after the notice required in paragraph (b)(2) of this section is provided; and

(4) At the time of the new offering deadline, the issuer continues to meet or exceed the target offering amount.

(c) Cancellations and Reconfirmations Based on Material Changes. (1) If there is a material change to the terms of an offering or to the information provided by the issuer, the intermediary must give or send to any investor who has made an investment commitment notice of the material change and that the investor's investment commitment will be cancelled unless the investor reconfirms his or her investment commitment within five business days of receipt of the notice. If the investor fails to reconfirm his or her investment within those five business days, the intermediary within five business days thereafter must:

(i) Give or send the investor a notification disclosing that the commitment was cancelled, the reason for the cancellation and the refund amount that the investor is expected to receive; and

(ii) Direct the refund of investor funds.

(2) If material changes to the offering or to the information provided by the issuer regarding the offering occur within five business days of the maximum number of days that an offering is to remain open, the offering must be extended to allow for a period of five business days for the investor to reconfirm his or her investment.

(d) Return of Funds If Offering Is Not Completed. If an issuer does not complete an offering, an intermediary must within five business days:

(1) Give or send each investor a notification of the cancellation, disclosing the reason for the cancellation, and the refund amount that the investor is expected to receive;

(2) Direct the refund of investor funds; and

(3) Prevent investors from making investment commitments with respect to that offering on its platform.

§ 227.305 Payments to third parties.

(a) Prohibition on Payments for Personally Identifiable Information. An intermediary may not compensate any person for providing the intermediary with the personally identifiable information of any investor or potential investor in securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)).

(b) For purposes of this rule, personally identifiable information means information that can be used to distinguish or trace an individual's identity, either alone or when combined with other personal or identifying information that is linked or linkable to a specific individual.

SUBPART D – Funding Portal Regulation

§227.400 Registration of funding portals.

(a) Registration. A funding portal must register with the Commission, by filing a complete Form Funding Portal (§ 249.2000 of this chapter) in accordance with the instructions on the form, and become a member of a national securities association registered under Section 15A of the Exchange Act (15 U.S.C. 78*o*-3). The registration will be effective the later of:

(1) 30 calendar days after the date that the registration is received by the Commission; or

(2) The date the funding portal is approved for membership by a national securities association registered under Section 15A of the Exchange Act (15 U.S.C. 78*o*-3).

(b) Amendments to Registration. A funding portal must file an amendment to Form Funding Portal (§ 249.2000 of this chapter) within 30 days of any of the information previously submitted on Form Funding Portal becoming inaccurate for any reason.

(c) Successor Registration.

(1) If a funding portal succeeds to and continues the business of a registered funding portal, the registration of the predecessor will remain effective as the registration of the successor

if the successor, within 30 days after such succession, files a registration on Form Funding Portal (§ 249.2000 of this chapter) and the predecessor files a withdrawal on Form Funding Portal; *provided, however*, that the registration of the predecessor funding portal will be deemed withdrawn 45 days after registration on Form Funding Portal is filed by the successor.

(2) Notwithstanding paragraph (c)(1) of this section, if a funding portal succeeds to and continues the business of a registered funding portal and the succession is based solely on a change of the predecessor's date or state of incorporation, form of organization, or composition of a partnership, the successor may, within 30 days after the succession, amend the registration of the predecessor on Form Funding Portal (§ 249.2000 of this chapter) to reflect these changes.

(d) Withdrawal. A funding portal must promptly file a withdrawal of registration on Form Funding Portal (§ 249.2000 of this chapter) in accordance with the instructions on the form upon ceasing to operate as a funding portal. Withdrawal will be effective on the later of 30 days after receipt by the Commission (after the funding portal is no longer operational), or within such longer period of time as to which the funding portal consents or which the Commission by order may determine as necessary or appropriate in the public interest or for the protection of investors.

(e) Applications and Reports. The applications and reports provided for in this section shall be considered filed when a complete Form Funding Portal (§ 249.2000 of this chapter) is submitted with the Commission. Duplicate originals of the applications and reports provided for in this section must be filed with surveillance personnel designated by any registered national securities association of which the funding portal is a member.

(f) Nonresident Funding Portals. Registration pursuant to this section by a nonresident funding portal shall be conditioned upon there being an information sharing arrangement in place between the Commission and the competent regulator in the jurisdiction under the laws of which

the nonresident funding portal is organized or where it has its principal place of business, that is applicable to the nonresident funding portal.

(1) *Definition.* For purposes of this section, the term *nonresident funding portal* shall mean a funding portal incorporated in or organized under the laws of a jurisdiction outside of the United States or its territories, or having its principal place of business in any place not in the United States or its territories.

(2) *Power of Attorney.*

(i) Each nonresident funding portal registered or applying for registration pursuant to this section shall obtain a written consent and power of attorney appointing an agent in the United States, other than the Commission or a Commission member, official or employee, upon whom may be served any process, pleadings or other papers in any action under the federal securities laws. This consent and power of attorney must be signed by the nonresident funding portal and the named agent(s) for service of process.

(ii) Each nonresident funding portal registered or applying for registration pursuant to this section shall, at the time of filing its application on Form Funding Portal (§ 249.2000 of this chapter), furnish to the Commission the name and address of its United States agent for service of process on Schedule C to the Form.

(iii) Any change of a nonresident funding portal's agent for service of process and any change of name or address of a nonresident funding portal's existing agent for service of process shall be communicated promptly to the Commission through amendment of the Schedule C to Form Funding Portal (§ 249.2000 of this chapter).

(iv) Each nonresident funding portal must promptly appoint a successor agent for service of process if the nonresident funding portal discharges its identified agent for service of process or

if its agent for service of process is unwilling or unable to accept service on behalf of the nonresident funding portal.

(v) Each nonresident funding portal must maintain, as part of its books and records, the written consent and power of attorney identified in paragraph (f)(2)(i) of this section for at least three years after the agreement is terminated.

(3) *Access to Books and Records; Inspections and Examinations.*

(i) *Certification and Opinion of Counsel.* Any nonresident funding portal applying for registration pursuant to this section shall:

(A) Certify on Schedule C to Form Funding Portal (§ 249.2000 of this chapter) that the nonresident funding portal can, as a matter of law, and will provide the Commission and any registered national securities association of which it becomes a member with prompt access to the books and records of such nonresident funding portal and can, as a matter of law, and will submit to onsite inspection and examination by the Commission and any registered national securities association of which it becomes a member; and

(B) Provide an opinion of counsel that the nonresident funding portal can, as a matter of law, provide the Commission and any registered national securities association of which it becomes a member with prompt access to the books and records of such nonresident funding portal and can, as a matter of law, submit to onsite inspection and examination by the Commission and any registered national securities association of which it becomes a member.

(ii) *Amendments.* The nonresident funding portal shall re-certify, on Schedule C to Form Funding Portal (§ 249.2000 of this chapter), within 90 days after any changes in the legal or regulatory framework that would impact the nonresident funding portal's ability to provide, or the manner in which it provides, the Commission, or any registered national securities association of

which it is a member, with prompt access to its books and records or that would impact the Commission's or such registered national securities association's ability to inspect and examine the nonresident funding portal. The re-certification shall be accompanied by a revised opinion of counsel describing how, as a matter of law, the nonresident funding portal can continue to meet its obligations under paragraphs (f)(3)(i)(A) and (B) of this section.

§ 227.401 Exemption.

A funding portal that is registered with the Commission pursuant to § 227.400 is exempt from the broker registration requirements of Section 15(a)(1) of the Exchange Act (15 U.S.C. 78*o*(a)(1)) in connection with its activities as a funding portal.

§ 227.402 Conditional safe harbor.

(a) General. Under Section 3(a)(80) of the Exchange Act (15 U.S.C. 78c(a)(80)), a funding portal acting as an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) may not: offer investment advice or recommendations; solicit purchases, sales, or offers to buy the securities offered or displayed on its platform or portal; compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its platform or portal; hold, manage, possess, or otherwise handle investor funds or securities; or engage in such other activities as the Commission, by rule, determines appropriate. This section is intended to provide clarity with respect to the ability of a funding portal to engage in certain activities, consistent with the prohibitions under Section 3(a)(80) of the Exchange Act. No presumption shall arise that a funding portal has violated the prohibitions under Section 3(a)(80) of the Exchange Act or this part by reason of the funding portal or its associated persons engaging in activities in connection with the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act that do not

meet the conditions specified in paragraph (b) of this section. The antifraud provisions and all other applicable provisions of the federal securities laws continue to apply to the activities described in paragraph (b) of this section.

(b) Permitted Activities. A funding portal may, consistent with the prohibitions under Section 3(a)(80) of the Exchange Act (15 U.S.C. 78c(a)(80)) and this part:

(1) Determine whether and under what terms to allow an issuer to offer and sell securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) through its platform; provided that a funding portal otherwise complies with this part;

(2) Apply objective criteria to highlight offerings on the funding portal's platform where:

(i) The criteria are reasonably designed to highlight a broad selection of issuers offering securities through the funding portal's platform, are applied consistently to all issuers and offerings and are clearly displayed on the funding portal's platform;

(ii) The criteria may include, among other things, the type of securities being offered (for example, common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the number or amount of investment commitments made, progress in meeting the issuer's target offering amount or, if applicable, the maximum offering amount; and the minimum or maximum investment amount; provided that the funding portal may not highlight an issuer or offering based on the advisability of investing in the issuer or its offering; and

(iii) The funding portal does not receive special or additional compensations for highlighting one or more issuers or offerings on its platform;

(3) Provide search functions or other tools that investors can use to search, sort, or categorize the offerings available through the funding portal's platform according to objective criteria where;

(i) The criteria may include, among other things, the type of securities being offered (for example, common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the number or amount of investment commitments made, progress in meeting the issuer's target offering amount or, if applicable, the maximum offering amount; and the minimum or maximum investment amount; and

(ii) The criteria may not include, among other things, the advisability of investing in the issuer or its offering, or an assessment of any characteristic of the issuer, its business plan, its key management or risks associated with an investment.

(4) Provide communication channels by which investors can communicate with one another and with representatives of the issuer through the funding portal's platform about offerings through the platform, so long as the funding portal (and its associated persons):

(i) Does not participate in these communications, other than to establish guidelines for communication and remove abusive or potentially fraudulent communications;

(ii) Permits public access to view the discussions made in the communication channels;

(iii) Restricts posting of comments in the communication channels to those persons who have opened an account on its platform; and

(iv) Requires that any person posting a comment in the communication channels clearly disclose with each posting whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or is otherwise compensated, whether in the past or prospectively, to promote an issuer's offering;

(5) Advise an issuer about the structure or content of the issuer's offering, including assisting the issuer in preparing offering documentation;

(6) Compensate a third party for referring a person to the funding portal, so long as the third party does not provide the funding portal with personally identifiable information of any potential investor, and the compensation, other than that paid to a registered broker or dealer, is not based, directly or indirectly, on the purchase or sale of a security in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) offered on or through the funding portal's platform;

(7) Pay or offer to pay any compensation to a registered broker or dealer for services, including referrals pursuant to paragraph (b)(6) of this section, in connection with the offer or sale of securities by the funding portal in reliance on Section 4(a)(6) of the Act(15 U.S.C. 77d(a)(6)), provided that:

(i) Such services are provided pursuant to a written agreement between the funding portal and the registered broker or dealer;

(ii) Such services and compensation are permitted under this part; and

(iii) Such services and compensation comply with the rules of any registered national securities association of which the funding portal is a member;

(8) Receive any compensation from a registered broker or dealer for services provided by the funding portal in connection with the offer or sale of securities by the funding portal in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), provided that:

(i) Such services are provided pursuant to a written agreement between the funding portal and the registered broker or dealer;

(ii) Such compensation is permitted under this part; and

(iii) Such compensation complies with the rules of any registered national securities association of which the funding portal is a member;

(9) Advertise the existence of the funding portal and identify one or more issuers or offerings available on the portal on the basis of objective criteria, as long as:

(i) The criteria are reasonably designed to identify a broad selection of issuers offering securities through the funding portal's platform, and are applied consistently to all potential issuers and offerings;

(ii) The criteria may include, among other things, the type of securities being offered (for example, common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the expressed interest by investors, as measured by number or amount of investment commitments made, progress in meeting the issuer's target offering amount or, if applicable, the maximum offering amount; and the minimum or maximum investment amount; and

(iii) The funding portal does not receive special or additional compensation for identifying the issuer or offering in this manner;

(10) Deny access to its platform to, or cancel an offering of an issuer, pursuant to § 227.301(c)(2), if the funding portal has a reasonable basis for believing that the issuer or the offering presents the potential for fraud or otherwise raises concerns about investor protection;

(11) Accept, on behalf of an issuer, an investment commitment for securities offered in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) by that issuer on the funding portal's platform;

(12) Direct investors where to transmit funds or remit payment in connection with the purchase of securities offered and sold in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)); and

(13) Direct a qualified third party, as required by § 227.303(e), to release proceeds to an issuer upon completion of a crowdfunding offering or to return proceeds to investors in the event an investment commitment or an offering is cancelled.

§ 227.403 Compliance.

(a) Policies and procedures. A funding portal must implement written policies and procedures reasonably designed to achieve compliance with the federal securities laws and the rules and regulations thereunder relating to its business as a funding portal.

(b) Privacy. A funding portal must comply with the requirements of part 248 of this chapter as they apply to brokers.

(c) Inspections and examinations. A funding portal shall permit the examination and inspection of all of its business and business operations that relate to its activities as a funding portal, such as its premises, systems, platforms, and records by representatives of the Commission and of the registered national securities association of which it is a member.

§ 227.404 Records to be made and kept by funding portals.

(a) Generally. A funding portal shall make and preserve the following records for five years, the first two years in an easily accessible place:

(1) All records related to an investor who purchases or attempts to purchase securities through the funding portal;

(2) All records related to issuers who offer and sell or attempt to offer and sell securities through the funding portal and the control persons of such issuers;

(3) Records of all communications that occur on or through its platform;

(4) All records related to persons that use communication channels provided by a funding portal to promote an issuer's securities or communicate with potential investors;

(5) All records required to demonstrate compliance with the requirements of Subparts C (§§ 227.300 through 305) and D (§§ 227.400 through 404);

(6) All notices provided by such funding portal to issuers and investors generally through the funding portal's platform or otherwise, including, but not limited to, notices addressing hours of funding portal operations (if any), funding portal malfunctions, changes to funding portal procedures, maintenance of hardware and software, instructions pertaining to access to the funding portal and denials of, or limitations on, access to the funding portal;

(7) All written agreements (or copies thereof) entered into by such funding portal relating to its business as such;

(8) All daily, monthly and quarterly summaries of transactions effected through the funding portal, including:

(i) Issuers for which the target offering amount has been reached and funds distributed; and

(ii) Transaction volume, expressed in:

(A) Number of transactions;

(B) Number of securities involved in a transaction;

(C) Total amounts raised by, and distributed to, issuers; and

(D) Total dollar amounts raised across all issuers, expressed in U.S. dollars; and

(9) A log reflecting the progress of each issuer who offers or sells securities through the funding portal toward meeting the target offering amount.

(b) Organizational documents. A funding portal shall make and preserve during the operation of the funding portal and of any successor funding portal, all organizational documents relating to the funding portal, including but not limited to, partnership agreements, articles of incorporation or charter, minute books and stock certificate books (or other similar type documents).

(c) Format. The records required to be maintained and preserved pursuant to paragraph (a) of this section must be produced, reproduced, and maintained in the original, non-alterable format in which they were created or as permitted under § 240.17a-4(f) of this chapter.

(d) Third parties. The records required to be made and preserved pursuant to this section may be prepared or maintained by a third party on behalf of a funding portal. An agreement with a third party shall not relieve a funding portal from the responsibility to prepare and maintain records as specified in this rule. A funding portal must file with the registered national securities association of which it is a member, a written undertaking in a form acceptable to the registered national securities association, signed by a duly authorized person of the third party, stating in effect that such records are the property of the funding portal and will be surrendered promptly on request of the funding portal. The undertaking shall include the following provision:

> With respect to any books and records maintained or preserved on behalf of [name of funding portal], the undersigned hereby acknowledges that the books and records are the property of [name of funding portal], and hereby undertakes to permit examination of such books and records at any time, or from time to time, during business hours by representatives of the Securities and Exchange Commission and the registered national securities association of which the funding portal is a member, and to promptly furnish to the Commission, its representatives,

and the registered national securities association of which the funding portal is a member, a true, correct, complete and current hard copy of any, all, or any part of, such books and records.

(e) Review of records. All records of a funding portal are subject at any time, or from time to time, to reasonable periodic, special, or other examination by the representatives of the Commission and the registered national securities association of which a funding portal is a member. Every funding portal shall furnish promptly to the Commission, its representatives, and the registered national securities association of which the funding portal is a member true, correct, complete and current copies of such records of the funding portal that are requested by the representatives of the Commission and the registered national securities association.

(f) Financial recordkeeping and reporting of currency and foreign transactions. A funding portal that is subject to the requirements of the Currency and Foreign Transactions Reporting Act of 1970 (15 U.S.C. 5311 *et seq.*) shall comply with the reporting, recordkeeping and record retention requirements of 31 CFR chapter X. Where 31 CFR chapter X and §§ 227.404(a) and 404(b) require the same records or reports to be preserved for different periods of time, such records or reports shall be preserved for the longer period of time.

SUBPART E – Miscellaneous Provisions

§ 227.501 Restrictions on resales.

(a) Securities issued in a transaction exempt from registration pursuant to Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) and in accordance with Section 4A of the Securities Act (15 U.S.C. 77d-1) and this part may not be transferred by any purchaser of such securities during the one-year period beginning when the securities were issued in a transaction exempt from

registration pursuant to Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)), unless such securities are transferred:

(1) To the issuer of the securities;

(2) To an accredited investor;

(3) As part of an offering registered with the Commission; or

(4) To a member of the family of the purchaser or the equivalent, to a trust controlled by the purchaser, to a trust created for the benefit of a member of the family of the purchaser or the equivalent, or in connection with the death or divorce of the purchaser or other similar circumstance.

(b) For purposes of this § 227.501, the term *accredited investor* shall mean any person who comes within any of the categories set forth in § 230.501(a) of this chapter, or who the seller reasonably believes comes within any of such categories, at the time of the sale of the securities to that person.

(c) For purposes of this section, the term *member of the family of the purchaser or the equivalent* includes a child, stepchild, grandchild, parent, stepparent, grandparent, spouse or spousal equivalent, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of the purchaser, and shall include adoptive relationships. For purposes of this paragraph (c), the term *spousal equivalent* means a cohabitant occupying a relationship generally equivalent to that of a spouse.

§ 227.502 Insignificant deviations from a term, condition or requirement of Regulation Crowdfunding.

(a) A failure to comply with a term, condition, or requirement of this part will not result in the loss of the exemption from the requirements of Section 5 of the Securities Act (15 U.S.C. 77e)

for any offer or sale to a particular individual or entity, if the issuer relying on the exemption shows:

(1) The failure to comply was insignificant with respect to the offering as a whole;

(2) The issuer made a good faith and reasonable attempt to comply with all applicable terms, conditions and requirements of this part; and

(3) The issuer did not know of such failure where the failure to comply with a term, condition or requirement of this part was the result of the failure of the intermediary to comply with the requirements of Section 4A(a) of the Securities Act (15 U.S.C. 77d-1(a)) and the related rules, or such failure by the intermediary occurred solely in offerings other than the issuer's offering.

(b) Paragraph (a) of this section shall not preclude the Commission from bringing an enforcement action seeking any appropriate relief for an issuer's failure to comply with all applicable terms, conditions and requirements of this part.

§ 227.503 Disqualification provisions.

(a) Disqualification events. No exemption under this Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) shall be available for a sale of securities if the issuer; any predecessor of the issuer; any affiliated issuer; any director, officer, general partner or managing member of the issuer; any beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power; any promoter connected with the issuer in any capacity at the time of such sale; any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with such sale of securities; or any general partner, director, officer or managing member of any such solicitor:

(1) Has been convicted, within 10 years before the filing of the offering statement (or five years, in the case of issuers, their predecessors and affiliated issuers), of any felony or misdemeanor:

(i) In connection with the purchase or sale of any security;

(ii) Involving the making of any false filing with the Commission; or

(iii) Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser, funding portal or paid solicitor of purchasers of securities;

(2) Is subject to any order, judgment or decree of any court of competent jurisdiction, entered within five years before the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)) that, at the time of such filing, restrains or enjoins such person from engaging or continuing to engage in any conduct or practice:

(i) In connection with the purchase or sale of any security;

(ii) Involving the making of any false filing with the Commission; or

(iii) Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser, funding portal or paid solicitor of purchasers of securities;

(3) Is subject to a final order of a state securities commission (or an agency or officer of a state performing like functions); a state authority that supervises or examines banks, savings associations or credit unions; a state insurance commission (or an agency or officer of a state performing like functions); an appropriate federal banking agency; the U.S. Commodity Futures Trading Commission; or the National Credit Union Administration that:

(i) At the time of the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)), bars the person from:

(A) Association with an entity regulated by such commission, authority, agency or officer;

(B) Engaging in the business of securities, insurance or banking; or

(C) Engaging in savings association or credit union activities; or

(ii) Constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct entered within ten years before such filing of the offering statement;

Instruction to paragraph (a)(3). Final order shall mean a written directive or declaratory statement issued by a federal or state agency, described in § 227.503(a)(3), under applicable statutory authority that provides for notice and an opportunity for hearing, which constitutes a final disposition or action by that federal or state agency.

(4) Is subject to an order of the Commission entered pursuant to Section 15(b) or 15B(c) of the Exchange Act (15 U.S.C. 78*o*(b) or 78*o*-4(c)) or Section 203(e) or (f) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(e) or (f)) that, at thc time of the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)):

(i) Suspends or revokes such person's registration as a broker, dealer, municipal securities dealer, investment adviser or funding portal;

(ii) Places limitations on the activities, functions or operations of such person; or

(iii) Bars such person from being associated with any entity or from participating in the offering of any penny stock;

(5) Is subject to any order of the Commission entered within five years before the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)) that, at the time of such filing, orders the person to cease and desist from committing or causing a violation or future violation of:

(i) Any scienter-based anti-fraud provision of the federal securities laws, including without limitation Section 17(a)(1) of the Securities Act (15 U.S.C. 77q(a)(1)), Section 10(b) of the Exchange Act (15 U.S.C. 78j(b)) and 17 CFR 240.10b-5, Section 15(c)(1) of the Exchange Act (15 U.S.C. 78o(c)(1)) and Section 206(1) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-6(1)) or any other rule or regulation thereunder; or

(ii) Section 5 of the Securities Act (15 U.S.C. 77e);

(6) Is suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or a registered national or affiliated securities association for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade;

(7) Has filed (as a registrant or issuer), or was or was named as an underwriter in, any registration statement or Regulation A (17 CFR 230.251 *et seq.*) offering statement filed with the Commission that, within five years before the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)), was the subject of a refusal order, stop order, or order suspending the Regulation A exemption, or is, at the time of such filing, the subject of an investigation or proceeding to determine whether a stop order or suspension order should be issued; or

(8) Is subject to a United States Postal Service false representation order entered within five years before the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)), or is, at the time of such filing, subject to a temporary restraining order or preliminary injunction with respect to conduct alleged by the United States Postal Service to constitute a scheme or device for obtaining money or property through the mail by means of false representations.

(b) Transition, waivers, reasonable care exception. Paragraph (a) of this section shall not apply:

(1) With respect to any conviction, order, judgment, decree, suspension, expulsion or bar that occurred or was issued before [INSERT DATE 180 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER];

(2) Upon a showing of good cause and without prejudice to any other action by the Commission, if the Commission determines that it is not necessary under the circumstances that an exemption be denied;

(3) If, before the filing of the information required by Section 4A(b) of the Securities Act (15 U.S.C. 77d-1(b)), the court or regulatory authority that entered the relevant order, judgment or decree advises in writing (whether contained in the relevant judgment, order or decree or separately to the Commission or its staff) that disqualification under paragraph (a) of this section should not arise as a consequence of such order, judgment or decree; or

(4) If the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed under paragraph (a) of this section.

Instruction to paragraph (b)(4). An issuer will not be able to establish that it has exercised reasonable care unless it has made, in light of the circumstances, factual inquiry into whether any disqualifications exist. The nature and scope of the factual inquiry will vary based on the facts and circumstances concerning, among other things, the issuer and the other offering participants.

(c) Affiliated issuers. For purposes of paragraph (a) of this section, events relating to any affiliated issuer that occurred before the affiliation arose will be not considered disqualifying if the affiliated entity is not:

(1) In control of the issuer; or

(2) Under common control with the issuer by a third party that was in control of the affiliated entity at the time of such events.

(d) Intermediaries. A person that is subject to a statutory disqualification as defined in Section 3(a)(39) of the Exchange Act (15 U.S.C. 78c(a)(39)) may not act as, or be an associated person of, an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) unless so permitted pursuant to Commission rule or order.

Instruction to paragraph (d). § 240.17f-2 of this chapter generally requires the fingerprinting of every person who is a partner, director, officer or employee of a broker, subject to certain exceptions.

PART 232 – REGULATION S-T – GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

4. The authority citation for part 232 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77f, 77g, 77h, 77j, 77s(a), 77z-3, 77sss(a), 78c(b), 781, 78m, 78n, 78o(d), 78w(a), 78ll, 80a-6(c), 80a-8, 80a-29, 80a-30, 80a-37, 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

5. Amend §232.101 by:

a. In paragraph (a)(1)(xvii) removing "and" at the end of the paragraph; and

b. In paragraph (a)(1)(xviii) removing the period at the end of the paragraph and adding in its place "; and"; and

c. Adding paragraphs (a)(1)(xix) and (a)(1)(xx).

The addition reads as follows:

§ 232.101 Mandated electronic submissions and exceptions.

(a) * * *

(1) * * *

(xix) Form C (§239.900 of this chapter). Exhibits to Form C (§239.900 of this chapter) may be filed on EDGAR as PDF documents in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T (§232.11 of this chapter). Notwithstanding Rule 104 of Regulation S-T (§232.104 of this chapter), the PDF documents filed under this paragraph will be considered as officially filed with the Commission; and

(xx) Form Funding Portal (§249.2000 of this chapter). Exhibits and attachments to Form Funding Portal (§249.2000 of this chapter) may be filed on EDGAR as PDF documents in the format required by the EDGAR Filer Manual, as defined in Rule 11 of Regulation S-T (§232.11 of this chapter). Notwithstanding Rule 104 of Regulation S-T (§232.104 of this chapter), the PDF documents filed under this paragraph will be considered as officially filed with the Commission.

* * * * *

PART 239 – FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

6. The authority citation for part 239 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78o-7 note, 78u-5, 78w(a), 78ll, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

* * * * *

7. Add § 239.900 to read as follows:

§ 239.900 Form C.

This form shall be used for filings under Regulation Crowdfunding (§§ 227.100 *et seq.* of this chapter).

Note: The text of Form C will not appear in the Code of Federal Regulations.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM C

UNDER THE SECURITIES ACT OF 1933

(Mark one.)

- ☐ **Form C: Offering Statement**
- ☐ **Form C-U: Progress Update:** ______________________________
- ☐ **Form C/A: Amendment to Offering Statement:** ______________________________
  - ☐ **Check box if Amendment is material and investors must reconfirm within five business days.**
- ☐ **Form C-AR: Annual Report**
- ☐ **Form C-AR/A: Amendment to Annual Report**
- ☐ **Form C-TR: Termination of Reporting**

Name of issuer: ______________________________
Legal status of issuer:
Form: ______________________________
Jurisdiction of Incorporation/Organization: ______________________________
Date of organization): ______________________________
Physical address of issuer: ______________________________
Website of issuer: ______________________________

Name of intermediary through which the offering will be conducted: ______________________________
CIK number of intermediary: ______________________________
SEC file number of intermediary: ______________________________
CRD number, if applicable, of intermediary: ______________________________

Amount of compensation to be paid to the intermediary, whether as a dollar amount or a percentage of the offering amount, or a good faith estimate if the exact amount is not available at the time of the filing, for conducting the offering, including the amount of referral and any other fees associated with the offering:

____

Any other direct or indirect interest in the issuer held by the intermediary, or any arrangement for the intermediary to acquire such an interest:

____

Type of security offered: ______________________________
Target number of securities to be offered: ______________________________
Price (or method for determining price): ______________________________
Target offering amount: ______________________________
Oversubscriptions accepted: ☐ Yes ☐ No

If yes, disclose how oversubscriptions will be allocated: □ Pro-rata basis □ First-come, first-served basis
□ Other – provide a description:_______________
Maximum offering amount (if different from target offering amount): _______________
Deadline to reach the target offering amount: _______________

NOTE: If the sum of the investment commitments does not equal or exceed the target offering amount at the offering deadline, no securities will be sold in the offering, investment commitments will be cancelled and committed funds will be returned.

Current number of employees: _______________

Total Assets:	Most recent fiscal year-end:	_______	Prior fiscal year-end:	_______
Cash & Cash Equivalents:	Most recent fiscal year-end:	_______	Prior fiscal year-end:	_______
Accounts Receivable:	Most recent fiscal year-end:	_______	Prior fiscal year-end:	_______
Short-term Debt:	Most recent fiscal year-end:	_______	Prior fiscal year-end:	_______
Long-term Debt:	Most recent fiscal year-end:	_______	Prior fiscal year-end:	_______
Revenues/Sales	Most recent fiscal year-end:	_______	Prior fiscal year-end:	_______
Cost of Goods Sold:	Most recent fiscal year-end:	_______	Prior fiscal year-end:	_______
Taxes Paid:	Most recent fiscal year-end:	_______	Prior fiscal year-end:	_______
Net Income:	Most recent fiscal year-end:	_______	Prior fiscal year-end:	_______

Using the list below, select the jurisdictions in which the issuer intends to offer the securities:

[List will include all U.S. jurisdictions, with an option to add and remove them individually, add all and remove all.]

GENERAL INSTRUCTIONS

I. Eligibility Requirements for Use of Form C

This Form shall be used for the offering statement, and any related amendments and progress reports, required to be filed by any issuer offering or selling securities in reliance on the exemption in Securities Act Section 4(a)(6) and in accordance with Section 4A and Regulation Crowdfunding (§ 227.100 *et seq.*). This Form also shall be used for an annual report required pursuant to Rule 202 of Regulation Crowdfunding (§ 227.202) and for the termination of reporting required pursuant to Rule 203(b)(2) of Regulation Crowdfunding (§ 227.203(b)(2)). Careful attention should be directed to the terms, conditions and requirements of the exemption.

II. Preparation and Filing of Form C

Information on the cover page will be generated based on the information provided in XML format. Other than the cover page, this Form is not to be used as a blank form to be filled in, but only as a guide in the preparation of Form C. General information regarding the preparation, format and how to file this Form is contained in Regulation S-T (§ 232 *et seq.*).

III. Information to be Included in the Form

Item 1. Offering Statement Disclosure Requirements

An issuer filing this Form for an offering in reliance on Section 4(a)(6) of the Securities Act and pursuant to Regulation Crowdfunding (§ 227.100 *et seq*) must file the Form prior to the commencement of the offering and include the information required by Rule 201 of Regulation Crowdfunding (§ 227.201).

An issuer must include in the XML-based portion of this Form: the information required by paragraphs (a), (e), (g), (h), (l), (n), and (o) of Rule 201 of Regulation Crowdfunding (§ 227.201(a), (e), (g), (h), (l), (n), and (o)); selected financial data for the prior two fiscal years (including total assets, cash and cash equivalents, accounts

receivable, short-term debt, long-term debt, revenues/sales, cost of goods sold, taxes paid and net income); the jurisdictions in which the issuer intends to offer the securities; and any information required by Rule 203(a)(3) of Regulation Crowdfunding (§ 227.203(a)(3)).

Other than the information required to be provided in XML format, an issuer may provide the required information in the optional Question and Answer format included herein or in any other format included on the intermediary's platform, by filing such information as an exhibit to this Form, including copies of screen shots of the relevant information, as appropriate and necessary.

If disclosure in response to any paragraph of Rule 201 of Regulation Crowdfunding (§ 227.201) or Rule 203(a)(3) is responsive to one or more other paragraphs of Rule 201 of Regulation Crowdfunding (§ 227.201) or to Rule 203(a)(3) of Regulation Crowdfunding (§ 227.203(a)(3)), issuers are not required to make duplicate disclosures.

Item 2. Legends

(a) An issuer filing this Form for an offering in reliance on Section 4(a)(6) of the Securities Act and pursuant to Regulation Crowdfunding (§ 227.100 *et seq.*) must include the following legends:

> A crowdfunding investment involves risk. You should not invest any funds in this offering unless you can afford to lose your entire investment.
>
> In making an investment decision, investors must rely on their own examination of the issuer and the terms of the offering, including the merits and risks involved. These securities have not been recommended or approved by any federal or state securities commission or regulatory authority. Furthermore, these authorities have not passed upon the accuracy or adequacy of this document.
>
> The U.S. Securities and Exchange Commission does not pass upon the merits of any securities offered or the terms of the offering, nor does it pass upon the accuracy or completeness of any offering document or literature.
>
> These securities are offered under an exemption from registration; however, the U.S. Securities and Exchange Commission has not made an independent determination that these securities are exempt from registration.

(b) An issuer filing this Form for an offering in reliance on Section 4(a)(6) of the Securities Act and pursuant to Regulation Crowdfunding (§ 227.100 *et seq.*) must disclose in the offering statement that it will file a report with the Commission annually and post the report on its website, no later than 120 days after the end of each fiscal year covered by the report. The issuer must also disclose how an issuer may terminate its reporting obligations in the future in accordance with Rule 202(b) of Regulation Crowdfunding (§ 227.202(b)).

Item 3. Annual Report Disclosure Requirements

An issuer filing this Form for an annual report, as required by Regulation Crowdfunding (§ 227.100 *et seq.*), must file the Form no later than 120 days after the issuer's fiscal year end covered by the report and include the information required by Rule 201(a), (b), (c), (d), (e), (f), (m), (p), (q), (r), (s), (t), (x) and (y) of Regulation Crowdfunding (§§ 227.201(a), (b), (c), (d), (e), (f), (m), (p), (q), (r), (s), (t), (x) and (y)). For purposes of paragraph (t), the issuer shall provide financial statements certified by the principal executive officer of the issuer to be true and complete in all material respects. If, however, the issuer has available financial statements prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) that have been reviewed or audited by an independent certified public accountant, those financial statements must be provided and the principal executive officer certification will not be required.

An issuer must include in the XML-based portion of this Form: the information required by paragraphs (a), and (e) of Rule 201 of Regulation Crowdfunding (§ 227.201(a) and (e)); and selected financial data for the prior two fiscal years (including total assets, cash and cash equivalents, accounts receivable, short-term debt, long-term debt, revenues/sales, cost of goods sold, taxes paid and net income).

SIGNATURE

Pursuant to the requirements of Sections 4(a)(6) and 4A of the Securities Act of 1933 and Regulation Crowdfunding (§ 227.100 *et seq.*), the issuer certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form C and has duly caused this Form to be signed on its behalf by the duly authorized undersigned.

____
(Issuer)

By

____
(Signature and Title)

Pursuant to the requirements of Sections 4(a)(6) and 4A of the Securities Act of 1933 and Regulation Crowdfunding (§ 227.100 *et seq.*), this Form C has been signed by the following persons in the capacities and on the dates indicated.

____
(Signature)

____
(Title)

____
(Date)

Instructions.

1. The form shall be signed by the issuer, its principal executive officer or officers, its principal financial officer, its controller or principal accounting officer and at least a majority of the board of directors or persons performing similar functions.

2. The name of each person signing the form shall be typed or printed beneath the signature.

Intentional misstatements or omissions of facts constitute federal criminal violations. *See* 18 U.S.C. 1001.

OPTIONAL QUESTION & ANSWER FORMAT

FOR AN OFFERING STATEMENT

Respond to each question in each paragraph of this part. Set forth each question and any notes, but not any instructions thereto, in their entirety. If disclosure in response to any question is responsive to one or more other questions, it is not necessary to repeat the disclosure. If a question or series of questions is inapplicable or the response is available elsewhere in the Form, either state that it is inapplicable, include a cross-reference to the responsive disclosure, or omit the question or series of questions.

Be very careful and precise in answering all questions. Give full and complete answers so that they are not misleading under the circumstances involved. Do not discuss any future performance or other anticipated event unless you have a reasonable basis to believe that it will actually occur within the foreseeable future. If any answer requiring significant information is materially inaccurate, incomplete or misleading, the Company, its management and principal shareholders may be liable to investors based on that information.

THE COMPANY

1. Name of issuer: ______________________________

ELIGIBILITY

2. □ Check this box to certify that all of the following statements are true for the issuer:

- Organized under, and subject to, the laws of a State or territory of the United States or the District of Columbia.
- Not subject to the requirement to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934.
- Not an investment company registered or required to be registered under the Investment Company Act of 1940.
- Not ineligible to rely on this exemption under Section 4(a)(6) of the Securities Act as a result of a disqualification specified in Rule 503(a) of Regulation Crowdfunding. (For more information about these disqualifications, see Question 30 of this Question and Answer format).
- Has filed with the Commission and provided to investors, to the extent required, the ongoing annual reports required by Regulation Crowdfunding during the two years immediately preceding the filing of this offering statement (or for such shorter period that the issuer was required to file such reports).
- Not a development stage company that (a) has no specific business plan or (b) has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies.

INSTRUCTION TO QUESTION 2: If any of these statements is not true, then you are NOT eligible to rely on this exemption under Section 4(a)(6) of the Securities Act.

3. Has the issuer or any of its predecessors previously failed to comply with the ongoing reporting requirements of Rule 202 of Regulation Crowdfunding? □ Yes □ No
Explain: ______________________________

DIRECTORS OF THE COMPANY

4. Provide the following information about each director (and any persons occupying a similar status or performing a similar function) of the issuer:

Name: ____________________ Dates of Board Service: ________
Principal Occupation: ____________________
Employer: ____________________ Dates of Service: ________
Employer's principal business: ____________________

List all positions and offices with the issuer held and the period of time in which the director served in the position or office:

Position: ____________________ Dates of Service: ________
Position: ____________________ Dates of Service: ________
Position: ____________________ Dates of Service: ________

Business Experience: List the employers, titles and dates of positions held during past three years with an indication of job responsibilities:

Employer: ____________________
Employer's principal business: ____________________
Title: ____________________ Dates of Service: ________
Responsibilities: ____________________

Employer: ____________________
Employer's principal business: ____________________
Title: ____________________ Dates of Service: ________
Responsibilities: ____________________

Employer: ____________________
Employer's principal business: ____________________
Title: ____________________ Dates of Service: ________
Responsibilities: ____________________

OFFICERS OF THE COMPANY

5. Provide the following information about each officer (and any persons occupying a similar status or performing a similar function) of the issuer:

Name: ____________________
Title: ____________________ Dates of Service: ________
Responsibilities: ____________________

List any prior positions and offices with the issuer and the period of time in which the officer served in the position or office:

Position: ____________________ Dates of Service: ________
Responsibilities: ____________________

Position: ____________________ Dates of Service: ________
Responsibilities: ____________________

Position: ______________________________ Dates of Service: ____________
Responsibilities: ____

Business Experience: List any other employers, titles and dates of positions held during past three years with an indication of job responsibilities:

Employer: ____
Employer's principal business: ______________________________
Title: ______________________________ Dates of Service: ____________
Responsibilities: ____

Employer: ____
Employer's principal business: ______________________________
Title: ______________________________ Dates of Service: ____________
Responsibilities: ____

Employer: ____
Employer's principal business: ______________________________
Title: ______________________________ Dates of Service: ____________
Responsibilities: ____

INSTRUCTION TO QUESTION 5: For purposes of this Question 5, the term officer means a president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, and any person routinely performing similar functions.

PRINCIPAL SECURITY HOLDERS

6. Provide the name and ownership level of each person, as of the most recent practicable date, who is the beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power.

Name of Holder	No. and Class of Securities Now Held	% of Voting Power Prior to Offering
		%
		%
		%
		%

INSTRUCTION TO QUESTION 6: The above information must be provided as of a date that is no more than 120 days prior to the date of filing of this offering statement.

To calculate total voting power, include all securities for which the person directly or indirectly has or shares the voting power, which includes the power to vote or to direct the voting of such securities. If the person has the right to acquire voting power of such securities within 60 days, including through the exercise of any option, warrant or right, the conversion of a security, or other arrangement, or if securities are held by a member of the family, through corporations or partnerships, or otherwise in a manner that would allow a person to direct or control the voting of the securities (or share in such direction or control — as, for example, a co-trustee) they should be included as being "beneficially owned." You should include an explanation of these circumstances in a footnote to the "Number of and Class of Securities Now Held." To calculate outstanding voting equity securities, assume all outstanding options are exercised and all outstanding convertible securities converted.

BUSINESS AND ANTICIPATED BUSINESS PLAN

7. Describe in detail the business of the issuer and the anticipated business plan of the issuer.

RISK FACTORS

A crowdfunding investment involves risk. You should not invest any funds in this offering unless you can afford to lose your entire investment.

In making an investment decision, investors must rely on their own examination of the issuer and the terms of the offering, including the merits and risks involved. These securities have not been recommended or approved by any federal or state securities commission or regulatory authority. Furthermore, these authorities have not passed upon the accuracy or adequacy of this document.

The U.S. Securities and Exchange Commission does not pass upon the merits of any securities offered or the terms of the offering, nor does it pass upon the accuracy or completeness of any offering document or literature.

These securities are offered under an exemption from registration; however, the U.S. Securities and Exchange Commission has not made an independent determination that these securities are exempt from registration.

8. Discuss the material factors that make an investment in the issuer speculative or risky:

(1) ____________________

(2) ____________________

(3) ____________________

(4) ____________________

(5) ____________________

(6) ____________________

(7) ____________________

(8) ____________________

(9) ____________________

(10) ____________________

INSTRUCTION TO QUESTION 8: Avoid generalized statements and include only those factors that are unique to the issuer. Discussion should be tailored to the issuer's business and the offering and should not repeat the factors addressed in the legends set forth above. No specific number of risk factors is required to be identified. Add additional lines and number as appropriate.

THE OFFERING

9. What is the purpose of this offering?

10. How does the issuer intend to use the proceeds of this offering?

	If Target Offering Amount Sold	If Maximum Amount Sold
Total Proceeds	$	$
Less: Offering Expenses		
(A)		
(B)		
(C)		
Net Proceeds	$	$
Use of Net Proceeds		
(A)		
(B)		
(C)		
Total Use of Net Proceeds	$	$

INSTRUCTION TO QUESTION 10: An issuer must provide a reasonably detailed description of any intended use of proceeds, such that investors are provided with an adequate amount of information to understand how the offering proceeds will be used. If an issuer has identified a range of possible uses, the issuer should identify and describe each probable use and the factors the issuer may consider in allocating proceeds among the potential uses. If the issuer will accept proceeds in excess of the target offering amount, the issuer must describe the purpose, method for allocating oversubscriptions, and intended use of the excess proceeds with similar specificity.

11. How will the issuer complete the transaction and deliver securities to the investors?

12. How can an investor cancel an investment commitment?

NOTE: Investors may cancel an investment commitment until 48 hours prior to the deadline identified in these offering materials.

The intermediary will notify investors when the target offering amount has been met.

If the issuer reaches the target offering amount prior to the deadline identified in the offering materials, it may close the offering early if it provides notice about the new offering deadline at least five business days prior to such new offering deadline (absent a material change that would require an extension of the offering and reconfirmation of the investment commitment).

If an investor does not cancel an investment commitment before the 48-hour period prior to the offering deadline, the funds will be released to the issuer upon closing of the offering and the investor will receive securities in exchange for his or her investment.

If an investor does not reconfirm his or her investment commitment after a material change is made to the offering, the investor's investment commitment will be cancelled and the committed funds will be returned.

OWNERSHIP AND CAPITAL STRUCTURE

The Offering

13. Describe the terms of the securities being offered.

14. Do the securities offered have voting rights? ☐ Yes ☐ No

15. Are there any limitations on any voting or other rights identified above? ☐ Yes ☐ No
Explain: ______________________________

16. How may the terms of the securities being offered be modified?

Restrictions on Transfer of the Securities Being Offered

The securities being offered may not be transferred by any purchaser of such securities during the one-year period beginning when the securities were issued, unless such securities are transferred:

(1) to the issuer;
(2) to an accredited investor;
(3) as part of an offering registered with the U.S. Securities and Exchange Commission; or
(4) to a member of the family of the purchaser or the equivalent, to a trust controlled by the purchaser, to a trust created for the benefit of a member of the family of the purchaser or the equivalent, or in connection with the death or divorce of the purchaser or other similar circumstance.

NOTE: The term "accredited investor" means any person who comes within any of the categories set forth in Rule 501(a) of Regulation D, or who the seller reasonably believes comes within any of such categories, at the time of the sale of the securities to that person.

The term "member of the family of the purchaser or the equivalent" includes a child, stepchild, grandchild, parent, stepparent, grandparent, spouse or spousal equivalent, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of the purchaser, and includes adoptive relationships. The term "spousal equivalent" means a cohabitant occupying a relationship generally equivalent to that of a spouse.

Description of Issuer's Securities

17. What other securities or classes of securities of the issuer are outstanding? Describe the material terms of any other outstanding securities or classes of securities of the issuer.

Class of Security	Securities (or Amount) Authorized	Securities (or Amount) Outstanding	Voting Rights	Other Rights
Preferred Stock (list each class in order of preference):				
______________			□ Yes □ No	□ Yes □ No Specify: ______
______________			□ Yes □ No	□ Yes □ No Specify: ______
Common Stock:			□ Yes □ No	□ Yes □ No Specify: ______
Debt Securities:			□ Yes □ No	□ Yes □ No Specify: ______
Other:				
______________			□ Yes □ No	□ Yes □ No Specify: ______
______________			□ Yes □ No	□ Yes □ No Specify: ______

Class of Security	Securities Reserved for Issuance upon Exercise or Conversion
Warrants:	
Options:	
Other Rights:	
______________	
______________	

18. How may the rights of the securities being offered be materially limited, diluted or qualified by the rights of any other class of security identified above?

19. Are there any differences not reflected above between the securities being offered and each other class of security of the issuer? □ Yes □ No
Explain: ______________________________

20. How could the exercise of rights held by the principal shareholders identified in Question 6 above affect the purchasers of the securities being offered?

21. How are the securities being offered being valued? Include examples of methods for how such securities may be valued by the issuer in the future, including during subsequent corporate actions.

22. What are the risks to purchasers of the securities relating to minority ownership in the issuer?

23. What are the risks to purchasers associated with corporate actions including:
- additional issuances of securities,
- issuer repurchases of securities,
- a sale of the issuer or of assets of the issuer or
- transactions with related parties?

24. Describe the material terms of any indebtedness of the issuer:

Creditor(s)	Amount Outstanding	Interest Rate	Maturity Date	Other Material Terms
	$__________	______%		
	$__________	______%		
	$__________	______%		

25. What other exempt offerings has the issuer conducted within the past three years?

Date of Offering	Exemption Relied Upon	Securities Offered	Amount Sold	Use of Proceeds
			$__________	
			$__________	
			$__________	

26. Was or is the issuer or any entities controlled by or under common control with the issuer a party to any transaction since the beginning of the issuer's last fiscal year, or any currently proposed transaction, where the amount involved exceeds five percent of the aggregate amount of capital raised by the issuer in reliance on Section 4(a)(6) of the Securities Act during the preceding 12-month period, including the amount the issuer seeks to raise in the current offering, in which any of the following persons had or is to have a direct or indirect material interest:

(1) any director or officer of the issuer;
(2) any person who is, as of the most recent practicable date, the beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power;
(3) if the issuer was incorporated or organized within the past three years, any promoter of the issuer; or
(4) any immediate family member of any of the foregoing persons.

If yes, for each such transaction, disclose the following:

Specified Person	Relationship to Issuer	Nature of Interest in Transaction	Amount of Interest
			$__________

$\$$__________
$\$$__________

INSTRUCTIONS TO QUESTION 26:

The term transaction includes, but is not limited to, any financial transaction, arrangement or relationship (including any indebtedness or guarantee of indebtedness) or any series of similar transactions, arrangements or relationships.

Beneficial ownership for purposes of paragraph (2) shall be determined as of a date that is no more than 120 days prior to the date of filing of this offering statement and using the same calculation described in Question 6 of this Question and Answer format.

The term "member of the family" includes any child, stepchild, grandchild, parent, stepparent, grandparent, spouse or spousal equivalent, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of the person, and includes adoptive relationships. The term "spousal equivalent" means a cohabitant occupying a relationship generally equivalent to that of a spouse.

Compute the amount of a related party's interest in any transaction without regard to the amount of the profit or loss involved in the transaction. Where it is not practicable to state the approximate amount of the interest, disclose the approximate amount involved in the transaction.

FINANCIAL CONDITION OF THE ISSUER

27. Does the issuer have an operating history? ☐ Yes ☐ No

28. Describe the financial condition of the issuer, including, to the extent material, liquidity, capital resources and historical results of operations.

INSTRUCTIONS TO QUESTION 28:

The discussion must cover each year for which financial statements are provided. Include a discussion of any known material changes or trends in the financial condition and results of operations of the issuer during any time period subsequent to the period for which financial statements are provided.

For issuers with no prior operating history, the discussion should focus on financial milestones and operational, liquidity and other challenges.

For issuers with an operating history, the discussion should focus on whether historical results and cash flows are representative of what investors should expect in the future.

Take into account the proceeds of the offering and any other known or pending sources of capital. Discuss how the proceeds from the offering will affect liquidity, whether receiving these funds and any other additional funds is necessary to the viability of the business, and how quickly the issuer anticipates using its available cash. Describe the other available sources of capital to the business, such as lines of credit or required contributions by shareholders.

References to the issuer in this Question 28 and these instructions refer to the issuer and its predecessors, if any.

FINANCIAL INFORMATION

29. Include the financial information specified below covering the two most recently completed fiscal years or the period(s) since inception, if shorter:

Aggregate Offering Amount (defined below):	Financial Information Required:	Financial Statement Requirements:
(a) $100,000 or less:	• The following information or their equivalent line items as reported on the federal income tax return filed by the issuer for the most recently completed year (if any): o Total income o Taxable income; and o Total tax; certified by the principal executive officer of the issuer to reflect accurately the information reported on the issuer's federal income tax returns; and • Financial statements of the issuer and its predecessors, if any.	Financial statements must be **certified** by the principal executive officer of the issuer as set forth below. If financial statements are available that have either been reviewed or audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead along with a signed audit or review report and need not include the information reported on the federal income tax returns or the certification of the principal executive officer.
(b) More than $100,000, but not more than $500,000:	• Financial statements of the issuer and its predecessors, if any.	Financial statements must be **reviewed** by a public accountant that is independent of the issuer and must include a signed review report. If financial statements of the issuer are available that have been audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead along with a signed audit report and need not include the reviewed financial statements.
(c) More than $500,000:	• Financial statements of the issuer and its predecessors, if any.	If the issuer **has** previously sold securities in reliance on Regulation Crowdfunding: Financial statements must be **audited** by a public accountant that is independent of the issuer and must include a signed audit report. If the issuer **has not** previously sold securities in reliance on Regulation Crowdfunding and it is offering more than $500,000 but not more than

$1,000,000:

Financial statements must be **reviewed** by a public accountant that is independent of the issuer and must include a signed review report.

If financial statements of the issuer are available that have been audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead along with a signed audit report and need not include the reviewed financial statements.

INSTRUCTIONS TO QUESTION 29: To determine the financial statements required, the Aggregate Offering Amount for purposes of this Question 29 means the aggregate amounts offered and sold by the issuer, all entities controlled by or under common control with the issuer, and all predecessors of the issuer in reliance on Section 4(a)(6) of the Securities Act within the preceding 12-month period plus the current maximum offering amount provided on the cover of this Form.

To determine whether the issuer has previously sold securities in reliance on Regulation Crowdfunding for purposes of paragraph (c) of this Question 29, "issuer" means the issuer, all entities controlled by or under common control with the issuer, and all predecessors of the issuer.

Financial statements must be prepared in accordance with U.S. generally accepted accounting principles and must include balance sheets, statements of comprehensive income, statements of cash flows, statements of changes in stockholders' equity and notes to the financial statements. If the financial statements are not audited, they shall be labeled as "unaudited."

Issuers offering securities and required to provide the information set forth in row (a) before filing a tax return for the most recently completed fiscal year may provide information from the tax return filed for the prior year (if any), provided that the issuer provides information from the tax return for the most recently completed fiscal year when it is filed, if filed during the offering period. An issuer that requested an extension of the time to file would not be required to provide information from the tax return until the date when the return is filed, if filed during the offering period.

A principal executive officer certifying financial statements as described above must provide the following certification**:

I, [identify the certifying individual], certify that:

(1) the financial statements of [identify the issuer] included in this Form are true and complete in all material respects; and

(2) the tax return information of [identify the issuer] included in this Form reflects accurately the information reported on the tax return for [identify the issuer] filed for the fiscal year ended [date of most recent tax return].

[Signature]
[Title]

** Intentional misstatements or omissions of facts constitute federal criminal violations. *See* 18 U.S.C. 1001.

To qualify as a public accountant that is independent of the issuer for purposes of this Question 29, the accountant must satisfy the independence standards of either:

(i) Rule 2-01 of Regulation S-X or

(ii) the AICPA.

The public accountant that audits or reviews the financial statements provided by an issuer must be (1) duly registered and in good standing as a certified public accountant under the laws of the place of his or her residence or principal office or (2) in good standing and entitled to practice as a public accountant under the laws of his or her place of residence or principal office.

An issuer will not be in compliance with the requirement to provide reviewed financial statement if the issuer received a review report that includes modifications. An issuer will not be in compliance with the requirement to provide audited financial statements if the issuer received a qualified opinion, an adverse opinion, or a disclaimer of opinion.

The issuer must notify the public accountant of the issuer's intended use of the public accountant's audit or review report in the offering.

For an offering conducted in the first 120 days of a fiscal year, the financial statements provided may be for the two fiscal years prior to the issuer's most recently completed fiscal year; however, financial statements for the two most recently completed fiscal years must be provided if they are otherwise available. If more than 120 days have passed since the end of the issuer's most recently completed fiscal year, the financial statements provided must be for the issuer's two most recently completed fiscal years. If the 120th day falls on a Saturday, Sunday, or holiday, the next business day shall be considered the 120th day for purposes of determining the age of the financial statements.

An issuer may elect to delay complying with any new or revised financial accounting standard until the date that a company that is not an issuer (as defined under section 2(a) of the Sarbanes-Oxley Act of 2002 is required to comply with such new or revised accounting standard, if such standard also applies to companies that are not issuers. Issuers electing such extension of time accommodation must disclose it at the time the issuer files its offering statement and apply the election to all standards. Issuers electing not to use this accommodation must forgo this accommodation for all financial accounting standards and may not elect to rely on this accommodation in any future filings

30. With respect to the issuer, any predecessor of the issuer, any affiliated issuer, any director, officer, general partner or managing member of the issuer, any beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities, calculated in the same form as described in Question 6 of this Question and Answer format, any promoter connected with the issuer in any capacity at the time of such sale, any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with such sale of securities, or any general partner, director, officer or managing member of any such solicitor, prior to **[INSERT DATE 180 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER]**:

(1) Has any such person been convicted, within 10 years (or five years, in the case of issuers, their predecessors and affiliated issuers) before the filing of this offering statement, of any felony or misdemeanor:

(i) in connection with the purchase or sale of any security? □ Yes □ No

(ii) involving the making of any false filing with the Commission? □ Yes □ No

(iii) arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser, funding portal or paid solicitor of purchasers of securities? □ Yes □ No

If Yes to any of the above, explain: ______________________________

(2) Is any such person subject to any order, judgment or decree of any court of competent jurisdiction, entered within five years before the filing of the information required by Section 4A(b) of the Securities Act that, at the time of filing of this offering statement, restrains or enjoins such person from engaging or continuing to engage in any conduct or practice:

(i) in connection with the purchase or sale of any security? □ Yes □ No;

(ii) involving the making of any false filing with the Commission? □ Yes □ No

(iii) arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser, funding portal or paid solicitor of purchasers of securities? □ Yes □ No

If Yes to any of the above, explain: ______________________________

(3) Is any such person subject to a final order of a state securities commission (or an agency or officer of a state performing like functions); a state authority that supervises or examines banks, savings associations or credit unions; a state insurance commission (or an agency or officer of a state performing like functions); an appropriate federal banking agency; the U.S. Commodity Futures Trading Commission; or the National Credit Union Administration that:

(i) at the time of the filing of this offering statement bars the person from:

(A) association with an entity regulated by such commission, authority, agency or officer? □ Yes □ No

(B) engaging in the business of securities, insurance or banking? □ Yes □ No

(C) engaging in savings association or credit union activities? □ Yes □ No

(ii) constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct and for which the order was entered within the 10-year period ending on the date of the filing of this offering statement? □ Yes □ No

If Yes to any of the above, explain: ______________________________

(4) Is any such person subject to an order of the Commission entered pursuant to Section 15(b) or 15B(c) of the Exchange Act or Section 203(e) or (f) of the Investment Advisers Act of 1940 that, at the time of the filing of this offering statement:

(i) suspends or revokes such person's registration as a broker, dealer, municipal securities dealer, investment adviser or funding portal? □ Yes □ No

(ii) places limitations on the activities, functions or operations of such person? □ Yes □ No

(iii) bars such person from being associated with any entity or from participating in the offering of any penny stock? □ Yes □ No

If Yes to any of the above, explain: ______________________________

(5) Is any such person subject to any order of the Commission entered within five years before the filing of this offering statement that, at the time of the filing of this offering statement, orders the person to cease and desist from committing or causing a violation or future violation of:

(i) any scienter-based anti-fraud provision of the federal securities laws, including without limitation Section 17(a)(1) of the Securities Act, Section 10(b) of the

Exchange Act, Section 15(c)(1) of the Exchange Act and Section 206(1) of the Investment Advisers Act of 1940 or any other rule or regulation thereunder?
□ Yes □ No

(ii) Section 5 of the Securities Act? □ Yes □ No

If Yes to either of the above, explain: ______

(6) Is any such person suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or a registered national or affiliated securities association for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade?
□ Yes □ No
If Yes, explain: ______

(7) Has any such person filed (as a registrant or issuer), or was any such person or was any such person named as an underwriter in, any registration statement or Regulation A offering statement filed with the Commission that, within five years before the filing of this offering statement, was the subject of a refusal order, stop order, or order suspending the Regulation A exemption, or is any such person, at the time of such filing, the subject of an investigation or proceeding to determine whether a stop order or suspension order should be issued?
□ Yes □ No
If Yes, explain: ______

(8) Is any such person subject to a United States Postal Service false representation order entered within five years before the filing of the information required by Section 4A(b) of the Securities Act, or is any such person, at the time of filing of this offering statement, subject to a temporary restraining order or preliminary injunction with respect to conduct alleged by the United States Postal Service to constitute a scheme or device for obtaining money or property through the mail by means of false representations?
□ Yes □ No
If Yes, explain: ______

If you would have answered "Yes" to any of these questions had the conviction, order, judgment, decree, suspension, expulsion or bar occurred or been issued after [INSERT DATE 180 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER], then you are NOT eligible to rely on this exemption under Section 4(a)(6) of the Securities Act.

INSTRUCTIONS TO QUESTION 30: Final order means a written directive or declaratory statement issued by a federal or state agency, described in Rule 503(a)(3) of Regulation Crowdfunding, under applicable statutory authority that provides for notice and an opportunity for hearing, which constitutes a final disposition or action by that federal or state agency.

No matters are required to be disclosed with respect to events relating to any affiliated issuer that occurred before the affiliation arose if the affiliated entity is not (i) in control of the issuer or (ii) under common control with the issuer by a third party that was in control of the affiliated entity at the time of such events.

OTHER MATERIAL INFORMATION

31. In addition to the information expressly required to be included in this Form, include:
    (1) any other material information presented to investors; and
    (2) such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.

INSTRUCTIONS TO QUESTION 31: If information is presented to investors in a format, media or other means not able to be reflected in text or portable document format, the issuer should include

(a) a description of the material content of such information;
(b) a description of the format in which such disclosure is presented; and
(c) in the case of disclosure in video, audio or other dynamic media or format, a transcript or description of such disclosure.

ONGOING REPORTING

The issuer will file a report electronically with the Securities & Exchange Commission annually and post the report on its website, no later than: ______________________________

(120 days after the end of each fiscal year covered by the report).

Once posted, the annual report may be found on the issuer's website at: ______________________________

The issuer must continue to comply with the ongoing reporting requirements until:

(1) the issuer is required to file reports under Section 13(a) or Section 15(d) of the Exchange Act;
(2) the issuer has filed at least one annual report pursuant to Regulation Crowdfunding and has fewer than 300 holders of record and has total assets that do not exceed $10,000,000;
(3) the issuer has filed at least three annual reports pursuant to Regulation Crowdfunding;
(4) the issuer or another party repurchases all of the securities issued in reliance on Section 4(a)(6) of the Securities Act, including any payment in full of debt securities or any complete redemption of redeemable securities; or
(5) the issuer liquidates or dissolves its business in accordance with state law.

* * * * *

PART 240 - GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

8. The authority citation for part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 et. seq., and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; and Pub. L. 111-203, 939A, 124 Stat. 1376, (2010), unless otherwise noted.

9. Add § 240.12g-6 to read as follows:

§ 240.12g-6 Exemption for securities issued pursuant to Section 4(a)(6) of the Securities Act of 1933.

For purposes of determining whether an issuer is required to register a security with the Commission pursuant to Section 12(g)(1) of the Act (15 U.S.C. 78l(g)(1)), the definition of held of record shall not include securities issued pursuant to the offering exemption under Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6)) by an issuer that:

(a) is current in filing its ongoing annual reports required pursuant to § 227.202 of this chapter;

(b) has total assets not in excess of $25 million as of the end of its most recently completed fiscal year; and

(c) has engaged a transfer agent registered pursuant to Section 17A(c) of the Act to perform the function of a transfer agent with respect to such securities.

An issuer that would be required to register a class of securities under Section 12(g) of the Act as a result of exceeding the asset threshold in subparagraph (b) may continue to exclude the relevant securities from the definition of "held of record" for a transition period ending on the penultimate day of the fiscal year two years after the date it became ineligible. The transition period terminates immediately upon the failure of an issuer to timely file any periodic report due pursuant to § 227.202 at which time the issuer must file a registration statement that registers that class of securities under the Act within 120 days.

* * * * *

PART 249 – FORMS, SECURITIES EXCHANGE ACT OF 1934

10. The authority citation for part 249 continues to read, in part, as follows:

Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; 12 U.S.C. 5461 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

11. Add subpart U, consisting of § 249.2000 to read as follows:

Subpart U – Forms for Registration of Funding Portals

§ 249.2000 Form Funding Portal

This form shall be used for filings by funding portals under Regulation Crowdfunding (§§ 227.100 *et seq.*).

Note: The text of Form Funding Portal will not appear in the Code of Federal Regulations.

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM FUNDING PORTAL

APPLICATION OR AMENDMENT TO APPLICATION FOR REGISTRATION OR WITHDRAWAL FROM REGISTRATION AS FUNDING PORTAL UNDER THE SECURITIES EXCHANGE ACT OF 1934

WARNING: Failure to complete this form truthfully, to keep this form current and to file accurate supplementary information on a timely basis, or the failure to keep accurate books and records or otherwise to comply with the provisions of law applying to the conduct of business as a *funding portal*, would violate the Federal securities laws and may result in disciplinary, administrative, injunctive or criminal action.

Check the appropriate box:
This is:
□ an initial application to register as a *funding portal* with the *SEC*.
□ an amendment to any part of the *funding portal*'s most recent Form Funding Portal, including a *successor* registration.
□ a withdrawal of the *funding portal*'s registration with the *SEC*.

Schedule A must be completed as part of all initial applications. Amendments to Schedule A must be provided on Schedule B. Schedule C must be completed by *nonresident funding portals*. If this is a withdrawal of a *funding portal*'s registration, complete Schedule D.

If this is an amendment to any part of the *funding portal's* most recent Form Funding Portal, provide an explanation describing the amendment: ______________________________

____

Item 1 – Identifying Information

Exact name, principal business address, mailing address, if different, and contact information of the *funding portal*:

A. Full name of the *funding portal*: ______________________________

B. Name(s)/Website URL(s) under which business is conducted, if different from Item 1A:

____

C. IRS Empl. Ident. No.: ______________________________

D. If a name and/or website URL in (1A) or (1B) has changed since the *funding portal*'s most recent Form Funding Portal, enter the previous name and/or website URL and specify whether the name change is of the □ *funding portal* name (1A), or □ name/website URL (1B).

Previous name(s) or website URL(s): ______________________________

E. *Funding portal*'s main street address (Do not use a P.O. Box):

____

____

F. Mailing address(es) (if different) and officc locations (if more than one):

____

____

G. Contact Information:
Telephone Number: ____________________
Fax Number: ____________________
Email Address: ____________________

H. Contact Employee Information:
Name: ____________________
Title: ____________________
Direct Telephone Number: ____________________
Fax Number: ____________________
Direct Email Address: ____________________

I. Month *applicant*'s fiscal year ends: ______________

J. Registrations

Was the *applicant* previously registered on Form Funding Portal as a *funding portal* or with the Commission in any other capacity?

□ Yes SEC File No.: ______________
□ No

K. Foreign registrations

(1) Is the *applicant* registered with a *foreign financial regulatory authority*? Answer "no" even if affiliated with a business that is registered with a *foreign financial regulatory authority.*

□ Yes □ No

If "yes," complete Section K.2. below.

(2) List the name, in English, of each *foreign financial regulatory authority* and country with which the *applicant* is registered. A separate entry must be completed for each *foreign financial regulatory authority* with which the *applicant* is registered.

English Name of *Foreign Financial Regulatory Authority*:
____

Registration Number (if any): ______________

Name of Country: ______________

Item 2 – Form of Organization

A. Indicate legal status of *applicant*.

☐ Corporation
☐ Sole Proprietorship
☐ Partnership
☐ Limited Liability Company
☐ Other (please specify) ______________

B. If other than a sole proprietor, indicate date and place *applicant* obtained its legal status (*i.e.*, state or country where incorporated, where partnership agreement was filed, or where *applicant* entity was formed):

State/Country of formation: ______________________
Date of formation: ______________________

Item 3 – Successions

A. Is the *applicant* at the time of this filing succeeding to the business of a currently registered *funding portal*?

□ Yes □ No

Do not report previous successions already reported on Form Funding Portal. If "yes," complete Section 3.B. below.

B. Complete the following information if succeeding to the business of a currently-registered *funding portal*. If the *applicant* acquired more than one *funding portal* in the succession being reported on this Form Funding Portal, a separate entry must be completed for each acquired firm.

Name of Acquired *Funding Portal*:

____

Acquired *Funding Portal*'s *SEC* File No.: ______________

C. Briefly describe details of the succession including any assets or liabilities not assumed by the *successor*.

Item 4 – Control Relationships

In this Item, identify every *person* that, directly or indirectly, *controls* the *applicant*, *controls* management or policies of the *applicant*, or that the *applicant* directly or indirectly *controls*.

____

____

If this is an initial application, the *applicant* also must complete Schedule A. Schedule A asks for information about direct owners and executive officers. If this is an amendment updating information reported on the Schedule A filed with the *applicant*'s initial application, the *applicant* must complete Schedule B.

Item 5 – Disclosure Information

In this Item, provide information about the *applicant*'s disciplinary history and the disciplinary history of all *associated persons* or *control affiliates* of the *applicant* (as applicable). This information is used to decide whether to revoke registration, to place limitations on the *applicant*'s activities as a *funding portal*, and to identify potential problem areas on which to focus during examinations. One event may result in the requirement to answer "yes" to more than one of the questions below. Check all answers that apply. Refer to the Explanation of Terms section of Form Funding Portal Instructions for explanation of italicized terms.

If the answer is "yes" to any question in this Item, the *applicant* must complete the appropriate Disclosure Reporting Page ("DRP") (FP) – Criminal, Regulatory Action, Civil Judicial Action, Bankruptcy/SIPC, Bond, or Judgment/Lien, as applicable.

Criminal Disclosure

If the answer is "yes" to any question below, complete a Criminal DRP.

A. In the past ten years, has the *applicant* or any *associated person*:

(1) been convicted of any *felony*, or pled guilty or nolo contendere ("no contest") to any charge of a *felony*, in a domestic, foreign, or military court?

□ Yes □ No

The response to the following question may be limited to charges that are currently pending:

(2) been *charged* with any *felony*?

□ Yes □ No

B. In the past ten years, has the *applicant* or any *associated person*:

(1) been convicted of any *misdemeanor*, or pled guilty or nolo contendere ("no contest"), in a domestic, foreign, or military court to any charge of a *misdemeanor* in a case involving: *investment-related* business, or any fraud, false statements, or omissions, wrongful taking of property, bribery, perjury, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses?

□ Yes □ No

The response to the following question may be limited to charges that are currently pending:

(2) been *charged* with a *misdemeanor* listed in Item 5-B(1)?

□ Yes □ No

Regulatory Action Disclosure

If the answer is "yes" to any question below, complete a Regulatory Action DRP.

C. Has the *SEC* or the Commodities Futures Trading Commission ("CFTC") ever:

(1) *found* the *applicant* or any *associated person* to have made a false statement or omission?

□ Yes □ No

(2) *found* the *applicant* or any *associated person* to have been *involved* in a violation of any *SEC* or CFTC regulations or statutes?

□ Yes □ No

(3) *found* the *applicant* or any *associated person* to have been a cause of the denial, suspension, revocation, or restriction of the authorization of an *investment-related* business to operate?

□ Yes □ No

(4) entered an *order* against the *applicant* or any *associated person* in connection with *investment-related* activity?

□ Yes □ No

(5) imposed a civil money penalty on the *applicant* or any *associated person*, or ordered the *applicant* or any *associated person* to cease and desist from any activity?

□ Yes □ No

D. Has any other federal regulatory agency, any state regulatory agency, or any *foreign financial regulatory authority*:

(1) ever *found* the *applicant* or any *associated person* to have made a false statement or omission, or been dishonest, unfair, or unethical?

□ Yes □ No

(2) ever *found* the *applicant* or any *associated person* to have been *involved* in a violation of *investment-related* regulations or statutes?

□ Yes □ No

(3) ever *found* the *applicant* or any *associated person* to have been the cause of a denial, suspension, revocation, or restriction of the authorization of an *investment-related* business to operate?

□ Yes □ No

(4) in the past ten years entered an *order* against the *applicant* or any *associated person* in connection with an *investment-related* activity?

□ Yes □ No

(5) ever denied, suspended, or revoked the registration or license of the *applicant* or that of any *associated person*, or otherwise prevented the *applicant* or any *associated person* of the *applicant*, by *order*, from associating with an *investment-related* business or restricted the activities of the *applicant* or any *associated person*?

□ Yes □ No

E. Has any *self-regulatory organization* or commodities exchange ever:

(1) *found* the *applicant* or any *associated person* to have made a false statement or omission?

□ Yes □ No

(2) *found* the *applicant* or any *associated person* to have been *involved* in a violation of its rules (other than a violation designated as a *minor rule violation* under a plan approved by the *SEC*)?

□ Yes □ No

(3) *found* the *applicant* or any *associated person* to have been the cause of a denial, suspension, revocation or restriction of the authorization of an *investment-related* business to operate?

□ Yes □ No

(4) disciplined the *applicant* or any *associated person* by expelling or suspending the *applicant* or the *associated person* from membership, barring or suspending the *applicant* or *the associated person* from association with other members, or by otherwise restricting the activities of the *applicant* or the *associated person*?

□ Yes □ No

F. Has the *applicant* or any *associated person* ever had an authorization to act as an attorney, accountant, or federal contractor revoked or suspended?

□ Yes □ No

G. Is the *applicant* or any *associated person* currently the subject of any regulatory *proceeding* that could result in a "yes" answer to any part of Item 5-C, 5-D, or 5-E?

□ Yes □ No

Civil Judicial Disclosure

If the answer is "yes" to a question below, complete a Civil Judicial Action DRP.

H. Has any domestic or foreign court:

(1) in the past ten years, *enjoined* the *applicant* or any *associated person* in connection with any *investment-related* activity?

□ Yes □ No

(2) ever *found* that the *applicant* or any *associated person* was *involved* in a violation of *investment-related* statutes or regulations?

□ Yes □ No

(3) ever dismissed, pursuant to a settlement agreement, an *investment- related* civil action brought against the *applicant* or any *associated person* by a state or *foreign financial regulatory authority*?

□ Yes □ No

I. Is the *applicant* or any *associated person* now the subject of any civil *proceeding* that could result in a "yes" answer to any part of Item 5-H(1)-(3)?

□ Yes □ No

Financial Disclosure

If the answer is "yes" to a question below, complete a Bankruptcy/Disclosure, Bond Disclosure or Judgment/Lien DRP, as applicable.

J. In the past ten years, has the *applicant* or a *control affiliate* of the *applicant* ever been a securities firm or a *control affiliate* of a securities firm that:

(1) has been the subject of a bankruptcy petition?

□ Yes □ No

(2) has had a trustee appointed or a direct payment procedure initiated under the Securities Investor Protection Act?

□ Yes □ No

K. Has a bonding company ever denied, paid out on, or revoked a bond for the *applicant*?

□ Yes □ No

L. Does the *applicant* have any unsatisfied judgments or liens against it?

□ Yes □ No

Item 6 – Non-Securities Related Business

Does *applicant* engage in any non-securities related business?

□ Yes □ No

If "yes," briefly describe the non-securities business.

____

____

Item 7 – Qualified Third Party Arrangements; Compensation Arrangements

A. Qualified Third Party Arrangements. Complete the following information for each *person* that will hold investor funds in escrow or otherwise pursuant to the requirements of Rule 303(e) of Regulation Crowdfunding (17 CFR 227.303(e)).

Name of *person*: ______________________________

Address: ______________________________

Phone Number: ______________________________

B. Compensation. Please describe any compensation arrangements *funding portal* has with issuers.

____

EXECUTION

The *funding portal* consents that service of any civil action brought by or notice of any proceeding before the Securities and Exchange Commission or any *self-regulatory organization* in connection with the *funding portal*'s investment-related business may be given by registered or certified mail to the *funding portal*'s contact *person* at the main address, or mailing address, if different, given in Items 1.E., 1.F., and 1.H. If the applicant is a *nonresident funding portal*, it must complete Schedule C to designate a U.S. agent for service of process.

The undersigned represents and warrants that he/she has executed this form on behalf of, and is duly authorized to bind, the *funding portal*. The undersigned and the *funding portal* represent that the information and statements contained herein and other information filed herewith, all of which are made a part hereof, are current, true and complete. The undersigned and the *funding portal* further represent that, if this is an amendment, to the extent that any information previously submitted is not amended, such information is currently accurate and complete.

Date: ______________________

Full Legal Name of *Funding Portal*: ______________________________

By:____
(signature)

Title: _________________________________

FORM FUNDING PORTAL
SCHEDULE A

Direct Owners and Executive Officers

1. Complete Schedule A only if submitting an initial application. Schedule A asks for information about the *applicant*'s direct owners and executive officers. Use Schedule B to amend this information.

2. Direct Owners and Executive Officers. List below the names of:

   (a) each Chief Executive Officer, Chief Financial Officer, Chief Operations Officer, Chief Legal Officer, Chief Compliance Officer, director and any other individuals with similar status or functions;

   (b) if *applicant* is organized as a corporation, each shareholder that is a direct owner of 5% or more of a class of the *applicant*'s voting securities, unless *applicant* is a public reporting company (a company subject to Section 13 or 15(d) of the Exchange Act);

   Direct owners include any *person* that owns, beneficially owns, has the right to vote, or has the power to sell or direct the sale of 5% or more of a class of the *applicant*'s voting securities. For purposes of this Schedule, a *person* beneficially owns any securities: (i) owned by his/her child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, sharing the same residence; or (ii) that he/she has the right to acquire, within 60 days, through the exercise of any option, warrant, or right to purchase the security.

   (c) if the *applicant* is organized as a partnership, <u>all</u> general partners and those limited and special partners that have the right to receive upon dissolution, or have contributed, 5% or more of the *applicant*'s capital;

   (d) in the case of a trust, (i) a *person* that directly owns 5% or more of a class of the *applicant*'s voting securities, or that has the right to receive upon dissolution, or has contributed, 5% or more of the *applicant*'s capital, (ii) the trust and (iii) each trustee; and

   (e) if the *applicant* is organized as a limited liability company ("LLC"), (i) those members that have the right to receive upon dissolution, or have contributed, 5% or more of the *applicant*'s capital, and (ii) if managed by elected managers, all elected managers.

3. In the DE/FE/NP column below, enter "DE" if the owner is a domestic entity, "FE" if the owner is an entity incorporated or domiciled in a foreign country, or "NP" if the owner or executive officer is a natural person.

4. Complete the Title or Status column by entering board/management titles; status as partner, trustee, sole proprietor, elected manager, shareholder, or member; and for shareholders or members, the class of securities owned (if more than one is issued).

5. Ownership codes are:

NA - less than 5%	B - 10% but less than 25%	D - 50% but less than 75%
A - 5% but less than 10%	C - 25% but less than 50%	E - 75% or more
	G - Other (general partner, trustee, or elected member)	

6. Control Person:
   (a) In the Control Person column, enter "Yes" if the *person* has *control* as defined in the Glossary of Terms to Form Funding Portal, and enter "No" if the *person* does not have *control*. Note that under this definition, most executive officers and all 25% owners, general partners, elected managers, and trustees are "control persons".

   (b) In the PR column, enter "PR" if the owner is a public reporting company under Section 13 or 15(d) of the Exchange Act.

7. Complete each column.

FULL LEGAL NAME (Natural Persons: Last Name, First Name, Middle Name)	**DE/FE/NP**	**Title or Status**	**Date Title or Status Acquired**		**Ownership Code**	**Control Person**		***CRD* No. (If None: S.S. No. and Date of Birth, IRS Tax No., or IRS Employer ID No.)**
			MM	YYYY		Yes/No	PR	

FORM FUNDING PORTAL
SCHEDULE B

Amendments to Schedule A

1. Use Schedule B only to amend information requested on Schedule A. Refer to Schedule A for specific instructions for completing this Schedule B. Complete each column. File with a completed Execution Page.

2. In the Type of Amendment column, indicate "A" (addition), "D" (deletion), or "C" (change in information about the same *person*).

3. Ownership codes are:

NA - less than 5%
A - 5% but less than 10%
B - 10% but less than 25%
C - 25% but less than 50%
D - 50% but less than 75%
E - 75% or more
G - Other (general partner, trustee, or elected member)

4. List below all changes to Schedule A (Direct Owners and Executive Officers):

FULL LEGAL NAME (Natural Persons: Last Name, First Name, Middle	**DE/FE/NP**	**Type of Amendment**	**Title or Status**	**Date Title or Status Acquired**		**Ownership Code**	**Control Person**		***CRD* No. (If None: S.S. No. and Date of Birth, IRS Tax No., or IRS Employer ID No.)**
				MM	YYYY		Yes/No	PR	

FORM FUNDING PORTAL
SCHEDULE C

Nonresident Funding Portals

Service of Process and Certification Regarding Prompt Access to Books and Records and Ability to Submit to Inspections and Examinations

Each *nonresident funding portal applicant* shall use Schedule C of Form Funding Portal to: identify its United States agent for service of process, and certify that it can, as a matter of law and will: (1) provide the Commission and any registered national securities association of which it becomes a member with prompt access to its books and records, and (2) submit to onsite inspection and examination by the Commission and any registered national securities association of which it becomes a member.

A. Agent for Service of Process:

1. Name of United States *person applicant* designates and appoints as agent for service of process:

____

2. Address of United States *person applicant* designates and appoints as agent for service of process

____

The above identified agent for service of process may be served any process, pleadings, subpoenas, or other papers in:

(a) any investigation or administrative proceeding conducted by the Commission that relates to the *applicant* or about which the *applicant* may have information; and

(b) any civil or criminal suit or action or proceeding under the federal securities laws brought against the *applicant* or to which the *applicant* has been joined as defendant or respondent, in any appropriate court in any place subject to the jurisdiction of any state or of the United States or of any of its territories or possessions or of the District of Columbia. The *applicant* has stipulated and agreed that any such suit, action or administrative proceeding may be commenced by the service of process upon, and that service of an administrative subpoena shall be effected by service upon, the above-named agent for service of process, and that service as aforesaid shall be taken and held in all courts and administrative tribunals to be valid and binding as if personal service thereof had been made.

B. Certification regarding access to records and ability to submit to inspections and examinations:

Applicant can, as a matter of law, and will:

1. provide the Commission and any registered national securities association of which it becomes a member with prompt access to its books and records, and

2. submit to onsite inspection and examination by the Commission and any registered national securities association of which it becomes a member.

Applicant must attach as an exhibit to this Form Funding Portal, Exhibit C, a copy of the opinion of counsel it is required to obtain in accordance with Rule 400(f) of Regulation Crowdfunding, i.e., the opinion of counsel that the nonresident funding portal can, as a matter of law, provide the Commission and any registered national securities association of which the nonresident funding portal becomes a member with prompt access to the books and records of such nonresident funding portal, and that the nonresident funding portal can, as a matter of law, submit to onsite inspection and examination by the Commission and any registered national securities association of which the nonresident funding portal becomes a member.

EXECUTION FOR NON-RESIDENT FUNDING PORTALS

The undersigned represents and warrants that he/she has executed this form on behalf of, and is duly authorized to bind, the *nonresident funding portal*. The undersigned and the *nonresident funding portal* represent that the information and statements contained herein and other information filed herewith, all of which are made a part hereof, are current, true and complete. The undersigned and the *nonresident funding portal* further represent that, if this is an amendment, to the extent that any information previously submitted is not amended, such information is currently accurate and complete.

The undersigned certifies that the *nonresident funding portal* can, as a matter of law, and will provide the Commission and any registered national securities association of which it becomes a member with prompt access to the books and records of such *nonresident funding portal* and can, as a matter of law, and will submit to onsite inspection and examination by the Commission and any registered national securities association of which it becomes a member. Finally, the undersigned authorizes any person having custody or possession of these books and records to make them available to federal regulatory representatives.

Signature: ______________________________

Name and Title: ____

Date: ___________________

FORM FUNDING PORTAL
SCHEDULE D

If this is a withdrawal of registration:

A. The date the *funding portal* ceased business or withdrew its registration request:
Date (MM/DD/YYYY): ______________

B. Location of Books and Records after Registration Withdrawal

Complete the following information for each location at which the *applicant* will keeps books and records after withdrawing its registration.

Name and address of entity where books and records are kept:

____

____

____

(area code)(telephone number) (area code) (fax number)

This is (check one): ☐ one of *applicant*'s branch offices or affiliates.
☐ a third party unaffiliated recordkeeper.
☐ other.

If this address is a private residence, check this box: ☐

Briefly describe the books and records kept at this location.

____

____

____

____

C. Is the *funding portal* now the subject of or named in any *investment-related*

1. Investigation

☐ Yes ☐ No

2. Investor initiated complaint

☐ Yes ☐ No

3. Private civil litigation

☐ Yes ☐ No

CRIMINAL ACTION DISCLOSURE REPORTING PAGE (FP)

General Instructions

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Items 5-A or 5-B of Form Funding Portal.

Check item(s) being responded to: ☐ 5-A(1) ☐ 5-A(2) ☐ 5-B(1) ☐ 5-B(2)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

Multiple counts of the same charge arising out of the same event(s) should be reported on the same DRP. Unrelated criminal actions, including separate cases arising out of the same event, must be reported on separate DRPs. Use this DRP to report all charges arising out of the same event. One event may result in more than one affirmative answer to the items listed above.

Part 1

Check all that apply:

1. The *person*(s) or entity(ies) for whom this DRP is being filed is (are) the:

   Select only one.

   ☐ *Applicant*
   ☐ *Applicant* and one or more *associated persons*
   ☐ One or more of *applicant*'s *associated persons*

If this DRP is being filed for the *applicant*, and it is an amendment that seeks to remove a DRP concerning the *applicant* from the record, the reason the DRP should be removed is:

☐ The *applicant* is registered or applying for registration, and the event or *proceeding* was resolved in the *applicant*'s favor.
☐ The DRP was filed in error.

If this DRP is being filed for an *associated person*:

This *associated person* is: ☐ a firm ☐ a natural person
The *associated person* is: ☐ registered with the *SEC* ☐ not registered with the *SEC*

Full name of the *associated person* (including, for natural persons, last, first and middle names):

If the *associated person* has a *CRD* number, provide that number. ______________________

If this is an amendment that seeks to remove a DRP concerning the *associated person*, the reason the DRP should be removed is:

- ☐ The *associated person* (s) is (are) no longer associated with the *applicant*.
- ☐ The event or *proceeding* was resolved in the *associated person*'s favor.
- ☐ The event or *proceeding* occurred more than ten years ago.
- ☐ The DRP was filed in error. Explain the circumstances:

____

____

Part 2

1. If charge(s) were brought against a firm or organization over which the *applicant* or a *associated person* exercise(s)(d) *control*:

   A. Enter the firm or organization's name ______________________

   B. Was the firm or organization engaged in an *investment-related* business?

   ☐ Yes ☐ No

   C. What was the relationship of the *applicant* with the firm or organization? (In the case of a *associated person*, include any position or title with the firm or organization.)

   ____

2. Court where formal charge(s) were brought in: (include the name of Federal, Military, State or Foreign Court, Location of Court - City or County and State or Country, and Docket/Case number).

   A. Name of Court: ______________________

   B. Location of Court:
   Street Address: ______________________
   City or County: ____________ State/Country: ____________
   Postal Code: ____________

   C. Docket/Case Number: ____________

3. Event Disclosure Detail (Use this for both organizational and individual charges.)

   A. Date First *Charged* (MM/DD/YYYY): ____________ ☐ Exact ☐ Explanation

If not exact, provide explanation:

____

B. Event Disclosure Detail (include charge(s)/charge Description(s), and for each charge provide: (1) number of counts, (2) *felony* or *misdemeanor*, (3) plea for each charge, and (4) product type if charge is *investment-related*).

____

C. Did any of the charge(s) within the event *involve a felony*? ☐ Yes ☐ No

D. Current status of the event? ☐ Pending ☐ On Appeal ☐ Final

E. Event status date (Complete unless status is pending)

(MM/DD/YYYY): ______________ ☐ Exact
☐ Explanation

If not exact, provide explanation:

____

4. Disposition Disclosure Detail: Include for each charge (a) Disposition Type (e.g., convicted, acquitted, dismissed, pretrial, etc.), (b) Date, (c) Sentence/Penalty, (d) Duration (if sentence-suspension, probation, etc.), (e) Start Date of Penalty, (f) Penalty/Fine Amount, and (g) Date Paid.

____

5. Provide a brief summary of circumstances leading to the charge(s) as well as the disposition. Include the relevant dates when the conduct that was the subject of the charge(s) occurred. (The response must fit within the space provided.)

____

____

REGULATORY ACTION DISCLOSURE REPORTING PAGE (FP)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-C, 5-D, 5-E-5-F or 5-G of Form Funding Portal.

Check item(s) being responded to: ☐ 5-C(1) ☐ 5-C(2) ☐ 5-C(3) ☐ 5-C(4)
☐ 5-C(5) ☐ 5-D(1) ☐ 5-D(2) ☐ 5-D(3) ☐ 5-D(4) ☐ 5-D(5)
☐ 5-E(1) ☐ 5-E(2) ☐ 5-E(3) ☐ 5-E(4) ☐ 5-F ☐ 5-G

Use a separate DRP for each event or *proceeding*. An event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Items 5-C, 5-D, 5-E, 5- F or 5-G. Use only one DRP to report details related to the same event. If an event gives rise to actions by more than one regulator, provide details for each action on a separate DRP.

Part 1

The *person*(s) or entity(ies) for whom this DRP is being filed is (are) the:

Select only one.

☐ *Applicant* (the *funding portal*)
☐ *Applicant* and one or more of the *applicant*'s *associated person* (s)
☐ One or more of *applicant*'s *associated person* (s)

If this DRP is being filed for the *applicant* and it is an amendment that seeks to remove a DRP concerning the *applicant* from the record, the reason the DRP should be removed is:

☐ The *applicant* is registered or applying for registration, and the event or *proceeding* was resolved in the *applicant*'s favor.
☐ The DRP was filed in error.

If this DRP is being filed for an *associated person*:

This *associated person* is: ☐ a firm
☐ a natural person

The *associated person is*: ☐ registered with the *SEC*
☐ not registered with the *SEC*

Full name of the *associated person* (including, for natural persons, last, first and middle names):

___

If the *associated person* has a *CRD* number, provide that number. ________

If this is an amendment that seeks to remove a DRP concerning the *associated person*, the reason the DRP should be removed is:

- ☐ The *associated person* (s) is (are) no longer associated with the *applicant*.
- ☐ The event or *proceeding* was resolved in the *associated person*'s favor.
- ☐ The DRP was filed in error. Explain the circumstances:

___

___

Part 2

1. Regulatory Action was initiated by:

☐ *SEC* ☐ Other Federal Authority ☐ *SRO*
☐ Foreign Authority ☐ State

(Full name of regulator, *foreign financial regulatory authority*, federal authority, state or *SRO*)

___

___

___

2. Principal Sanction (check appropriate item):

☐ Civil and Administrative Penalty(ies)/Fine(s)

☐ Restitution	☐ Expulsion	☐ Disgorgement
☐ Bar	☐ Revocation	☐ Suspension
☐ Cease and Desist	☐ Injunction	☐ Undertaking
☐ Censure	☐ Prohibition	☐ Other
☐ Denial	☐ Reprimand	

Other Sanctions:

___

___

___

3. Date Initiated (MM/DD/YYYY): ______________

☐ Exact
☐ Explanation

If not exact, provide explanation:
____
____
____
____

4. Docket/Case Number: __________

5. *Associated person*'s Employing Firm when activity occurred that led to the regulatory action (if applicable):
____
____
____

6. Principal Product Type (check appropriate item):

☐ Annuity(ies) - Fixed
☐ Annuity(ies) - Variable
☐ Money Market Fund(s)
☐ CD(s)
☐ Commodity Option(s)
☐ Debt - Asset Backed
☐ Debt - Corporate
☐ Debt - Government
☐ Debt - Municipal
☐ Derivative(s)
☐ Direct Investment(s) - DPP & LP Interest(s)
☐ Equity - OTC
☐ Equity Listed (Common & Preferred Stock)
☐ Futures - Commodity
☐ Futures - Financial
☐ Index Option(s)
☐ Insurance
☐ Investment Contract(s)
☐ Mutual Fund(s)
☐ Options
☐ Penny Stock(s)
☐ Unit Investment Trust(s)
☐ Other
☐ No Product

Other Product Types:
____
____
____

7. Describe the allegations related to this regulatory action. (The response must fit within the space provided.)
____
____
____

8. Current status? ☐ Pending ☐ On Appeal ☐ Final

9. If on appeal, to whom the regulatory action was appealed (*SEC*, *SRO*, Federal or State Court) and date appeal filed:

____

____

If Final or On Appeal, complete all items below. For Pending Actions, complete Item 13 only.

10. How was matter resolved (check appropriate item):

☐ Acceptance, Waiver & Consent (AWC)	☐ Dismissed	☐ Vacated
☐ Consent	☐ Withdrawn	☐ *Order*
☐ Decision	☐ Settled	☐ Other
☐ Decision & *Order* of Offer of Settlement	☐ Stipulation and Consent	

11. Resolution Date (MM/DD/YYYY): ____________________ ☐ Exact ☐ Explanation

If not exact, provide explanation:

____

____

12. Resolution Detail:

A. Were any of the following Sanctions Ordered (check all appropriate items)?

☐ Monetary/Fine	☐ Revocation/Expulsion/Denial	☐ Censure
Amount: $____________	☐ Disgorgement	☐ Suspension
☐ Bar	☐ Cease & Desist/Injunction	

B. Other Sanctions Ordered:

____

____

C. Sanction detail: If suspended, *enjoined* or barred, provide duration including start date and capacities affected (General Securities Principal, Financial Operations Principal, etc.). If requalification by exam/retraining was a condition of the sanction, provide length of time given to requalify/retrain, type of exam required and whether condition has been satisfied. If disposition resulted in a fine, penalty, restitution, disgorgement or monetary compensation, provide total amount, portion levied against the *applicant* or an *associated person*, date paid and if any portion of penalty was waived:

____

____

13. Provide a brief summary of details related to the action status and (or) disposition, and include relevant terms, conditions and dates.

____

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (FP)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-H or 5-I of Form Funding Portal.

Check item(s) being responded to: ☐ 5-H(1) ☐ 5-H(2) ☐ 5-H(3) ☐ 5-I

Use a separate DRP for each event or *proceeding*. An event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Item 5-H or 5-I. Use only one DRP to report details related to the same event. Unrelated civil judicial actions must be reported on separate DRPs.

Part 1

The *person*(s) or entity(ies) for whom this DRP is being filed is (are) the:

Select only one.

☐ *Applicant* (the *funding portal*)
☐ *Applicant* and one or more of the applicant's *associated person* (s)
☐ One or more of the *applicant*'s associated *person* (s)

If this DRP is being filed for the *applicant* and it is an amendment that seeks to remove a DRP concerning the *applicant* from the record, the reason the DRP should be removed is:

☐ The *applicant* is registered or applying for registration, and the event or *proceeding* was resolved in the *applicant*'s favor.
☐ The DRP was filed in error.

If this DRP is being filed for an *associated person*:

This *associated person* is: ☐ a firm ☐ a natural person
The *associated person*: ☐ registered with the *SEC* ☐ not registered with the *SEC*

Full name of the *associated person* (including, for natural persons, last, first and middle names):

____

If the *associated person* has a *CRD* number, provide that number. ______________

If this is an amendment that seeks to remove a DRP concerning the *associated person*, the reason the DRP should be removed is:

☐ The *associated person* (s) is (are) no longer associated with the *applicant*.
☐ The event or *proceeding* was resolved in the *associated person*'s favor.
☐ The DRP was filed in error. Explain the circumstances:

____

____

Part 2

1. Court Action initiated by: (Name of regulator, *foreign financial regulatory authority, SRO*, commodities exchange, agency, firm, private plaintiff, etc.)

2. Principal Relief Sought (check appropriate item):

☐ Cease and Desist (Private/Civil Complaint)
☐ Restraining Order
☐ Injunction
☐ Other _________
☐ Disgorgement
☐ Civil Penalty(ies)/Fine(s)
☐ Restitution
☐ Money Damages

Other Relief Sought: ____

3. Filing Date of Court Action (MM/DD/YYYY): _______________ ☐ Exact ☐ Explanation

If not exact, provide explanation:

____

4. Principal Product Type (check appropriate item):

☐ Annuity(ies) - Fixed
☐ Annuity(ies) - Variable
☐ Money Market Fund(s)
☐ Mutual Fund(s)
☐ Equity Listed (Common & Preferred Stock)
☐ Debt - Asset Backed
☐ Debt - Corporate
☐ Debt - Government
☐ Debt - Municipal
☐ Derivative(s)
☐ Direct Investment(s) – DPP & LP Interest(s)
☐ CD(s)
☐ Commodity Option(s)
☐ Futures - Commodity
☐ Futures - Financial
☐ Index Option(s)
☐ Insurance
☐ Investment Contract(s)
☐ Equity - OTC
☐ No Product
☐ Options
☐ Penny Stock(s)
☐ Unit Investment Trust(s)
☐ Other

Other Product Types:

____

5. Formal Action was brought in (include the name of the Federal, State, or Foreign Court; Location of Court – City or County and State or Country; and Docket/Case Number

____

6. *Associated person*'s Employing Firm when activity occurred that led to the civil judicial action (if applicable):

____

7. Describe the allegations related to this civil action (the response must fit within the space provided):

____

____

8. Current status? ☐ Pending ☐ On Appeal ☐ Final

9. If on appeal, court to which the action was appealed (provide name of the court) and Date Appeal Filed (MM/DD/YYYY):

____

____

10. If pending, date notice/process was served (MM/DD/YYYY): ____________________

☐ Exact ☐ Explanation

If not exact, provide explanation:

____

If Final or On Appeal, complete all items below. For Pending Actions, complete Item 14 only.

11. How was matter resolved (check appropriate item):

☐ Consent ☐ Judgment Rendered ☐ Settled ☐ Dismissed ☐ Opinion
☐ Withdrawn ☐ Other ______________

12. Resolution Date (MM/DD/YYYY): ____________________ ☐ Exact
☐ Explanation

If not exact, provide explanation:

____

13. Resolution Detail:

A. Were any of the following Sanctions Ordered or Relief Granted (check appropriate items)?

☐ Monetary/Fine
Amount: $ ________
☐ Bar

☐ Revocation/Expulsion/Denial
☐ Censure
☐ Suspension

☐ Disgorgement/Restitution
☐ Cease and Desist/Injunction

B. Other Sanctions Ordered:

____
____
____

C. Sanction detail: If suspended, *enjoined* or barred, provide duration including start date and capacities affected (General Securities Principal, Financial Operations Principal, etc.). If requalification by exam/retraining was a condition of the sanction, provide length of time given to requalify/retrain, type of exam required and whether condition has been satisfied. If disposition resulted in a fine, penalty, restitution, disgorgement or monetary compensation, provide total amount, portion levied against the *applicant* or an *associated person*, date paid and if any portion of penalty was waived:

____
____
____
____
____
____

14. Provide a brief summary of circumstances related to the action(s), allegation(s), disposition(s) and/or finding(s) disclosed above.

____
____
____

BANKRUPTCY/SIPC DISCLOSURE REPORTING PAGE (FP)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-J of Form Funding Portal.

Check item(s) being responded to: ☐ 5-J(1) ☐ 5-J(2)

Use a separate DRP for each event or *proceeding*. An event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Item 5-J. Use only one DRP to report details related to the same event. Unrelated civil judicial actions must be reported on separate DRPs.

Part 1

1. The *person*(s) or entity(ies) for whom this DRP is being filed is (are) the:

   Select only one.

   ☐ *Applicant*
   ☐ *Applicant* and one or more *control affiliate*(s)
   ☐ One or more of *control affiliate*(s)

If this DRP is being filed for a *control affiliate*, give the full name of the *control affiliate* below (for individuals, Last name, First name, Middle name).

If the *control affiliate* is registered with the CRD, provide the CRD number. If not, indicate "non-registered'' by checking the appropriate checkbox.

FP DRP - CONTROL AFFILIATE

____
Control Affiliate CRD Number

This *control affiliate* is: ☐ a firm
☐ a natural person

Registered: ☐ Yes ☐ No

Full name of the *control affiliate* (including, for natural persons, last, first and middle names):

____

☐ This is an amendment that seeks to remove a DRP record because the *control affiliate*(s) is (are) no longer associated with the *funding portal*.

2. If the *control affiliate* is registered through the CRD, has the *control affiliate* submitted a DRP (with Form U-4) or BD DRP to the CRD System for the event? If the answer is "Yes," no other information on this DRP must be provided.

Yes ☐ No ☐

NOTE: The completion of this Form does not relieve the *control affiliate* of its obligation to update its CRD records.

Part 2

1. Action Type: (check appropriate item)

☐ Bankruptcy ☐ Declaration ☐ Receivership

☐ Compromise ☐ Liquidated ☐ Other___________

2. Action Date (MM/DD/YYYY):__________________ ☐ Exact

☐ Explanation

If not exact, provide explanation:____________________

3. If the financial action relates to an organization over which the *applicant* or *control affiliate person* exercise(s)(d) *control*, enter organization name and the *applicant*'s or *control affiliate*'s position, title or relationship:

____

Was the Organization *investment-related*? ☐ Yes ☐ No

4. Court action brought in (Name of Federal, State or Foreign Court), Location of Court (City or County and State or Country), Docket/Case Number and Bankruptcy Chapter Number (if Federal Bankruptcy Filing):

____

5. Is action currently pending? ☐ Yes ☐ No

6. If not pending, provide Disposition Type: (check appropriate item)

☐ Direct Payment Procedure ☐ Dismissed ☐ Satisfied/Released
☐ Discharged ☐ Dissolved ☐ SIPA Trustee Appointed

☐ Other _______

7. Disposition Date (MM/DD/YYYY): ☐ Exact ☐ Explanation

If not exact, provide explanation: ____________________

8. Provide a brief summary of events leading to the action, and if not discharged, explain. (The information must fit within the space provided):

____

9. If a SIPA trustee was appointed or a direct payment procedure was begun, enter the amount paid by you; or the name of trustee:

Currently Open? ☐ Yes ☐ No

Date Direct Payment Initiated/Filed or Trustee Appointed (MM/DD/YYYY):____________

☐ Exact ☐ Explanation

If not exact, provide explanation:____________________

10. Provide details to any status disposition. Include details as to creditors, terms, conditions, amounts due and settlement schedule (if applicable):____________________________

BOND DISCLOSURE REPORTING PAGE (FP)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-K of Form Funding Portal.

Check item(s) being responded to: ☐ 5-K

Use a separate DRP for each event or *proceeding*. An event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Item 5-K. Use only one DRP to report details related to the same event. If an event gives rise to actions by more than one regulator, provide details for each action on a separate DRP.

1. Firm Name: (Policy Holder)

____

2. Bonding Company Name:

____

3. Disposition Type: (check appropriate item)

   ☐ Denied ☐ Payout ☐ Revoked

4. Disposition Date (MM/DD/YYYY): ☐ Exact ☐ Explanation

   If not exact, provide explanation:

____
____
____

5. If disposition resulted in Payout, list Payout Amount and Date Paid:

____
____
____

6. Summarize the details of circumstances leading to the necessity of the bonding company action:

____
____
____
____
____

JUDGMENT / LIEN DISCLOSURE REPORTING PAGE (FP)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP FP) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 5-L of Form Funding Portal.

Check item(s) being responded to: ☐ 5-L

Use a separate DRP for each event or *proceeding*. An event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page. One event may result in more than one affirmative answer to Item 5-L. Use only one DRP to report details related to the same event. If an event gives rise to actions by more than one regulator, provide details for each action on a separate DRP.

1. Judgment/Lien Amount:____
2. Judgment/Lien Holder:____

3. Judgment/Lien Type: (check appropriate item)

   ☐ Civil ☐ Default ☐ Tax

4. Date Filed (MM/DD/YYYY):__________ ☐ Exact ☐ Explanation

   If not exact, provide explanation: ______________________________________

5. Is Judgment/Lien outstanding? ☐ Yes ☐ No

   If No, provide explanation:____

   If No, how was matter resolved? (check appropriate item)

   ☐ Discharged ☐ Released ☐ Removed ☐ Satisfied

6. Court where judgment was given:

   A. Name of Court ____

   B. Location of Court:
   Street Address: ____
   City or County: ____________ State/Country: ________________
   Postal Code: ____________

   C. Docket/Case Number ____________________

7. Provide a brief summary of events leading to the action and any payment schedule details, including current status (if applicable):____________________________________

FORM FUNDING PORTAL INSTRUCTIONS

A. GENERAL INSTRUCTIONS

1. EXPLANATION OF FORM

- This is the form that a *funding portal* must use to register with the Securities and Exchange Commission ("SEC" or "Commission"), to amend its registration and to withdraw from registration.
- The Commission may make publicly accessible all current Forms Funding Portal, including amendments and registration withdrawal requests, which may be searchable by the public, with the exception of certain personally identifiable information or other information with significant potential for misuse (including the contact employee's direct phone number, fax number and e-mail address and any IRS Tax Number, IRS Employer Identification Number, social security number, date of birth, or any other similar information). If the *applicant* submits any attachments to Form Funding Portal in PDF format it is the responsibility of the *applicant* to redact certain personally identifiable information or other information with significant potential for misuse (including the contact employee's direct phone number, fax number and e-mail address and any IRS Tax Number, IRS Employer Identification Number, social security number, date of birth, or any other similar information) from the PDF.

2. WHEN TO FILE FORM FUNDING PORTAL

- A *funding portal*'s registration must become effective before offering or selling any securities in reliance on Section 4(a)(6) through a platform. Under Rule 400, a *funding portal*'s registration will be effective the later of: (1) 30 calendar days after the date a complete Form Funding Portal is received by the Commission or (2) the date the *funding portal* is approved for membership by a national securities association registered under Section 15A of the Securities Exchange Act of 1934 ("Exchange Act").

- A registered *funding portal* must promptly file an amendment to Form Funding Portal when any information previously submitted on Form Funding Portal becomes inaccurate or incomplete for any reason.

- A *successor funding portal* may succeed to the registration of a registered *funding portal* by filing a registration on Form Funding Portal within 30 days after the succession.

- If a *funding portal* succeeds to and continues the business of a registered *funding portal* and the succession is based solely on a change of the predecessor's date or state of incorporation, form of organization, or composition of a partnership or similar reason, the *successor* may, within 30 days of the succession, amend the registration on Form Funding Portal to reflect these changes.

- A *funding portal* must also file a withdrawal on Form Funding Portal (and complete Schedule D) promptly upon ceasing to operate as a *funding portal*. Withdrawal will be effective on the later of 30 days after receipt by the Commission, after the *funding portal* is no longer operational, or within such longer period of time as to which the *funding portal* consents or which the Commission by order may determine as necessary or appropriate in the public interest or for the protection of investors.

- A Form Funding Portal filing will not be considered complete unless it complies with all applicable requirements.

3. **ELECTRONIC FILING** – The *applicant* must file Form Funding Portal electronically, and must utilize this system to file and amend Form Funding Portal electronically to assure the timely acceptance and processing of those filings.

4. **CONTACT EMPLOYEE** – The individual listed as the contact employee must be authorized to receive all compliance information, communications, and mailings, and be responsible for disseminating it within the *applicant*'s organization.

5. **FEDERAL INFORMATION LAW AND REQUIREMENTS**

- The principal purpose of this form is to provide a mechanism by which a *funding portal* can register with the Commission, amend its registration and withdraw from registration. The Commission maintains a file of the information on this form and will make certain information collected through the form publicly available. The SEC will not accept forms that do not include the required information.

- Section 4A(a) of the Securities Act of 1933 [15 U.S.C. §77d-1(a)] and Sections 3(h) and 23(a) the Exchange Act [15 U.S.C. §§78c(h) and 78w(a)] authorize the SEC to collect the information required by Form Funding Portal. The SEC collects the information for regulatory purposes. Filing Form Funding Portal is mandatory for *persons* that are registering as *funding portals* with the SEC.

- Any member of the public may direct to the Commission any comments concerning the accuracy of the burden estimate on this Form and any suggestions for reducing this burden. This collection of information has been reviewed by the Office of Management and Budget in accordance with the clearance requirements of 44 U.S.C. §3507. The information contained in this form is part of a system of records subject to the Privacy Act of 1974, as amended. The Securities and Exchange Commission has published in the Federal Register the Privacy Act Systems of Records Notice for these records.

B. FILING INSTRUCTIONS

1. FORMAT

- All fields requiring a response in Items 1-7 must be completed before the filing will be accepted.

- *Applicant* must complete the execution page certifying that Form Funding Portal and amendments thereto have been executed properly and that the information contained therein is accurate and complete.

- To amend information, the *applicant* must update the appropriate Form Funding Portal pages or Schedules.

- A paper copy, with original manual signatures, of the initial Form Funding Portal filing and amendments to Form Funding Portal and Disclosure Reporting Pages must be retained by the *applicant* and be made available for inspection upon a regulatory request.

2. **DISCLOSURE REPORTING PAGES (DRP)** – Information concerning the *applicant* or *associated person* that relates to the occurrence of an event reportable under Item 5 must be provided on the *applicant*'s appropriate DRP (FP). If an *associated person* is an individual or organization registered through the CRD, such *associated person* need only complete the *associated person* name and CRD number of the *applicant*'s appropriate DRP. Details for the event must be submitted on the *associated person*'s appropriate DRP or DRP (U-4). If an *associated person* is an individual or organization not registered through the CRD, provide complete answers to all of the questions and complete all fields requiring a response on the *associated person*'s appropriate DRP (FP).

3. **DIRECT OWNERS** - Amend the Direct Owners and Executive Officers page when changes in ownership occur.

4. **NONRESIDENT APPLICANTS** – Any *applicant* that is a *nonresident funding portal* must complete Schedule C and attach the opinion of counsel referred to therein.

C. EXPLANATION OF TERMS

1. GENERAL

APPLICANT - The *funding portal* applying on or amending this form.

ASSOCIATED PERSON - Any partner, officer, director or manager of the funding portal (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling or controlled by the funding portal, or any employee of the funding portal, except that any person associated with a funding portal whose functions are solely clerical or ministerial shall not be included in the meaning of such term for purposes of section 15(b) of the Exchange Act (other than paragraphs (4) and (6) thereof).

CONTROL - The power, directly or indirectly, to direct the management or policies of the *funding portal*, whether through contract, or otherwise. A *person* is presumed to *control* a *funding portal* if that *person*: (1) is a director, general partner or officer exercising executive responsibility (or has a similar status or functions); (2) directly or indirectly has the right to vote 25 percent or more of a class of a voting security or has the power to sell or direct the sale of 25 percent or more of a class of voting securities of the *funding portal*; or (3) in the case of a partnership, has contributed, or has a right to receive, 25 percent or more of the capital of the *funding portal*. (This definition is used solely for the purposes of Form Funding Portal).

CONTROL AFFILIATE – A *person* named in Item 4 or any other individual or organization that directly or indirectly controls, is under common control with, or is controlled by, the *applicant*, including any current employee of the *applicant* except one performing only clerical, administrative, support or similar functions, or who, regardless of title, performs no executive duties or has no senior policy making authority.

FOREIGN FINANCIAL REGULATORY AUTHORITY – Includes (1) a foreign securities authority; (2) other governmental body or foreign equivalent of a *self-regulatory organization* empowered by a foreign government to administer or enforce its laws relating to the regulation of *investment* or *investment-related* activities; and (3) a foreign membership organization, a function of which is to regulate the participation of its members in the activities listed above.

FUNDING PORTAL - A broker acting as an intermediary in a transaction involving the offer or sale of securities offered and sold in reliance on Section 4(a)(6), that does not, directly or indirectly: (1) offer *investment* advice or recommendations; (2) solicit purchases, sales or offers to buy the securities displayed on its platform; (3) compensate employees, agents, or other *persons* for such solicitation or based on the sale of securities displayed or referenced on its platform; or (4) hold, manage, possess, or otherwise handle investor funds or securities.

JURISDICTION – Any state of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the U.S. Virgin Islands, any other territory of the United States, or any subdivision or regulatory body thereof.

NONRESIDENT FUNDING PORTAL – A *funding portal* incorporated in or organized under the laws of a jurisdiction outside of the United States or its territories, or having its principal place of business in any place not in the United States or its territories.

PERSON - An individual, partnership, corporation, trust, or other organization.

SELF-REGULATORY ORGANIZATION ("SRO") – A national securities association registered under Section 15A of the Exchange Act or any national securities exchange or registered clearing agency.

SUCCESSOR –A *funding portal* that assumes or acquires substantially all of the assets and liabilities, and that continues the business of, a registered predecessor *funding portal* that ceases its *funding portal* activities. *See* Rule 400(c) of Regulation Crowdfunding (17 CFR 227.400(c)).

2. FOR THE PURPOSE OF ITEM 5 AND THE CORRESPONDING DISCLOSURE REPORTING PAGES (DRPs) (FP)

CHARGED - Being accused of a crime in a formal complaint, information, or indictment (or equivalent formal charge).

ENJOINED – Includes being subject to a mandatory injunction, prohibitory injunction, preliminary injunction, or temporary restraining order.

FELONY – For *jurisdictions* that do not differentiate between a *felony* and a *misdemeanor*, a *felony* is an offense punishable by a sentence of at least one year imprisonment and/or a fine of at least $1,000. The term also includes a general court martial.

FOUND – Includes adverse final actions, including consent decrees in which the respondent has neither admitted nor denied the findings, but does not include agreements, deficiency letters, examination reports, memoranda of understanding, letters of caution, admonishments, and similar informal resolutions of matters.

INVESTMENT OR INVESTMENT-RELATED – Pertaining to securities, commodities, banking, savings association activities, credit union activities, insurance, or real estate (including, but not limited to, acting as or being associated with a *funding portal* broker-dealer, municipal securities dealer, government securities broker or dealer, issuer, investment company, investment adviser, futures sponsor, bank, security-based swap dealer, major security-based swap participant, savings association, credit union, insurance company, or insurance agency).

INVOLVED – Doing an act or aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act.

MINOR RULE VIOLATION – A violation of a *self-regulatory organization* rule that has been designated as "minor" pursuant to a plan approved by the SEC or Commodity Futures Trading Commission. A rule violation may be designated as "minor" under a plan if the sanction imposed consists of a fine of $2,500 or less and if the sanctioned *person* does not contest the fine. (Check with the appropriate *self-regulatory organization* to determine if a particular rule violation has been designated as "minor" for these purposes).

MISDEMEANOR – For *jurisdictions* that do not differentiate between a *felony* and a *misdemeanor*, a *misdemeanor* is an offense punishable by a sentence of less than one year

imprisonment and/or a fine of less than $1,000. The term also includes a special court martial.

ORDER – A written directive issued pursuant to statutory authority and procedures, including orders of denial, suspension, or revocation; does not include special stipulations, undertakings or agreements relating to payments, limitations on activity or other restrictions unless they are included in an *order*.

PROCEEDING – Includes a formal administrative or civil action initiated by a governmental agency, *self-regulatory organization* or a *foreign financial regulatory authority*; a *felony* criminal indictment or information (or equivalent formal charge); or a *misdemeanor* criminal information (or equivalent formal charge). Does not include other civil litigation, investigations, or arrests or similar charges effected in the absence of a formal criminal indictment or information (or equivalent formal charge).

* * * * *

PART 269 – FORMS PRESCRIBED UNDER THE TRUST INDENTURE ACT OF 1939

12. The authority citation for part 269 continues to read as follows:

Authority: 15 U.S.C. 77ddd(c), 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77sss, and 78ll(d), unless otherwise noted.

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PART 274 – FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

13. The authority citation for part 274 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a–8, 80a–24, 80a–26, and 80a–29, unless otherwise noted.

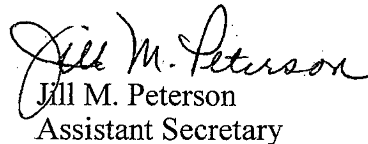
* * * * *

14. Form ID (referenced in §§239.63, 249.446, 269.7 and 274.402 of this chapter) is amended by adding a check box that reads "Funding Portal" in alphabetical order in the list of applicants in Part I; and the Instructions to Form ID are amended to include the definition of "Funding Portal" in alphabetical order under Part I and reads "Funding Portal: A broker acting as

an intermediary in a transaction involving the offer or sale of securities offered and sold in reliance on Section 4(a)(6) of the Securities Act, that does not: (1) offer investment advice or recommendations; (2) solicit purchases, sales or offers to buy the securities displayed on its platform; (3) compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its platform; or (4) hold, manage, possess, or otherwise handle investor funds or securities."

(Note: The amendments to Form ID will not appear in the Code of Federal Regulations.)

By the Commission.



Jill M. Peterson
Assistant Secretary

Date: October 30, 2015

EXHIBIT A

Comment Letters Received Regarding Proposing Release
to Implement Regulation Crowdfunding (File No. S7-09-13)

AABOC:	Letter from Doby Gavn, President and CEO, African American Business Opportunities Communities, Oct. 26, 2013
ABA:	Letter from Catherine T. Dixon, Chair, Federal Regulation of Securities Committee, Business Law Section, American Bar Association
Accredify:	Letter from Herwig G. Konings, CEO, Accredify LLC, Nov. 30, 2013
Active Agenda:	Letter from Daniel F. Zahlis, Founder, Product Architect, Active Agenda LLC, Jan. 29, 2014
Advanced Hydro:	Letter from Dileep Agnihotri, Ph.D., CEO, Advanced Hydro Inc., Oct. 23, 2013
AEO:	Letter from Connie E. Evans, President & CEO, Association for Enterprise Opportunity, Feb. 3, 2014
AFL-CIO:	Letter from Brandon J. Rees, Acting Director, Office of Investment, AFL-CIO, Feb. 3, 2014
AFR:	Letter from Americans for Financial Reform, March 5, 2014
Ahmad:	Letter from Mohamed Ahmad, Aug. 21, 2014
AICPA:	Letter from The American Institute of Certified Public Accountants, Feb. 3, 2014
Amram 1:	Letter from Elan Amram, Feb. 3, 2014
Amram 2:	Letter from Elan Amram, Feb. 3, 2014
Angel 1:	Letter from James J. Angel, Ph.D., CFA, Visiting Associate Professor, Georgetown University, Feb. 5, 2014
Angel 2:	Letter from James J. Angel, Ph.D., CFA, Visiting Associate Professor, Georgetown University, Jul. 1, 2014

AngelList:	Letter from Naval Ravikant, CEO, AngelList, Jan. 24, 3014
Anonymous 1:	Letter from an anonymous person, Nov. 9, 2013
Anonymous 2:	Letter from an anonymous person, Nov. 13, 2013
Anonymous 3:	Letter from an anonymous person, Nov. 25, 2013
Anonymous 4:	Letter from an anonymous person, Dec. 5, 2013
Anonymous 5:	Letter from an anonymous person, Jan. 25, 2014
Anonymous 6:	Letter from an anonymous person, Feb. 7, 2014
Arctic Island 1:	Letter from Scott Purcell, Founder and CEO, Arctic Island LLC, Nov. 4, 2013
Arctic Island 2:	Letter from Scott Purcell, Founder and CEO, Arctic Island LLC, Dec. 4, 2013
Arctic Island 3:	Letter from Scott Purcell, Founder and CEO, Arctic Island LLC, Dec. 4, 2013
Arctic Island 4:	Letter from Scott Purcell, Founder and CEO, Arctic Island LLC, Dec. 4, 2013
Arctic Island 5:	Letter from Scott Purcell, Founder and CEO, Arctic Island LLC, Dec. 6, 2013
Arctic Island 6:	Letter from Scott Purcell, Founder and CEO, Arctic Island LLC, Dec. 6, 2013
Arctic Island 7:	Letter from Scott Purcell, Founder and CEO, Arctic Island LLC, Dec. 6, 2013
Arctic Island 8:	Letter from Scott Purcell, Founder and CEO, Arctic Island LLC, Dec. 31, 2013
ASSOB:	Letter from Paul M. Niederer, CEO, ASSOB Equity Funding Platform Australia, Oct. 25, 2013
ASTTC:	Letter from Mark C. Healy, President and Chief Executive Officer, American Stock Transfer & Trust Company, Brooklyn, New York, Feb. 3, 2014
AWBC:	Letter from Marsha Bailey, Chair, Association of Women's Business Centers, Feb. 3, 2014

BackTrack:	Letter from Randy Shain, Founder and EVP, BackTrack Reports, Nov. 12, 2013
Ball:	Letter from Robert Ball, Feb. 1, 2014
BCFCU:	Letter from Margot Brandenburg, Chair, Brooklyn Cooperative Federal Credit Union, New York, New York, Feb. 3, 2014
Benavente:	Letter from Javier E. Benavente, Jan. 16, 2014
Benjamin:	Letter from Jordan Benjamin, Nov. 30, 2013
BetterInvesting:	Letter from Kamie Zaracki, Chief Executive Officer, et. al., Jul. 29, 2014
Borrell:	Letter from Monica L. Borell, Jan. 27, 2014
Brown D.:	Letter from Douglas Brown, Start-up business owner, Jan. 29, 2014
Brown J.:	Letter from J. Robert Brown, Jr., Professor of Law, University of Denver, Sturm College of Law, Jan. 27, 2014
Bullock:	Letter from Leo M. Bullock, IV, Nov. 10, 2013
Bushroe:	Letter from Fred Bushroe, Oct. 29, 2013
CalTech Entrepreneurs:	Letter from Russell M. Frandsen, Esquire, The Business Legal Group Executive Committee of the Caltech Entrepreneurs Forum, Jan. 29, 2014
Campbell R.:	Letter from Rutheford B. Campbell, Jr., Spears-Gilbert Professor of Law, University of Kentucky, Feb. 14, 2014
CAMEO:	Letter from Claudia Viek, CEO, California Association for Micro Enterprise Opportunity, Feb. 3, 2014
CapSchedule:	Letter from Scott Purcell, CapSchedule.com, LLC, Oct. 23, 2013
CarbonTech:	Letter from Robert Shatz, CEO, CarbonTech Global LLC, Oct. 24, 2013
CCI:	Letter from Carrie Devorah, The Center For Copyright Integrity, Feb. 3, 2014

CEI:	Letter from John Berlau, Senior Fellow, Finance and Access to Capital, Competitive Enterprise Institute, Feb. 3, 2014
CFA Institute:	Letter from Kurt N. Schacht, CFA, Managing Director, Standards and Financial Market Integrity, and Linda L. Rittenhouse, Director, Capital Markets, CFA Institute, Feb. 3, 2014
CFIRA 1:	Letter from Freeman White, Board Member, et al., CFIRA, Jan. 19, 2014
CFIRA 2:	Letter from Kim Wales, Executive Board Member, and Chris Tyrrell, Chairman, CFIRA, Jan. 20, 2014
CFIRA 3:	Letter from Kim Wales, Executive Board Member, and Chris Tyrrell, Chairman, CFIRA, Jan. 26, 2014
CFIRA 4:	Letter from Kim Wales, Executive Board Member, et al., CFIRA, Jan. 26, 2014
CFIRA 5:	Letter from Kim Wales, Founder and CEO, Wales Capital, and Executive Board Member, CFIRA, Jan. 26, 2014
CFIRA 6:	Letter from Joy Schoffler, Board Member, et al., CFIRA, Jan. 27, 2014
CFIRA 7:	Letter from Mary Juetten, Board Member, et al., CFIRA, Jan. 31, 2014
CFIRA 8:	Letter from Jonathan Miller, Board Member, et al., CFIRA
CFIRA 9:	Letter from Daryl Bryant, Board Member, et al., CFIRA, Feb. 4, 2014
CFIRA 10:	Letter from Robert Carbone, CFIRA Board Member, CrowdBouncer, CEO, New York, New York, Feb. 6, 2014
CFIRA 11:	Letter from Chris Tyrell, Chairman, and Kim Wales, Executive Board Member, CFIRA, New York, New York, Feb. 6, 2014
CFIRA 12:	Letter from Kim Wales, CEO, Wales Capital, and CFIRA Executive Board Member, and Scott

Purcell, CEO, Artic Island, and CFIRA Board Member, Apr. 24, 2014

City First:	Letter from John Hamilton, President, City First Enterprises, Washington, District of Columbia, Feb. 3, 2014
Clapman:	Letter from Mordechai Clapman, Oct. 25, 2013
ClearTrust:	Letter from Kara Kennedy, Executive Director, ClearTrust, LLC, Jan. 20, 2014
Cole A.:	Letter from Adam Cole, Nov. 24, 2013
Cole D.:	Letter from Don Cole, Oct. 25, 2013
Commonwealth of Massachusetts:	Letter from William F. Galvin, Secretary of the Commonwealth of Massachusetts, Feb. 3, 2014
Computershare:	Letter from Martin (Jay) J. McHale, Jr., President, US Equity Services, Computershare, Canton, Massachusetts, Feb. 3, 2014
Concerned Capital:	Letter from Bruce Dobb, Concerned Capital - A Social Benefit Corp., Feb. 2, 2014
Consumer Federation:	Letter from Barbara Roper, Director of Investor Protection, Consumer Federation of America, Feb. 2, 2014
Craw:	Letter from Kristopher R. Craw, J.D., Denver, Colorado, Jun. 14, 2014
CSTTC:	Letter from Steven G. Nelson, President and Chairman of Continental Stock Transfer Trust Company, Jan. 31, 2014
CST:	Letter from Carylyn K. Bell, President, Corporate Stock Transfer, Inc., Jan. 15, 2014
Coombs:	Letter from Jason Coombs, Feb. 7, 2014
CfPA:	Letter from Charles Sidman, MBA, PhD, President and Chair, for the Board of, the Crowdfunding Professional Association, Feb. 3, 2014
CRF:	Letter from Frank Altman, President and CEO, Community Reinvestment Fund, USA, Feb. 3, 2014

Cromwell:	Letter from David M. Cromwell, Yale School of Management, Adjunct Professor of Entrepreneurship, Oct. 27, 2013
CrowdBouncer:	Letter from Robert C. Carbone, Founder & CEO, CrowdBouncer, Inc., Buffalo, New York, Feb. 3, 2014
CrowdCheck 1:	Letter from Sara Hanks, CEO, CrowdCheck, Inc., Jan. 9, 2014
CrowdCheck 2:	Letter from Andrew D. Stephenson, Research Manager, CrowdCheck, Inc., Jan. 23, 2014
CrowdCheck 3:	Letter from Sara Hanks, CEO, CrowdCheck, Inc., Feb. 2, 2014
CrowdCheck 4:	Letter from Brian R. Knight, VP, CrowdCheck, Inc., Feb. 2, 2014
CrowdFundConnect:	Letter from Randy A. Shipley, CrowdFundConnect Incorporated, Dec. 14, 2013
Crowdpassage 1:	Letter from Matthew R. Nutting, Esq., Executive Director, National Legal Director, Crowdpassage.com, Jan. 31, 2014
Crowdpassage 2:	Letter from Matthew R. Nutting, Esq., Executive Director, National Legal Director, Crowdpassage.com, Jan. 31, 2014
Crowdpassage 3:	Letter from Matthew R. Nutting, Esq., Executive Director, National Legal Director, Crowdpassage.com, Jan. 31, 2014
CrowdStockz:	Letter from Frederic C. Schultz, Esq. and Alastair Onglingswan, Esq., Owners of CrowdStockz.com., CrowdStockETFs.com., and CrowdStockFunds.com, Feb. 3, 2014
Crowley:	Letter from Vincent Crowley, Nov. 11, 2013
CrwdCorp:	Letter from Sean Shepherd, Founder & Chief Executive Officer, CrwdCorp, LLC, Jan. 16, 2014
Cunningham 1:	Letter from William Michael Cunningham, Social Investing Advisor, Washington, District of Columbia, Feb. 3, 2014

Cunningham 2:	Letter from William Michael Cunningham, M.B.A., M.A., Social Investing Advisor, Washington, District of Columbia, Feb. 3, 2014
dbb*mckennon:*	Letter from dbb*mckennon*, Certified Public Accountants, Oct. 1, 2014
DeMarco:	Letter from Peter J. DeMarco, Student, Stanford Law School, Nov. 12, 2013
Denlinger 1:	Letter from Craig Denlinger, CPA, Denver, Colorado, Feb. 3, 2014
Denlinger 2:	Letter from Craig Denlinger, CPA, CrowdfundCPA, Aug. 21, 2014
Doctor:	Letter from Roger Doctor, Dec. 10, 2013
Donohue:	Letter from Patrick E. Donohue, Minneapolis, Minnesota, Feb. 24, 2014
DreamFunded:	Letter from Manny Fernandez, Co-Founder and CEO, www.DreamFunded.com, Jan. 8, 2014
Duke:	Letter from Heather Duke, Dec. 3, 2013
EarlyShares:	Letter from Joanna Schwartz, CEO, EarlyShares.com, Inc., Feb. 3, 2014
Echterling:	Letter from Ian Echterling, Entrepreneur Feb. 21, 2014
Ellenbogen:	Letter from David M. Ellenbogen, Jan. 27, 2014
EMKF:	Letter from Alicia Robb, Ph.D, Senior Fellow, and Dane Stangler, Vice President, Research & Policy, Ewing Marion Kauffman Foundation, Feb. 3, 2014
Empire Stock:	Letter from Matthew J. Blevins, Vice President, Empire Stock Transfer Inc., Jan. 15, 2014
EquityNet:	Letter from Judd E. Hollas, Founder and CEO, EquityNet, LLC
Equity Stock:	Letter from Mohit Bhansali, Chief Operating Officer, Equity Stock Transfer LLC, New York, New York, Feb. 3, 2014

Ex24:	Letter from James. P. Lennane, ex24, Inc., Jan. 29, 2014
EY:	Letter from Ernst & Young LLP, Feb. 3, 2014
Farnkoff:	Letter from Brian Farnkoff, Editor-in-Chief, Journal of Contemporary Health Law and Policy, Feb. 3, 2014
Farese:	Letter from Robert L. Farese, Jr., Oct. 30, 2014
FAST:	Letter from Salli A. Marinov, President and CEO, First American Stock Transfer, Inc., January 23, 2014
Feinstein:	Letter from Todd Feinstein, Feinstein Law, P.A., Feb. 3, 2014
Finkelstein:	Letter from Elizabeth R. Makris, Finkelstein Thompson LLP, Jan. 31, 2014
FOLIOfn:	Letter from Michael J. Hogan, President & Chief Executive Officer, FOLIOfn Investments, Inc., McLean, Virginia, Feb. 3, 2014
Frutkin:	Letter from Jonathan Frutkin, The Frutkin Law Firm, Jan. 30, 2014
Fryer:	Letter from Gregory S. Fryer, Esq., Partner, Verrill Dana, LLP, Portland, Maine, Feb. 5, 2014
FSI:	Letter from David T. Bellaire, Esq., Executive Vice President & General Counsel, Financial Services Institute, Feb. 3, 2014
Fund Democracy:	Letter from Mercer Bullard, President and Founder, Fund Democracy, Associate Professor, University of Mississippi School of Law, Oxford, Mississippi, Feb. 3, 2014
Funderbuddies:	Letter from John Mark Wendler, CPA, Funderbuddies, Nov. 26, 2013
FundHub 1:	Letter from Kendall Almerico, Crowdfunding Expert, Attorney and CEO, Fund Hub and ClickStartMe, Jan. 29, 2014

FundHub 2:	Letter from Kendall Almerico, Crowdfunding Attorney and CEO of FundHub.Biz, Tampa, Florida, Oct. 8, 2014
Generation Enterprise:	Letter from Ubon Isang, Executive, Generation Enterprise Corporation, Oct. 24, 2013
Gibb:	Letter from Jeremy Gibb, Nov. 13, 2013
Gill:	Letter from Michael D. Gill, III, Esq., Jan. 22, 2014
Gimpelson 1:	Letter from Alexander Gimpelson, Chest Nut Hill, Massachusetts, Feb. 3, 2014
Gimpelson 2:	Letter from Alexander Gimpelson, Chest Nut Hill, Massachusetts, Feb. 3, 2014
Grassi:	Letter from Louis C. Grassi, CPA, CFE, Managing Partner, Grassi and Co., Jan. 20, 2014
Graves:	Letter from Sam Graves, Chairman, U.S. House of Representatives, Committee on Small Business, Washington, District of Columbia, Feb. 3, 2014
Greenfield:	Letter from Richard D. Greenfield, Esq., Greenfield Goodman LLC, Nov. 10, 2013
Greer:	Letter from Diana Greer, Jan. 27, 2014
Growthfountain:	Letter from Growthfountain LLC, Jan. 7, 2014
GSJ Advisors:	Letter from George Surgeon, President and CEO, GSJ Advisors, Ltd., Feb. 3, 2014
Guzik 1:	Letter from Samuel S. Guzik, Guzik and Associates, Los Angeles, California, Feb. 11, 2014
Guzik 2:	Letter from Samuel S. Guzik, Guzik and Associates, Los Angeles, Feb. 20, 2014
Guzik 3:	Letter from Samuel S. Guzik, Guzik and Associates, Los Angeles, California, Feb. 28, 2014
Hackers/Founders:	Letter from Charles Belle, Ken Priore, and Timothy Yim, Hackers/Founders, Feb. 3, 2014
Hakanson:	Letter from Sten E. Hakanson, Stillwater, Minnesota, Feb. 28, 2014

Hamilton:	Letter from Brenda L. Hamilton, Hamilton & Associates Law Group, P.A., Nov. 8, 2013
Hamman:	Letter from Charles J. Hamman, Oct. 24, 2013
Harrison:	Letter from Mark Harrison, Ph.D., Jan. 6, 2014
Holland:	Letter from Alexandra D. Holland, Ph.D., Founder and CEO, PIARCS, PBC, June 3, 2014
Martin:	Letter from Andrew Martin, OFS, CB, Rockville, Maryland, Oct. 18, 2014
MCS:	Letter from Andrew M. Hartnett, Missouri Commissioner of Securities, Feb. 3, 2014
Merkley:	Letter from Jeffrey A. Merkley, United States Senator, Apr. 29, 2014
Haylock:	Letter from Todd Haylock, Dec. 10, 2013
Heritage:	Letter from David R. Burton, Senior Fellow in Economic Policy, The Heritage Foundation, Feb. 3, 2014
Hyatt:	Letter from Todd R. Hyatt, Nov. 6, 2013
IAC Recommendation:	Recommendation of the SEC's Investor Advisory Committee: Crowdfunding Regulations, Apr. 10, 2014
iCrowd:	Letter from J. Bradford McGee and John P. Callaghan, Founders, iCrwod, LLC, Jan. 31, 2014
Inkshares:	Letter from Adam J. Gomolin, General Counsel, Inkshares, Inc., Feb. 3, 2014
Jacobson:	Letter from William A. Jacobson, Clinical Professor of Law, Cornell Law School, and Director, Cornell Securities Law Clinic, Ithaca, New York, Feb. 3, 2014
Jazz:	Letter from Jim C. Shaw, Jazz Gas, Jan. 12, 2014
Johnston:	Letter from Phil Johnston, Feb. 3, 2014
Joinvestor:	Letter from Bryan Healey, CEO, Joinvestor, Jan. 2, 2014

Kelso:	Letter from Carl Kelso, Jan. 7, 2014
Kickstarter Coaching:	Letter from Jay Wittner, President Kickstarter Coaching, Bradenton, Florida, Feb. 3, 2014
Kingonomics:	Letter from Rodney S. Sampson, CEO, Kingonomics, Feb. 3, 2014
Kishon:	Letter from Mannis Kishon, Dec. 22, 2013
Knudsen:	Letter from Michael Knudsen, Jan. 6, 2014
Konecek:	Letter from Kathleen Konecek, Nov. 30, 2013
Langrell:	Letter from Alex M. Langrell, Camp Pendelton, California, Jan. 21, 2014
Leverage PR:	Letter from Joy Schoffler, Principal, Leverage PR, Austin, Texas, Sep. 2, 2014
Lopossa:	Letter from Gabriel M. Lopossa, Oct. 30, 2013
Luster:	Letter from Louise Luster, Oct. 31, 2013
Mahoney:	Letter from Steve Mahoney, Managing Director, Highlands Ranch, Colorado, Jan. 20, 2014
Mantel:	Letter from Russ Mantel, Oct. 23, 2013
M.A.V.:	Letter from M.A.V., Nov. 3, 2013
Marsala:	Letter from Charles E. Marsala -Profitibale Dining LLC, Feb. 15, 2014
McCulley:	Letter from Matthew McCulley, Jan. 10, 2014
McGladrey:	Letter from McGladrey LLP, Feb. 3, 2014
Meling:	Letter from Rosemary Meling, Oct. 30, 2013
Menlo Park:	Letter from James O. Mason, Founder/CEO, Menlo Park Social Media Crowdfunding Incubator, Feb. 28, 2014
Miami Nation:	Letter from Ben Barnes, Director of Tribal Gaming, Miami Nation Enterprises, Oct. 25, 2013
Milken Institute:	Letter from Daniel S. Gorfine, Director, Financial Markets Policy, and Staci Warden, Executive

Director, Center for Financial Markets, Milken Institute, Washington, District of Columbia, Feb. 3, 2014

Mlinarich:	Letter from Brett A. Mlinarich, Jan. 2, 2014
Mollick:	Letter from Ethan R. Mollick, Edward B. and Shirley R. Shils Assistant Professor of Management, Wharton School, University of Pennsylvania, Phildelphia, Pennsylvania, Feb. 5, 2014
Morse:	Letter from Matt R. Morse, Sr., Dec. 3, 2013
Moskowitz:	Letter from Yonatan Moskowitz, Nov. 13, 2013
Moyer:	Letter from Mike Moyer, Adjunct Associate Professor of Entrepreneurship at the University of Chicago Booth School of Business, Adjunct Lecturer of Entrepreneurship at Northwestern University, Jan. 25, 2014
Mountain Hardwear:	Letter from Alan A. Tabor, Co-founder, Mountain Hardwear, Jan. 27, 2014
Multistate Tax:	Letter from Frank L. Dantonio, Managing Principal, Multistate Tax Service, LLC, Oct. 29, 2013
NAAC:	Letter from Faith Bautista, President and CEO, National Asian American Coalition, Oct. 31, 2013
NACVA:	Letter from David M. Freedman, Editorial Advisor, The Value Examiner magazine (NACVA), Jan. 16, 2014
NAHB:	Letter from David L. Ledford, Senior Vice President, Housing Finance & Regulatory Affairs, National Association of Home Builders, Jan. 31, 2014
NASAA:	Letter from Andrea Seidt, President, North American Securities Administrators Association, Inc. (NASAA)
NASE:	Letter from Katie Vlietstra, Vice President of Government Relations Public Affairs, The National Association for the Self-Employed, Washington, District of Columbia, Feb. 3, 2014

NaviGantt:	Letter from Christopher R. York, CEO, NaviGantt, Jan. 27, 2014
NYSSCPA:	Letter from J. Michael Kirkland, President, New York State Society of Certified Public Accountants, Jan. 20, 2014
Nether:	Letter from Darrell W. Nether, Nov. 1, 2013
NFIB:	Letter from Dan Danner, President and CEO, National Federation of Independent Business, Feb. 3, 2014
NPCM:	Letter from Robert C. Guinto, Jr., President, Non Profit Capital management, LLC, Oct. 24, 2013
NSBA:	Letter from Todd O. McCracken, President, National Small Business Association, Feb. 3, 2014
Odhner:	Letter from Chad E. Odhner, Nov. 25, 2013
ODS:	Letter from Faye Morton, General Counsel, Oklahoma Department of Securities, Feb. 3, 2014
Omara:	Letter from Sherouk Omara, Nov. 14, 2013
Otherworld:	Letter from Mark Henry, Founder, Otherworld Pictures, Apr. 11, 2014
Parsont:	Letter from Jason W. Parsont, Feb. 18, 2014
Partners:	Letter from Jeannine Jacokes, CEO, Partners for the Common Good, Washington DC, District of Columbia, Feb. 3, 2014
Patel:	Letter from Raj Patel, Jan. 17, 2014
PBA:	Letter from Graham R. Laub, Chair, and Katayun I. Jaffari, Vice Chair, Securities Regulation Committee of the Business Law Section, Philadelphia Bar Association, Philadelphia, Pennsylvania, Feb. 3, 2014
Peers:	Letter from Kit Hayes, Campaign Director, Peers.org, Feb. 7, 2014
Perfect Circle:	Letter from Frederick C. Young, Perfect Circle Solutions, Oct. 30, 2013

PeoplePowerFund:	Letter from Steve Mayer, PeoplePowerFund.com, Jan. 31, 2014
Phillips:	Letter from Everette Phillips, Entrepreneur, Jan. 15, 2014
Pioneer Realty:	Letter from Charles E. Williams, MBA, EA, Founder and Managing Director, Pioneer Realty Capital, Jan 15, 2014
Platkin:	Letter from Matthew Platkin, Nov. 13, 2013
Powers:	Letter from Jordan Berg Powers, Nov. 4, 2013
PPA:	Letter from Douglas R. Slain, Managing Partner, Private Placement Advisors LLC
Projectheureka:	Letter from Anthony and Erika Endres, Projectheureka LLC, Nov. 17, 2013
Propellr 1:	Letter from Todd M. Lippiatt, CEO, Propellr, LLC, Jan. 27, 2014
Propellr 2:	Letter from Todd M. Lippiatt, CEO, Propellr, LLC, Jan. 27, 2014
Public Startup 1:	Letter from Jason Coombs, Co-Founder and CEO, Public Startup Company, Inc., Dec. 15, 2013
Public Startup 2:	Letter from Jason Coombs, Co-Founder and CEO, Public Startup Company, Inc., Feb. 3, 2014
Public Startup 3:	Letter from Jason Coombs, Co-Founder and CEO, Public Startup Company, Inc., Feb. 11, 2014
Public Startup 4:	Letter from Jason Coombs, Co-Founder and CEO, Public Startup Company, Inc., Feb. 22, 2014
Qizilbash:	Letter from Muhammad A. Qizilbash, Dec. 18. 2013
Raindance:	Letter from Jeffrey L. Tucker, CEO, The Raindance Group, Dec. 17, 2013
Ramsey:	Letter from Rebecca Ramsey, Oct. 24, 2013
Reed:	Letter from Terry Reed, J.D., Jan. 21, 2014
Reichman:	Letter from Vic Reichman, Esq., Dec. 2, 2013

RFPIA:	Letter from T. W. Kennedy, BE, CEO, Regulated Funding Portal Industry Association, Jan. 26, 2014
Ritter:	Letter from Justin A. Ritter, Esquire, Associate Attorney, Spinella, Owings & Shaia, P.C., Nov. 18, 2013
RoC:	Letter from Sang H. Lee, CEO, Return on Change, Jan. 30, 2014
RocketHub:	Letter from Alon Hillel-Tuch and Jed Cohen, RocketHub, New York, New York, Feb. 3, 2014
Rosenthal O.:	Letter from Oren Rosenthal, Attorney, Nov. 4, 2013
Sam H.:	Letter from Sam H., Oct. 27, 2013
Sander:	Letter from Steven M. Sander, CEO, Oct. 27, 2013
Sarles:	Letter from Jeff Sarles, Oct. 25, 2013
Saunders:	Letter from R. Kevin Saunders, Staff Editor, Vanderbilt Journal of Entertainment Technology Law, Nashville, Tennessee, Feb. 3, 2014
Sawhney:	Letter from Sanjay Sawhney, Jan. 27, 2014
SBA Office of Advocacy:	Letter from Winslow Sargeant, Ph.D., Chief Counsel for Advocacy, and Dillon Taylor, Assistant Chief Counsel for Advocacy, SBA Office of Advocacy, Jan. 16, 2014
SBEC:	Letter from Karen Kerrigan, President & CEO, Small Business & Entrepreneurship Council, Feb. 3, 2014
SBM:	Letter from Cassie Mills, Communications Associate, Small Business Majority, Feb. 4, 2014
Schatz:	Letter from Jonathan Schatz, Nov. 13, 2013
Schwartz:	Letter from Andrew A. Schwartz, Associate Professor of Law, University of Colorado, Boulder, Colorado, Feb. 3, 2014
Scruggs:	Letter from Frank Scruggs, Jan. 17, 2014
SeedInvest 1:	Letter from Kiran Lingam, Esq., General Counsel, SeedInvest, Jan. 21, 2014

SeedInvest 2:	Letter from Kiran Lingam, General Counsel, SeenInvest, Jan. 22, 2014
SeedInvest 3:	Letter from Kiran Lingam, Esq., General Counsel, SeedInvest, Feb. 3, 2014
Seed&Spark:	Letter from Max Silverman, COO, Seed & Spark
Sewell:	Letter from Michael J. Sewell, Esq., Jan 17, 2014
Seyfarth:	Letter from Seyfarth Shaw LLP, New York, New York, Feb. 10, 2014
SFAA:	Letter from Robert. J. Duke, Corporate Counsel, The Surety & Fidelity Association of America, Nov. 19, 2013
Sfinarolakis	Letter from Manolis E. Sfinarolakis, CFIRA, CFPA, NLCFA, New Britain, Connecticut, Aug. 6, 2014
Sharewave:	Letter from Joshua S. Levine, Co-Founder and CEO, Sharewave, LLC, Dec. 18, 2013
Smith D.:	Letter from Darrell Smith, Jan. 19, 2014
Smith K.:	Letter from Kevin G. Smith, Electrical Engineer, Oct. 31, 2013
Song:	Letter from Ntxhi Song, Student, Johnson and Wales University Charlotte, Charlotte, North Carolina, Feb. 3, 2014
STA:	Letter from Charles V. Rossi, Chairman, STA Board Advisory Committee, The Securities Transfer Association, Inc., Dec. 18, 2013
Stalt:	Letter from Bill Senner, Stalt, Inc., Jan. 27, 2014
StartEngine 1:	Letter from Ron Miller, CEO, StartEngine, Los Angeles, California, Jul. 25, 2014
StartEngine 2:	Letter from Ron Miller, CEO, StartEngine Crowdfunding, Inc., Oct. 7, 2014
StartupValley:	Letter from Daryl H. Bryant, CEO, StartupValley, Inc., Jan. 15, 2014

Stephenson:	Letter from Andrew D. Stephenson, Brian Knight, and Matthew Bahleda, Feb. 3, 2014
Stieglitz:	Letter from Edward B. Stieglitz, Oct. 28, 2013
Syed:	Letter from Idrus R. Syed, MBA, Oct. 24, 2013
Tafara:	Letter from Peter Tafara, Nov. 8, 2013
Hillside:	Letter from Anthony M. Tate, Hillside Technological Innovation LLC, Cedar Rapids, Iowa, Feb. 11, 2014
TAN:	Letter from Olawale Ayeni, MBA, and Bolaji Olutade, Ph.D., The African Network, Dec. 12, 2013
Taylor M.:	Letter from Mack Taylor, Nov. 8, 2013
Taylor R.:	Letter from Ryan S. Taylor, Crowdfunder, Oct. 24, 2013
Taylor T.:	Letter from Terry L. Taylor, Oct. 24, 2013
Thomas 1:	Letter from Jeff Thomas, JD, CPA, Chair of Business and Associate Professor, Johnson & Wales University, Charlotte, North Carolina, Feb. 3, 2014
Thomas 2:	Letter from Jeff Thomas, JD, CPA, Chair of Business and Associate Professor, Charlotte, North Carolina, Feb. 3, 2014
Thompson:	Letter from Lyle Thompson, Entrepreneur, Dec.10, 2013
Tiny Cat:	Letter from L. David Varvel and Ellenor Varvel, Founders, Tiny Cat Loans, Feb. 3, 2014
TraceFind:	Letter from Wendi C. Hawley, MA, ATR-BC, CEO, TraceFind Technologies, Inc., Oct. 24, 2013
Traklight:	Letter from Mary E. Juetten, Founder & CEO, Traklight.com, Feb. 2, 2014
Tucker:	Letter from Gary Tucker, Feb. 17, 2014
US Black Chambers:	Letter from Ron Busby, President, US Black Chambers, Inc., Washington, District of Columbia, Feb. 3, 2014

U.S. Chamber of Commerce:	Letter from Tom Quaadman, Vice President, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, Feb. 3, 2014
Verinvest:	Letter from David Benway, Chief Executive Officer, Verinvest Corporation, Jan. 17, 2014
Vann:	Letter from James Vann, Greenfield, Missouri, Apr. 11, 2014
Vest:	Letter from Sean Osterday & Peter Wild, Vest Inc., San Francisco, California, Feb. 3, 2014
Vidal:	Letter from Eduardo Vidal, Jan. 27, 2014
Vossberg:	Letter from Trevor Vossberg, Oct. 23, 2013
Wales Capital 1:	Letter from Kim Wales, Founder and CEO, Wales Capital, Feb. 3, 2014
Wales Capital 2:	Letter from Kim Wales, Founder and CEO, Wales Capital, Mar. 2, 2014
Wales Capital 3:	Letter from Kim Wales, Founder and CEO, Wales Capital, Mar. 12, 2014
WealthForge:	Letter from Mathew Dellorso, CEO, WealthForge Holdings, Inc., Richmond, Virginia, Feb. 3, 2014
Wear:	Letter from Zak Wear, Dec. 10, 2013
Wefunder:	Letter from Nicholas Tommarello, CEO, Wefunder, January 31, 2014
Whitaker Chalk:	Letter from John R. Fahy and Wayne M. Whitaker, Whitaker Chalk Swindle & Schwartz PLLC, Jan. 7, 2014
Wilhelm:	Letter from Jonathan R. Wilhelm, Jan. 27, 2014
Wilson:	Letter from Margaret A. Wilson, Professor of Technology Commercialization, Austin, Texas, Feb. 3, 2014
Winters:	Letter from Dennis Winters, Esq., Jan. 9, 2014
WIPP:	Letter from Barbara Kasoff, President, Women Impacting Public Policy, Feb. 3, 2014

Woods:	Letter from Thell M. Woods, Jan. 13, 2014
Yudek:	Letter from David B. Kopp, CEO, Yudek, Inc. Oct. 29, 2013
Zeman:	Letter from Jason Zeman, Nov. 30, 2013
Zhang:	Letter from Runan Zhang, Esq., Law Offices of Runan Zhang, Washington, District of Columbia, Feb. 3, 2014
7thenterprise:	Letter from Jarone V. Price, CEO, 7thenterprise International Inc., Jan. 22, 2014
11 Wells:	Letter from Robert McManus, The 11 Wells Spirits Company, Jan. 28, 2014

Commissioner Piwowar
Disapproved

SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 230

[Release Nos. 33-9973; 34-76319; File No. S7-22-15]

RIN 3235-AL80

Proposed Rule Amendments to Facilitate Intrastate and Regional Securities Offerings

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rules.

SUMMARY: We are proposing amendments to Rule 147 under the Securities Act of 1933, which currently provides a safe harbor for compliance with the Section 3(a)(11) exemption from registration for intrastate securities offerings. Our proposal would modernize the rule and establish a new exemption to facilitate capital formation, including through offerings relying upon recently adopted intrastate crowdfunding provisions under state securities laws. The proposed amendments to the rule would eliminate the restriction on offers and ease the issuer eligibility requirements, while limiting the availability of the exemption at the federal level to issuers that comply with certain requirements of state securities laws.

We further propose rule amendments to Rule 504 of Regulation D under the Securities Act to facilitate issuers' capital raising efforts and provide additional investor protections. The proposed amendments to Rule 504 would increase the aggregate amount of securities that may be offered and sold in any twelve-month period from $1 million to $5 million and disqualify certain bad actors from participation in Rule 504 offerings.

DATES: Comments should be received by [insert date 60 days after publication in the Federal Register].

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment forms (http://www.sec.gov/rules/proposed.shtml);
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-22-15 on the subject line; or
- Use the Federal Rulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

- Send paper comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-22-15. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's website (http://www.sec.gov/rules/proposed.shtml). Comments also are available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

Studies, memoranda or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the SEC's website. To ensure direct electronic

receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by e-mail.

FOR FURTHER INFORMATION CONTACT: Anthony G. Barone, Special Counsel, or Zachary O. Fallon, Special Counsel, Office of Small Business Policy, Division of Corporation Finance, at (202) 551-3460, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

SUPPLEMENTARY INFORMATION: We propose to amend Rule 147[1] and Rule 504[2] of Regulation D[3] under the Securities Act of 1933 (the "Securities Act")[4] and to make technical amendments to Rules 504 and 505[5] of Regulation D.

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1 17 CFR 230.147.

2 17 CFR 230.504.

3 17 CFR 230.500 through 230.508.

4 15 U.S.C. 77a *et seq.*

5 17 CFR 230.505.

TABLE OF CONTENTS

I. INTRODUCTION AND BACKGROUND 6
II. PROPOSED AMENDMENTS TO RULE 147 8
A. Rationale for Proposed Amendments to Rule 147 8
B. Explanation of Proposed Amendments to Rule 147 13
1. Elimination of Limitation on Manner of Offering 14
2. Elimination of Residence Requirement for Issuers 17
3. Requirements for Issuers "Doing Business" In-State 19
4. Additional Amendments to Rule 147 28
a. Reasonable Belief as to Purchaser Residency Status 28
b. Residence of Entity Purchasers 31
c. Limitation on Resales 32
d. Integration 36
e. Other Considerations 43
f. State Law Requirements 47
C. Preservation of Section 3(a)(11) Statutory Intrastate Offering Exemption 52
III. PROPOSED AMENDMENTS TO RULES 504 AND 505 OF REGULATION D 54
A. Overview of Rules 504 and 505 54
B. Proposed Amendments to Rules 504 and 505 57
C. Continued Utility of Rule 505 as an Exemption from Registration 67
IV. GENERAL REQUEST FOR COMMENT 71
V. ECONOMIC ANALYSIS 71
A. Baseline 72
1. Current Market Participants 73
a. Issuers 74
b. Investors 80
c. Intermediaries 82
2. Alternative Methods of Raising up to $5 Million of Capital 84
a. Exempt Offerings 85
b. Regulation Crowdfunding 90
c. Private Debt Financing 92
B. Analysis of Proposed Rules 97
1. Introduction 97
2. Analysis of Proposed Amendments to Rule 147 105
a. Elimination of Limitation on Manner of Offering 105
b. Ease of Eligibility Requirements for Issuers 107
c. Maximum Offering Amount and Investment Limitations for Offerings with Exemption from State Registration 115
3. Additional Amendments to Rule 147 117
4. Analysis of Proposed Amendments to Rule 504 121
C. Alternatives 129
1. Rescind Rule 505 Exemption 129

2. Lower Qualifying Thresholds under "Doing Business" In-State Tests........ 131
3. Eliminate "Doing Business" In-State Tests........ 132
4. Decreasing or Increasing Rule 504 Maximum Offering Limit........ 133
5. Additional Amendments to Rule 504........ 134
D. Request for Comment........ 134
VI. PAPERWORK REDUCTION ACT 138
VII. INITIAL REGULATORY FLEXIBILITY ACT ANALYSIS 149
VIII. SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT 160
IX. STATUTORY BASIS AND TEXT OF PROPOSED RULES 160

I. INTRODUCTION AND BACKGROUND

Today's proposals are part of the Commission's efforts to assist smaller companies with capital formation consistent with other public policy goals, including investor protection. These proposals also complement recent efforts by the U.S. Congress,[6] state legislatures,[7] and state securities regulators[8] to modernize existing federal and state securities laws and regulations to assist smaller companies with capital formation. We believe that the proposed amendments to Rule 147 and the amendment to increase the offering amount limitation in Rule 504 will help to facilitate capital formation by smaller companies by increasing the utility of these rules while maintaining appropriate protections for investors who purchase securities in these offerings. We believe that the proposed disqualification of certain bad actors from participation in Rule 504 offerings will provide for greater consistency across Regulation D and increase investor protection in such offerings.

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6 Congress enacted the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"), which was signed into law by President Obama on April 5, 2012. Pub. L. No. 112-106, 126 Stat. 306. Pursuant to Title II of the JOBS Act, the Commission adopted new paragraph (c) of Rule 506 of Regulation D, removing the prohibition on general solicitation or general advertising for securities offerings relying on Rule 506. *See* SEC Rel. No. 33-9415 (July 10, 2013). Pursuant to Title IV of the JOBS Act, the Commission amended Regulation A in order to permit issuers to raise up to $50 million annually. SEC Rel. No. 33-9741 (March 25, 2015) ("2015 Regulation A Release"). Pursuant to Title III of the JOBS Act, the Commission adopted rules permitting companies to use the Internet to offer and sell securities through crowdfunding ("Regulation Crowdfunding"). *See* SEC Rel. No. 33-9974 (Oct. 30, 2015) ("Regulation Crowdfunding Adopting Release").

7 *See, e.g.,* ALA. CODE § 8-6-11 (2014); ARIZ. REV. STAT. ANN. § 44-1844 (2015); COLO. REV. STAT. § 11-51-304(6) (2014); FLA. STAT. § 571.021, 517.061, 517.0611, 517.12, 517.121, 517.161, 626.9911; IND. CODE § 6-3.1-24-14 (2014); KY. REV. STAT. ANN. § 292.410-292.415 (2015); ME. REV. STAT. ANN. tit. 32, § 16304, sub-§6-a (2014).

8 *See, e.g.,* D.C. MUN. REGS. tit. 26-B, § 250 (2014); GA. COMP. R. & REGS. 590-4-2-.08 (2011); IDAHO CODE ANN. § 30-14-203 (providing an exemption by order on a case-by-case basis); KAN. ADMIN. REGS. § 81-5-21 (2011).

We propose to modernize and expand Rule 147 under the Securities Act, a safe harbor for intrastate offerings exempt from registration pursuant to Securities Act Section 3(a)(11).[9] Consistent with the suggestions of market participants and state securities regulators,[10] the proposal would expand upon the statutory exemption in order to modify certain regulatory requirements of the rule that no longer comport with modern business practices or communications technology, thereby limiting the utility of the safe harbor for intrastate offerings, particularly in offerings by issuers seeking to raise capital pursuant to recently adopted crowdfunding provisions under state securities laws. The proposed amendments would eliminate the current restriction on offers, while continuing to require that sales be made only to residents of the issuer's state or territory. The proposed amendments also would redefine what it means to be an "intrastate offering" and ease some of the issuer eligibility requirements in the current rule, making the rule available to a greater number of businesses seeking intrastate financing. We also propose to limit the availability of the exemption to offerings that are either registered in the state in which all of the purchasers are resident or conducted pursuant to an exemption from state law registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in a twelve-month period and imposes an investment limitation on investors.

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9 15 U.S.C. 77c(a)(11) (exempting "any security which is a part of an issue offered and sold only to persons resident within a single state or territory, where the issuer of such security is a person residing and doing business within, or, if a corporation, incorporated by and doing business within such state or territory.").

10 *See, e.g.*, Transcript of Record at 78, SEC Advisory Committee on Small and Emerging Companies (June 3, 2015), *available at* http://www.sec.gov/info/smallbus/acsec/acsec-minutes-060315.pdf; State Based Crowdfunding, presentation by Michael S. Pieciak, NASAA Corporate Finance Chair, SEC Advisory Committee on Small and Emerging Companies (June 3, 2015), *available at* http://www.sec.gov/info/smallbus/acsec/state-based-crowdfunding.pdf; Letter from Stanley Keller, Fed. Regulation of Sec. Comm. of the Bus. Law Section of the American Bar Assoc., to Linda C. Quinn and Mary E.T. Beach of the SEC Div. of Corp. Fin. ("ABA Letter"), submitted as appendix to letter from Stanley Keller to the SEC Advisory Committee on Small and Emerging Companies (June 1, 2015), *available at* http://www.sec.gov/comments/265-27/26527-50.pdf.

We also propose to amend Rule 504 of Regulation D under the Securities Act to increase the aggregate amount of securities that may be offered and sold pursuant to Rule 504 in any twelve-month period from $1 million to $5 million and to disqualify certain bad actors from participation in Rule 504 offerings. The proposed increase would facilitate capital formation by increasing the flexibility that state securities regulators have to implement coordinated review programs to facilitate regional offerings.[11] The proposed bad actor disqualification provisions would provide for greater consistency across Regulation D. If adopted, the amendments to Rule 504 could result in the diminished utility of Rule 505, which historically has been little utilized in comparison to Rule 506[12] of Regulation D. We therefore seek comment on whether Rule 505 should be retained in its current or a modified form as an exemption from registration, or repealed.

II. PROPOSED AMENDMENTS TO RULE 147

A. Rationale for Proposed Amendments to Rule 147

The proposed amendments to Rule 147 would establish a new Securities Act exemption for intrastate offerings of securities by companies doing business in-state, including offerings relying upon newly adopted and proposed crowdfunding provisions under state securities laws.

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[11] The state registration of securities offerings under coordinated review programs are examples of efforts undertaken by states to streamline the state registration process for issuers seeking to undertake multi-state registrations. These programs establish uniform review standards and are designed to expedite the registration process, thereby potentially saving issuers time and money. Participation in such programs is voluntary and imposes no additional costs on issuers. The states have created coordinated review protocols for equity, small company and franchise offerings; direct participation program securities; and for certain offerings of securities pursuant to Regulation A. For more information on coordinated review programs, *see* *http://www.nasaa.org/industry-resources/corporation-finance/coordinated-review/.*

[12] For the period 2009 through 2014, 109,237 Forms D were filed, of which 1,409 reported an offering made in reliance upon Rule 505 of Regulation D, representing 1% of all offerings made in reliance upon Regulation D during this time period and 2% of all Regulation D offerings raising less than $5 million. During this same time period, 3,789 filings reported an offering made in reliance upon Rule 504, representing 3% of all offerings made in reliance upon Regulation D during this time period and 10% of all Regulation D offerings raising less than $1 million. The vast majority of Form D filings during this period reported an offering made in reliance on Rule 506.

The proposed amendments seek to modernize Rule 147, while retaining the underlying intrastate character of Rule 147 that permits companies to raise money from investors within their state pursuant to state securities laws without concurrently registering the offers and sales at the federal level.

Securities Act Section 3(a)(11) provides an exemption from registration under the Securities Act for, "[a]ny security which is part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory."[13] In 1974, the Commission adopted Rule 147 under the Securities Act to provide objective standards for local businesses seeking to rely on Section 3(a)(11).[14] The Rule 147 safe harbor was intended to provide assurances that the intrastate offering exemption would be used for the purpose Congress intended in enacting Section 3(a)(11), namely the local financing of companies by investors within the company's state or territory.[15] Nothing in Rule 147 obviates the need for compliance with any state law relating to the offer and sale of the securities[16] and nothing in our proposed amendments would affect continued compliance with such laws.

Section 3(a)(11) and the Commission's Rule 147 safe harbor limit both *offers* and *sales* to residents of the same state or territory in which the issuer is resident and doing business.

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13 15 U.S.C. 77c(a)(11).

14 SEC Rel. No. 33-5450 (Jan. 7, 1974) [39 FR 2353 (Jan. 21, 1974)] ("Rule 147 Adopting Release"); SEC Rel. No. 33-5349 (Jan. 8, 1973) [38 FR 2468 (Jan. 26, 1973)] ("Rule 147 Proposing Release").

15 *See* Rule 147 Adopting Release. *See also* H.R. REP. NO. 73-85, at 6-7 (1933), H.R. REP. NO. 73-1838, at 40-41 (1934) (Conf. Rep.) and SEC Rel. No. 33-4434, at 4 (Dec. 6, 1961) [26 FR 11896 (Dec. 13, 1961)] ("1961 Release").

16 *See* 17 CFR 230.147 (Preliminary Note 2).

Rule 147 also includes prescriptive threshold requirements that an issuer must satisfy in order to be considered "doing business" in-state. To satisfy these requirements, an issuer must, among other things:

- derive at least 80% of its consolidated gross revenues in-state;
- have at least 80% of its consolidated assets in-state; and
- intend to use and use at least 80% of the net proceeds from an offering conducted pursuant to Rule 147 in connection with the operation on an in-state business or real property.[17]

Market participants and commenters have indicated that the combined effect of Section 3(a)(11)'s statutory limitation on offers and the prescriptive threshold requirements of Rule 147 unduly limit the availability of the exemption for local companies that would otherwise conduct intrastate offerings.[18] For example, market participants and commenters have noted that the use of the Internet for offerings makes it difficult for issuers to limit offers to in-state residents.[19] These concerns, in addition to developments in communication technologies and the increasing interstate nature of small business activities that have occurred since Section 3(a)(11) was enacted and Rule 147 was originally adopted, suggest that the current limitations are in need of modernization.[20]

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17 17 CFR 230.147(c)(2)(i)-(iii).

18 *See* note 10 above.

19 *See, e.g.*, Transcript of Record at 84, SEC Advisory Committee on Small and Emerging Companies (June 3, 2015).

20 Rule 147 has not been substantively changed since it was adopted in 1974.

A number of states have adopted and/or enacted crowdfunding[21] provisions in their rules or statutes, which may serve as another valuable tool small companies can use to raise capital.[22] Other states have similar forms of state-based crowdfunding bills pending.[23] State-based crowdfunding provisions generally require that an issuer, in addition to complying with various state-specific requirements to qualify for the exemption,[24] also comply with Section 3(a)(11) and Rule 147.[25] The Commission has received feedback from state securities regulators and market participants, however, who have indicated that the current statutory requirements in Section 3(a)(11) and regulatory requirements in Rule 147 make it difficult for issuers to take advantage of these new state crowdfunding provisions.[26]

The most common concerns expressed about Rule 147 are:

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21 As the Commission noted in its proposing release for the rules implementing Title III of the JOBS Act, crowdfunding is a relatively new and evolving method to raise money using the Internet. Crowdfunding serves as an alternative source of capital to support a wide range of ideas and ventures. An entity or individual raising funds through crowdfunding typically seeks small individual contributions from a large number of people. *See* SEC Rel. No. 33-9470 (Oct. 23, 2013) [79 FR 66428 (Nov. 5, 2013)].

22 As of the date of this proposal, data from the North American Securities Administrators Association ("NASAA") indicates that 29 states and the District of Columbia have enacted some form of a state-based crowdfunding exemption to state registration either through legislation, regulation or administrative orders. *See* notes 7-8 above; *see also* Intrastate Crowdfunding Directory, NASAA, http://www.nasaa.org/industry-resources/corporation-finance/instrastate-crowdfunding-resource-center/intrastate-crowdfunding-directory/.

23 *See, e.g.*, Intrastate Crowdfunding Legislation, prepared by NASAA, *available at* http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2014/12/NASAA-Crowdfunding-Index_8-1-2015a1.pdf (summarizing the latest developments in intrastate crowdfunding, including the status of proposed state intrastate crowdfunding legislation and regulations).

24 *See, e.g.*, ALA. CODE § 8-6-11 (2014) (aggregate offering limits); ARIZ. REV. STAT. ANN. § 44-1844 (2015) (investor limits); FLA. STAT. §§ 571.021, 517.061, 517.0611, 517.12, 517.121, 517.161, 626.9911 (2015) (audited financial statement requirements); IND. CODE § 6-3.1-24-14 (2014) (state filing requirements); KY. REV. STAT. ANN. §§ 292.410-292.415 (2015) (delivery of a disclosure document).

25 Of the 29 states and the District of Columbia that have adopted intrastate crowdfunding provisions, only Maine allows an issuer to rely upon a federal exemption other than a combination of Securities Act Section 3(a)(11) and Rule 147, namely the exemption provided by Rule 504 of Regulation D. *See* ME. REV. STAT. tit. 32, § 16304(6-A)(D) (2013).

26 *See* note 18 above. *See also* Recommendation to the Commission by the Advisory Committee on Small and Emerging Companies (Sept. 23, 2015), *available at http://www.sec.gov/info/smallbus/acsec/acsec-recommendation-modernize-rule-147.pdf*.

- the limitation of offers to in-state residents only, which raises questions about the proper use of the Internet for these offerings;
- the limitation of eligible issuers only to those that are incorporated or organized in-state, which excludes local issuers with local operations that incorporate or organize in a different state for business reasons; and
- the limitation of eligible issuers only to those that can satisfy each of the three 80% thresholds concerning their revenues, assets and use of net proceeds in order for the issuers to be deemed "doing business" within a state or territory, which unduly restricts the local businesses that may rely upon the exemption for local financings in their home state or territory.[27]

The proposed amendments to Rule 147 would amend these requirements and revise the rule to allow an issuer to engage in any form of general solicitation or general advertising, including the use of publicly accessible Internet websites, to offer and sell its securities, so long as all sales occur within the same state or territory in which the issuer's principal place of business is located, and the offering is registered in the state in which all of the purchasers are resident or is conducted pursuant to an exemption from state law registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in a twelve-month period and imposes an investment limitation on investors. The proposed amendments would define an issuer's principal place of business as the location in which the officers, partners, or managers of the issuer primarily direct, control and coordinate the activities of the issuer and further require the issuer to satisfy at least one of four threshold

[27] *Id.*

requirements that would help ensure the in-state nature of the issuer's business.[28] As proposed, certain provisions of existing Rule 147 regarding legends and mandatory disclosures to purchasers and prospective purchasers would continue to apply to offerings conducted pursuant to the exemption.[29] In addition, any offer or sale under the proposed amendments to Rule 147 would need to comply with state securities laws.

B. Explanation of Proposed Amendments to Rule 147

As noted above, Rule 147 was adopted as a safe harbor for compliance with Section 3(a)(11). Our proposed amendments to the rule, however, would allow an issuer to make offers accessible to out-of-state residents and to be incorporated out-of-state, so long as sales are made only to in-state residents and the issuer's principal place of business is in-state and it satisfies at least one additional requirement that would further demonstrate the in-state nature of the issuer's business. As proposed, an issuer would only be able to avail itself of the proposed exemption if the offering is registered in the state in which all of the purchasers are resident or is conducted pursuant to an exemption from state law registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in a twelve-month period and imposes an investment limitation on investors. Rule 147, as proposed to be amended, would no longer fall within the statutory parameters of Section 3(a)(11).[30] Accordingly, we propose to amend Rule 147 to create an exemption pursuant to our general exemptive authority under Section 28 of the Securities Act.[31] As amended, Rule 147 would

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28 *See* proposed Rule 147(c).

29 *See* proposed Rule 147(f).

30 Issuers that seek guidance on how to comply with Section 3(a)(11) after the adoption of any final rules amending Rule 147, as proposed, would continue to be able to rely on judicial and administrative interpretive positions on Rule 147 issued prior to the effectiveness of any such final rules.

31 15 USC 77z-3.

function as a separate exemption from Securities Act registration rather than as a safe harbor under Section 3(a)(11).[32] The proposed amendments, if adopted, would not alter the fact that the Section 3(a)(11) statutory exemption continues to be a capital raising alternative for issuers with local operations seeking local financing.

1. Elimination of Limitation on Manner of Offering

To satisfy Section 3(a)(11) and the current Rule 147 safe harbor, all of the securities in an offering must be both offered *and* sold exclusively to residents of the state or territory in which the issuer is resident and doing business. While the language limiting offers and sales to in-state residents in the statute and rule is clear, the legislative history of Section 3(a)(11), its subsequent amendments, and prior Commission guidance have created some uncertainty as to the scope of permissible offers that may be made pursuant to the exemption.

When Congress enacted Section 3(a)(11) in 1934, the legislative history stated, among other things, that "a person who comes within the purpose of the exemption, but happens to use a newspaper for the circulation of his advertising literature, which newspaper is transmitted in interstate commerce, does not thereby lose the benefits of the exemption."[33] Consistent with this statement, the Commission in 1937 released staff guidance on the nature of the Section 3(a)(11) exemption in the form of a letter from the Commission's General Counsel.[34] In this letter, the General Counsel stated that, "the so-called 'intrastate exemption' is not in any way dependent

[32] As noted above, our proposed amendments to Rule 147 are intended, in part, to facilitate the use of state-based crowdfunding statutes. Because many state statutes and rules require issuers to comply with the requirements of both Section 3(a)(11) and Rule 147, states should consider whether our proposed amendments to Rule 147 would require additional amendments to their respective statutes or rules to allow issuers to comply with requirements at both the state and federal level.

[33] *See* H.R. Rep. No. 73-1838, at 40-41 (1934) (Conf. Rep.). Section 3(a)(11) initially was enacted as Securities Act Section 5(c). When Congress enacted the Securities Exchange Act of 1934, it also amended the Securities Act, including revising and re-designating Section 5(c) as Section 3(a)(11).

upon absence of use of the mails or instruments of transportation or communication in interstate commerce in the distribution."[35] Rather, the letter explained that, so long as all the statutory requirements of the exemption are satisfied, such securities may be offered and sold through the mails and may even be delivered in interstate commerce to purchasers, if such purchasers, though resident, are temporarily out of the state. In this context, the letter further noted that securities exempt from registration pursuant to Section 3(a)(11) "may be made the subject of general newspaper advertisement (provided the advertisement is appropriately limited to indicate that offers to purchase are solicited only from, and sales will be made only to, residents of the particular state involved)."[36]

The Commission released further guidance on Section 3(a)(11) in 1961 that restated the staff guidance in the 1937 Letter of General Counsel.[37] In its 1961 Release, the Commission explained that in order "[t]o give effect to the fundamental purpose of the exemption, it is necessary that the entire issue of securities shall be offered and sold to, and come to rest only in the hands of residents within the state. If any part of the issue is offered or sold to a non-resident, the exemption is unavailable not only for the securities so sold, but for all securities forming a part of the issue, including those sold to residents."[38]

As noted above, however, market participants and commenters have indicated that Section 3(a)(11)'s statutory limitation on offers unduly limits the availability of the exemption,

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[34] *See* SEC Rel. No. 33-1459 (May 29, 1937) [11 FR 10958 (Sept. 27, 1946)] ("1937 Letter of General Counsel").

[35] *Id.*

[36] *Id.*

[37] *See* 1961 Release at 4.

[38] *Id.*; *see also* 1937 Letter of General Counsel (stating that Section 3(a)(11) is "limited to case in which the entire issue of securities is offered and sold exclusively to residents of the state in question.").

for example, by limiting the manner in which issuers may communicate with or locate potential in-state investors over the Internet.[39] Rule 147, as proposed to be amended, would require issuers to limit sales to in-state residents, but would no longer limit offers by the issuer to in-state residents.[40] Accordingly, amended Rule 147 would permit issuers to engage in general solicitation and general advertising that could reach out-of-state residents in order to locate potential in-state investors using any form of mass media, including unrestricted, publicly available websites, to advertise their offerings, so long as all sales of securities so offered are made to residents of the state or territory in which the issuer has its principal place of business.

Given that amended Rule 147 would allow offers to be accessible by out-of-state residents, the proposed amendments would require an issuer to include a prominent disclosure on all offering materials used in connection with a Rule 147 offering, stating that sales will be made only to residents of the same state or territory as the issuer.[41] This proposed disclosure requirement is intended to advise investors who are not residents of the state in which sales are being made that the intrastate offering would be unavailable to them.

Request for Comment

1. Should we amend Rule 147 to eliminate the limitation on offers to in-state residents, as proposed? Why or why not? Please explain.
2. Should we retain the existing safe harbor and create a new rule pursuant to our authority under Section 28 to reflect our proposed revisions? Why or why not? How would our proposed revisions interact with other recent rules adopted pursuant to the JOBS Act, if at all?

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39 *See, e.g.*, notes 10 and 19 above.

40 *See* proposed Rule 147(d).

3. Should we adopt the proposed disclosure requirement for all offering materials used in reliance on this rule? Why or why not? Should we require additional or different disclosure? If so, what language would be appropriate?

2. Elimination of Residence Requirement for Issuers

Rule 147 currently requires issuers to be incorporated or organized under the laws of the state or territory in which the intrastate offering is conducted.[42] This requirement, while based on the language of Section 3(a)(11), is at odds with modern business practice in which issuers incorporate or organize in states other than the state or territory of their principal place of business, for example, to take advantage of well-established bodies of corporate or partnership law.[43] We do not believe that locus of entity formation should affect the ability of an issuer to be considered "resident" for purposes of an intrastate offering exemption at the federal level. Given modern business practices, the current requirement may be unnecessarily restrictive and may limit the usefulness of the exemption.

Therefore, for corporations, limited partnerships, trusts, or other forms of business organizations, we propose to eliminate the current requirement of Rule 147 that limits the availability of the rule to issuers organized in the state in which an offering takes place.[44] Our proposed amendments would expand the universe of eligible issuers by eliminating the current "residence" requirement, while continuing to require that an issuer have a sufficient in-state

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41 *See* proposed Rule 147(f)(3).

42 *See* Rule 147(c)(1)(i) [17 CFR 230.147(c)(1)(i)]. For issuers such as general partnerships or other forms of business organizations that are not organized under any state or territorial law, Rule 147(c)(1)(ii) considers such issuers residents of the state or territory where the issuers' principal offices are located.

43 For example, data provided by issuers in Form D filings with the Commission indicates that approximately 30% of issuers conducting Rule 504 offerings and 62% of issuers conducting either Rule 505 or Rule 506 offerings have a principal place of business in a state other than the issuer's state of incorporation or organization. *See* discussion in Section V below.

44 Rule 147(c)(1)(i).

presence determined by the location of the issuer's principal place of business.[45] In conjunction with the proposed requirement that all purchasers be in-state residents,[46] we believe that requiring an issuer to have an in-state principal place of business and to satisfy at least one additional requirement that demonstrates the in-state nature of the issuer's business should adequately ensure the intrastate nature of the offering, such that state authorities can effectively regulate an issuer's activities and enforce states' securities laws for the protection of resident investors.

The proposed amendments also would replace the current rule's "principal office" requirement for an issuer, such as a general partnership or other form of business organization that is not organized under any state or territorial law,[47] with the proposed "principal place of business" requirement.[48]

Request for Comment

4. Should we amend Rule 147 to eliminate the requirement that entities be incorporated or organized under the laws of the state in which the offering takes place, as proposed? Additionally, should we limit availability of the exemption to issuers organized or incorporated in the United States or one of its territories? Why or why not? Please explain.

5. Should we amend Rule 147, as proposed, to eliminate the current issuer residence requirement, while continuing to require an issuer to have a principal place of business

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45 *See* proposed Rule 147(c)(1). *See also* discussion on principal place of business in Section II.B.3. below, and the related discussion of the proposed requirement that an issuer satisfy at least one of four threshold requirements in order to help ensure the in-state nature of its business.

46 *See* discussion in Section II.B.1.

47 Rule 147(c)(1)(ii).

48 *See* proposed Rule 147(c)(1).

in the state in which an intrastate offer and sale takes place? Would this requirement, in conjunction with the additional proposed requirements for an issuer to demonstrate the in-state nature of its business[49] and the requirement that all purchasers be in-state residents,[50] adequately ensure the intrastate nature of the offering such that a state can effectively regulate an issuer's activities?

6. In addition to requiring that an issuer have its principal place of business in the state where the offer and sale occurs, should we also require that the issuer be registered in-state as an out-of-state entity and/or that the issuer have obtained all licenses and registrations necessary to lawfully conduct business in-state? Why or why not?

3. Requirements for Issuers "Doing Business" In-State

The Section 3(a)(11) intrastate offering exemption allows businesses to raise money within the state from investors who are more likely than those outside the state to be familiar with the issuer and its management. Accordingly, the doing business requirement of Section 3(a)(11) has traditionally been viewed strictly.[51] In adopting Rule 147, the Commission adhered to the concepts in existing court and Commission interpretations of Section 3(a)(11) that not only should the issuer's business be physically located within the state, but the principal or

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[49] *See* discussion in Section II.B.3 (Requirements for Issuers "Doing Business" In-State) below.

[50] *See* note 46 above.

[51] Rule 147 Adopting Release at 3.

predominant business must be carried on there[52] and substantially all of the proceeds of the offering must be put to use within the state.[53]

Rule 147 followed these concepts by setting forth three 80% threshold tests for the issuer to be deemed "doing business" in-state. Specifically, Rule 147(c)(2) deems an issuer to be doing business in-state if its principal office is located within the state and at least:

- 80% of its consolidated gross revenues are derived from the operation of a business or of real property located in or from the rendering of services within such state or territory;
- 80% of its consolidated assets are located within such state or territory; and
- 80% of the net proceeds from the offering are intended to be used by the issuer, and are in fact used, in connection with the operation of a business or of real property, the purchase of real property located in, or the rendering of services within such state or territory.[54]

We propose to simplify the doing business in-state determination by amending the current rule requirements so that an issuer's ability to rely on the rule would be based on the location of the issuer's principal place of business, as opposed to its "principal office."[55] For purposes of the rule, we propose to define the term "principal place of business" to mean the

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[52] *Id.* at 3, n. 4, *citing,* Chapman v. Dunn, 414 F.2d 153 (6th Cir. 1969). *See also* 1961 Release at 2 ("In view of the local character of the Section 3(a)(11) exemption, the requirement that the issuer be doing business in the state can only be satisfied by the performance of substantial operational activities in the state of incorporation. The doing business requirement is not met by functions in the particular state such as bookkeeping, stock record and similar activities or by offering securities in the state.").

[53] *Id.* at 3, n.5, *citing,* SEC v. Truckee Showboat, Inc., 157 F.Supp. 824 (S.D. Cal. 1957). *See also* 1961 Release at 2 ("If the proceeds of the offering are to be used primarily for the purpose of a new business conducted outside of the state of incorporation and unrelated to some incidental business locally conducted, the exemption should not be relied upon.").

[54] 17 CFR 230.147(c)(2).

[55] *See* 17 CFR 230.147(c)(2)(iv). We note that the issuer's "principal place of business" is conceptually consistent with the current rule's requirement that the "principal office" of the issuer be located within the

location from which the officers, partners, or managers of the issuer primarily direct, control and coordinate the activities of the issuer.[56] As defined, an issuer would only be able to have a "principal place of business" within a single state or territory and would therefore only be able to conduct an offering pursuant to amended Rule 147 within that state or territory. Issuers also would be required to register the offering in the state in which all of the purchasers are resident, or rely on an exemption from registration that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in a twelve-month period and imposes an investment limitation on investors.[57]

As discussed more fully in Section II.B.4.c below, we believe that our rules should continue to require that the securities sold in an intrastate offering in one state should have to come to rest within such state before sales are permitted to out-of-state residents.[58] Consistent with this view, we propose to limit the ability of an issuer that has changed its principal place of business to conduct an intrastate offering in a different state until such time as the securities sold in reliance on the proposed exemption in the prior state have come to rest in that state.[59] For these purposes, we propose that issuers that have changed their principal place of business after making sales in an intrastate offering pursuant to proposed Rule 147 would not be able to conduct an intrastate offering pursuant to proposed Rule 147 in another state for a period of nine

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state or territory of the offering. *See* proposed Rule 147(c)(1). *See also* related discussion on issuer residency requirements in Section II.B.2 and note 47 above.

56 Proposed Rule 147(c)(1). The proposed principal place of business definition is consistent with the use of that term in Exchange Act Rule 3a71-3, 17 CFR 240.3a71-3, for cross-border security based swap dealing activity and the use of the term "principal office and place of business" in Investment Advisers Act Rule 203A-3(c), 17 CFR 275.203A-3(c).

57 *See* discussion in Section II.B.f (State Law Requirements) below.

58 *See* 1961 Release at 4.

59 *See* proposed Rule 147(e) (proposing to limit resales of a given security purchased in an offering pursuant to Rule 147 to out-of-state residents for a nine-month period from the date such security is sold by the issuer).

months from the date of the last sale in the prior state, which is consistent with the duration of the resale limitation period specified in proposed Rule 147(e).[60]

Additionally, we propose to require issuers to satisfy an additional criterion that we believe would provide further assurance of the in-state nature of the issuer's business within the state in which the offering takes place. For these purposes, we propose to retain the 80% threshold tests of the current rule in modified form with the addition of an alternative test based on the location of a majority of the issuer's employees.[61] While the substance of the 80% threshold requirements of current Rule 147(c)(2) would be retained in the proposed rules, we propose to make compliance with any one of the 80% threshold requirements sufficient to demonstrate the in-state nature of the issuer's business. This would be a change to the current test, which requires issuers to meet all three conditions. We further propose to make certain technical revisions to the existing 80% thresholds that would simplify the structure, and clarify the application, of the rules.[62] In light of our proposal to require issuers to satisfy only one of the threshold tests, we propose to eliminate the current provision in Rule 147(c)(2)(i)(B), which does not apply the revenue test to issuers with less than $5,000 in revenue during the prior fiscal year.[63] While this accommodation may be reasonable in the context of the current conjunctive 80% threshold requirements of Rule 147(c)(2), we do not believe it would be necessary under the

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60 *See* Note 1 to proposed Rule 147(c)(1), specifying that an issuer that has previously conducted an intrastate offering pursuant to proposed Rule 147 may not conduct another intrastate offering pursuant to the exemption, based upon satisfaction of the principal place of business definition in a different state or territory, until the expiration of the time period specified in proposed Rule 147(e), calculated on the basis of the date of the last sale in such offering.

61 *See* proposed Rule 147(c)(2).

62 For example, in order to streamline the presentation of proposed Rule 147(c)(2), we propose to redesignate current Rule 147(c)(2)(i)(A)-(B), 17 CFR 230.147(c)(2)(i)(A)-(B), which includes instructions on how to calculate revenue under Rule 147(c)(2)(i), as a note to the rule.

63 17 CFR 230.147(c)(2)(i)(B).

proposed rule. We further propose to add an alternative requirement to the three modified 80% threshold requirements that relates to the location of a majority of the issuer's employees. This proposed requirement would provide an additional method by which an issuer could demonstrate that it conducts in-state business sufficient to justify reliance on Rule 147, as proposed to be amended. For these purposes, we propose to permit an issuer to satisfy the requirement of proposed Rule 147(c)(2) by having a majority of its employees based in such state or territory.[64] We believe that these proposed requirements would not only provide important indicia of the in-state nature of the issuer's business, but also would provide issuers with additional flexibility to satisfy the proposed requirements, especially in light of the different roles employees play within smaller companies and the different locations at which such roles are carried out.

As proposed, and in addition to the requirement that an issuer have its principal place of business in-state, an issuer would be required to meet at least one of the following requirements:

- The issuer derived at least 80% of its consolidated gross revenues from the operation of a business or of real property located in or from the rendering of services within such state or territory;[65]
- The issuer had at the end of its most recent semi-annual fiscal period prior to the first offer of securities pursuant to the exemption, at least 80% of its consolidated assets located within such state or territory;[66]
- The issuer intends to use and uses at least 80% of the net proceeds to the issuer from sales made pursuant to the exemption in connection with the operation of a business or of real

64 *See* proposed Rule 147(c)(2)(iv).

65 *See* proposed Rule 147(c)(2)(i) and related notes to the rule indicating how and when an issuer would calculate its revenue for purposes of compliance with the proposed rule, based on when the first offer of securities is made pursuant to the exemption.

property, the purchase of real property located in, or the rendering of services within such state or territory;[67] or

- A majority of the issuer's employees are based in such state or territory.[68]

We believe the proposed amendments would expand capital raising opportunities for companies while continuing to require them to have an in-state presence sufficient to justify reliance on the exemption. Given the increasing "interstate" nature of small business activities, it has become increasingly difficult for companies, even smaller companies that are physically located within a single state or territory, to satisfy all of the residence requirements of current Rule 147(c)(2).[69] The proposed modification of these requirements would facilitate the use of the exemption for capital raising by providing issuers with greater flexibility to comply with the requirements and would help to eliminate potential uncertainty about the availability of the exemption.[70] If we were to adopt a final rule, we expect the staff would undertake to study and submit a report to the Commission no later than three years following the effective date of the amendments on whether this framework appropriately provides assurances that an issuer is doing business in the state in which the offering takes place. The Commission could also independently decide to engage in a retrospective review of the rule at any time.

In addition, states could decide whether to adopt specific additional requirements not specifically contemplated in this proposal that are consistent with their respective interests in

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66 *See* proposed Rule 147(c)(2)(ii).

67 *See* proposed Rule 147(c)(2)(iii).

68 *See* proposed Rule 147(c)(2)(iv).

69 *See* discussion in Section V below.

70 *See, e.g.*, Transcript of Record 82-91, SEC Advisory Committee on Small and Emerging Companies (June 3, 2015); *see also Exempted Transactions Under the Securities Act of 1933*, J. William Hicks, Thomas Reuters/West (2009), Ch. 4 (Intrastate Offerings Under Section 3(a)(11)) at §4:66 (noting confusion and uncertainty in the application of Rule 147's objective standards to specific factual situations).

facilitating capital formation and protecting their resident investors in intrastate securities offerings within their jurisdiction.[71] If we were to adopt a rule in substantially the form proposed today, we believe that states that currently have statutes and/or rules that require compliance with Securities Act Section 3(a)(11) and Rule 147 would need to amend their provisions in order for issuers to fully avail themselves of the new rule.[72] We further believe that, in connection with any such amendment to their statutes and/or rules, states could consider whether any additional requirements should be adopted at the state level to regulate local offerings within their jurisdiction and provide additional investor protections.

Request for Comment

7. Should we amend Rule 147 as proposed to require an issuer to have an in-state principal place of business and satisfy at least one of four alternative requirements that demonstrate the in-state nature of the issuer's business? Why or why not?
8. As proposed, should we limit the ability of issuers that have previously conducted an intrastate offering in reliance on proposed Rule 147, but that have since changed their principal place of business, to conduct an offering in reliance on the proposed rule in a different state until all of the securities sold in a prior intrastate offering have come to rest in the state in which the previous offering took place? Why or why not? Or, would the integration provisions of proposed Rule 147(g) sufficiently prevent an issuer from conducting two intrastate offerings pursuant to proposed Rule 147 within a short period

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[71] States currently employ this approach to varying degrees in their respective state crowdfunding statutes. *See, e.g.*, D.C. MUN. REGS. tit. 26-B, § 250 (2014) (escrow required until minimum offering amount satisfied), IND. CODE § 6-3.1-24-14 (2014) (funding portal required). *See* discussion in Section II.B.f below for specific state law requirements for reliance on the proposed exemption.

[72] *See* note 25 and related discussions in Section II.A above and Section II.B.f below.

of time, such that the proposed limitation would not be necessary? Should the proposed limitation be longer (*e.g.*, 12 months)? Why or why not?

9. Should we modify, as proposed, the current 80% threshold requirements of Rule 147(c)(2)(i)-(iii) to no longer require an issuer to satisfy all of the thresholds and include an alternative requirement based on the location of a majority of the issuer's employees? Why or why not? If not, should we retain the current threshold requirements for an issuer to be deemed "doing business" within a state or territory, but at lower percentage thresholds? If so, please specify the appropriate percentage thresholds. Or should we use different alternative threshold tests than under the current or proposed rules? Please explain.

10. As proposed, if we retain the threshold requirements in modified form, should issuers only be required to meet one or more of the requirements? Should they be required to meet two or more of the requirements? Please explain.

11. Do the proposed 80% threshold requirements provide sufficient guidance to issuers as to how to comply with such requirements? If not, what additional guidance, rules or revisions to the proposed rules should the Commission provide to clarify compliance with the proposed requirements?

12. Is the proposed alternative requirement that an issuer have derived at least 80% of its consolidated gross revenues in-state an appropriate indicator of in-state business activities for purposes of an issuer's eligibility for the proposed exemption? Does this alternative requirement provide sufficient clarity for issuers that would seek to comply with it? As proposed, should this requirement continue to require an issuer to calculate gross revenue on a consolidated basis? Please explain.

13. Is the proposed alternative requirement that the issuer had, at the end of its most recent semi-annual fiscal period prior to an initial offer of securities in any offering or subsequent offering pursuant to the exemption, at least 80% of its consolidated assets located in-state an appropriate indicator of in-state business activities for purposes of an issuer's eligibility for the proposed exemption? Does this alternative requirement provide sufficient clarity for issuers that would seek to comply with it? As proposed, should this requirement continue to require an issuer to calculate assets by including the assets of its subsidiaries on a consolidated basis? Please explain.

14. Is the proposed alternative requirement that the issuer intend to use and use at least 80% of the net proceeds from sales made pursuant to the exemption in connection with the operation of a business or of real property, the purchase of real property located in, or the rendering of services within such state or territory an appropriate indicator of in-state business activities for purposes of an issuer's eligibility for the proposed exemption? Does this alternative requirement provide sufficient clarity for issuers that would seek to comply with it? Please explain.

15. As proposed, and in addition to the proposed alternative 80% threshold requirements, should we add an alternative threshold requirement based on the location of a majority of an issuer's employees? Why or why not?

16. In addition to the requirement in proposed Rule 147(c)(1) that an issuer have a principal place of business in-state, does the proposed requirement that an issuer be able to satisfy the requirements of proposed Rule 147(c)(2) by having a majority of its employees based in such state or territory provide a sufficient basis to determine the in-state nature of the issuer's business? Why or why not? If not, what additional or

alternative criteria could we add to the proposed requirement to provide a sufficient basis?

17. As proposed, should we limit availability of the exemption to those issuers that can satisfy the proposed "principal place of business" definition and at least one of the additional requirements of proposed Rule 147(c)(2) that would demonstrate the in-state nature of the issuer's business? Why or why not? Please explain.

18. Is our proposed definition of "principal place of business" appropriate? Why or why not? Would the proposed definition of "principal place of business" alone adequately establish in-state status for purposes of determining eligibility to conduct an offering pursuant to the exemption at the federal level? Are there any additional or alternative requirements that should be included in the rule to establish in-state status?

4. Additional Amendments to Rule 147

a. Reasonable Belief as to Purchaser Residency Status

Current Rule 147(d) requires that offers and sales of securities pursuant to the rule be made only to persons resident within the state or territory of which the issuer is a resident.[73] Regardless of the efforts an issuer takes to determine that potential investors are residents of the state in which the issuer is a resident, the exemption would be lost for the entire offering if securities are offered or sold to one investor that was not in fact a resident of the state. We believe that this requirement in the current rule is unnecessarily restrictive and gives rise to uncertainty for issuers. We therefore believe it should be changed in the amended rule.

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73 17 CFR 230.147(d).

Consistent with the requirements in Regulation D,[74] we propose to add a reasonable belief standard to the issuer's determination as to the residence of the purchaser at the time of the sale of the securities.[75] As proposed, an issuer would satisfy the requirement that the purchaser in the offering be a resident of the same state or territory as the issuer's principal place of business by either the existence of the fact that the purchaser is a resident of the applicable state or territory, or by establishing that the issuer had a reasonable belief that the purchaser of the securities in the offering was a resident of such state or territory.[76] We believe that permitting issuers to sell on the basis of a reasonable belief of a purchaser's in-state residency status will increase the utility of the exemption by providing issuers with additional certainty about the availability of the exemption.

Consistent with our proposal to permit issuers to satisfy the purchaser residency requirement by establishing a reasonable belief that such purchasers are in-state residents, we propose to eliminate the current requirement in Rule 147 that issuers obtain a written representation from each purchaser as to his or her residence.[77] We believe that this requirement is unnecessary in light of the proposed reasonable belief standard. In the context of the current intrastate exemption, the Commission has previously indicated that "[t]he mere obtaining of formal representations of residence ... should not be relied upon without more as establishing the availability of the exemption."[78] Whether an issuer has formed a reasonable belief that the

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74 Rule 501(a) of Regulation D includes in the definition of "accredited investor," persons who come within the enumerated categories of the rule, or who the issuer reasonably believes come within any of such categories, at the time of sale to such person. [17 CFR 230.501(a)].

75 *See* proposed Rule 147(d).

76 *Id.*

77 17 CFR 230.147(f)(1)(iii).

78 *See* 1961 Release at 3.

prospective purchaser is an in-state resident would need to be determined on the basis of all facts and circumstances. Such facts and circumstances could include, but would not be limited to, for example, a pre-existing relationship between the issuer and the prospective purchaser that provides the issuer with sufficient insight and knowledge as to the prospective purchaser's primary residence so as to enable the issuer to establish a reasonable basis to believe that the prospective purchaser is an in-state resident. An issuer may also consider other facts and circumstances establishing the residency of a prospective purchaser, such as evidence of the home address of the prospective purchaser as documented by a recently dated utility bill, pay-stub, information contained in state or federal tax returns, or any state-issued documentation, such as a driver's license or identification card.

Additionally, we are concerned that maintaining the current requirement for an issuer to obtain a written representation from purchasers of in-state residency status may cause confusion with the proposed reasonable belief standard. Issuers, particularly smaller issuers likely to conduct intrastate offerings, may mistakenly believe that obtaining a written representation from purchasers of in-state residency status would, without more, be sufficient to establish a reasonable belief that such purchasers are in-state residents, which, as noted above, would not be the case. For these reasons, we propose to eliminate the requirement that issuers obtain a written representation from purchasers as to their in-state residency. We are, however, seeking comment on whether this requirement should be retained.

Request for Comment

19. Should we add a reasonable belief standard to the issuer's determination as to the residence of the purchaser at the time of the sale of the securities, as proposed? Why or why not?

20. Should we eliminate the requirement to obtain a written representation from the purchaser, as proposed? Why or why not? Alternatively, should we retain the requirement to obtain a written representation but supplement it with a reasonable belief standard? Why or why not? What additional benefit, if any, would be provided by supplementing the current written representation requirement with a reasonable belief standard?

21. Should the rules provide a safe harbor for determining an individual purchaser's residence, based upon certain objective criteria, such as: (1) the jurisdiction in which a person owns or leases its primary home, (2) the jurisdiction in which a person maintains certain other indicia of residence (such as a driver's license, voting registration, tax situs), or (3) the jurisdiction in which a person's principal occupation is based? Why or why not? Are there other criteria that should be used to establish such a safe harbor?

b. Residence of Entity Purchasers

The proposed amendments also would define the residence of a purchaser that is a legal entity, such as a corporation, partnership, trust or other form of business organization, as the location where, at the time of the sale, the entity has its principal place of business.[79] The proposed amendments define a purchaser's "principal place of business," consistent with the proposed definition for issuer eligibility purposes, as the location in which the officers, partners, or managers of the entity primarily direct, control and coordinate the activities of the issuer.[80]

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[79] *See* proposed Rule 147(d). Under the current rule, an entity is a resident of the state or territory where the entity has its "principal office." We have not defined "principal office." Rule 147(c)(2)(iv) [17 CFR 230.147(c)(2)(iv)].

[80] *See* proposed Rule 147(c)(1).

Request for Comment

22. Should we define the residence of a purchaser that is a legal entity, such as a corporation, partnership, trust or other form of business organization, as the location where, at the time of the sale, the entity has its principal place of business? Why or why not? Should we define principal place of business differently for this purpose? If so, how should we define it?

23. Current Rule 147(d)(3) provides that an entity organized for the specific purpose of acquiring the securities offered pursuant to the rule is not treated as a resident of the state or territory unless all of the beneficial owners of such organization are also residents of such state or territory.[81] Should we revise the rule to base the test upon the location of the principal place of business of the specific purpose entity, as opposed to the residency of all of its beneficial owners? Why or why not?

c. Limitation on Resales

Under current Rule 147(e), "during the period in which securities that are part of an issue are being offered and sold by the issuer, and for a period of nine months from the date of the last sale by the issuer of such securities, all resales of any part of the issue, by any person, shall be made only to persons resident within such state or territory."[82] The limitation on resales in Rule 147(e), which is also a condition that must be satisfied in order for the issuer to be able to rely on the safe harbor,[83] is designed to help ensure that the securities issued in an intrastate offering have come to rest in the state of the offering before any potential redistribution out-of-

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81 17 CFR 230.147(d)(3).

82 17 CFR 230.147(e).

83 *See* Rule 147(a), 17 CFR 230.147(a).

state.[84] While this requirement may be appropriate for purposes of compliance with a safe harbor under Section 3(a)(11), we believe it is unduly restrictive[85] and that its application in Rule 147 can give rise to uncertainty for issuers in the offering process by conditioning the availability of the safe harbor on circumstances beyond the issuer's control. We therefore propose to amend both the substance and application of Rule 147(e).

As the Commission previously noted when discussing resales pursuant to Section 3(a)(11), the requirement that the entire distribution of securities pursuant to the intrastate exemption be offered and sold to in-state residents should not be read to suggest "that securities which have actually come to rest in the hands of resident investors, such as persons purchasing without a view to further distribution or resale to non-residents, may not in due course be resold by such persons, whether directly or through dealers or brokers, to non-residents without in any way affecting the exemption."[86]

The Commission's approach in the 1961 Release reflects the view that the determination as to when a given purchase of securities in an intrastate offering has come to rest in-state depends less on a defined period of time after the final sale by the issuer in such offering than it does on whether a resident purchaser—that seeks to resell any securities purchased in such an offering—has taken the securities "without a view to further distribution or resale to non-residents."[87] In this regard, we believe that a time-based limitation on potential resales to non-residents of securities purchased in an intrastate offering that relates back to the date of the

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84 *See* 1961 Release at 3.

85 For example, in an offering of securities that takes an issuer one year to complete, a purchaser of securities on day one of the offering must wait twenty-one months before it is able to resell to an investor out-of-state, while the last purchaser in such offering would only be required to wait for a period of nine months before similarly being able to sell to out-of-state purchasers.

86 1961 Release, at 4.

initial purchase by a resident investor from the issuer would more precisely address the concern regarding out-of-state resales.[88]

For these reasons, we propose to amend the limitation on resales in Rule 147(e) to provide that "for a period of nine months from the date of the sale by the issuer of a security sold pursuant to this rule, any resale of such security by a purchaser shall be made only to persons resident within such state or territory, as determined pursuant to paragraph (d) of this rule."[89] We believe that a nine-month limitation on resales by resident purchasers to non-residents would adequately ensure that the securities purchased by such residents were purchased without a view to further distribution to non-residents.[90]

Additionally, as mentioned above, the application of Rule 147(e) in the context of the Section 3(a)(11) safe harbor may give rise to uncertainty in the offering process that we propose to address in the amended rules. Currently, Rule 147(a) requires issuers to comply with all of the terms and conditions of the rule in order for an offering to come within the safe harbor.[91] This provision makes the safe harbor unavailable to an issuer for the entire offering if, regardless of the efforts the issuer takes to ensure that secondary sales comply with the resale limitations,[92] securities are sold in the secondary market before the expiration of the resale period to a person

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87 *Id.*

88 *Id.* ("[i]f the securities are resold but a short time after their acquisition to a non-resident this fact, although not conclusive, might support an inference that the original offering had not come to rest in the state . . ."). The Commission previously has taken a time-based holding period approach, for example, in Securities Act Rule 144, regarding resales of restricted securities issued in private offerings in order to help ensure that resellers of the securities are not engaged in a distribution of securities and, therefore, not considered underwriters of the securities issued under the definition of such term in Securities Act Section 2(a)(11).

89 Proposed Rule 147(e).

90 In such circumstances, resales of securities that were initially purchased in an intrastate offering must themselves be registered or exempt from registration in any state in which such resale takes place.

91 Rule 147(a), 17 CFR 230.147(a).

92 *See, e.g.*, Rule 147(f) (requiring legends and stop transfer instructions to the issuer's transfer agent).

that is not in fact an in-state resident. The application of Rule 147(e) in the overall scheme of the safe harbor can therefore cause uncertainty for issuers during, and for a period of nine months after the completion of, the offering about whether the safe harbor is or continues to be available based on circumstances outside of the issuer's control.[93]

While we propose to maintain the resale limitations in Rule 147(e), in the modified form discussed above, we also propose to amend Rule 147(b) so that an issuer's ability to rely on Rule 147 would no longer be conditioned on a purchaser's compliance with Rule 147(e).[94] We believe that this proposed amendment to the application of Rule 147(e), as it relates to Rule 147(b), would increase the utility of the exemption by eliminating the uncertainty created in the offering process for issuers under the current rules. Additionally, we do not believe that eliminating this uncertainty would result in an increased risk of issuer non-compliance with the rules because, as proposed, issuers would remain subject to requirements relating to, for example, in-state sales limitations, and legend, stop transfer instructions for transfer agents, and offeree and purchaser disclosures, in order to satisfy the exemption at the federal level. In addition, issuers would continue to be subject to the antifraud and civil liability provisions of the federal securities laws, as well as state securities law requirements.

Request for Comment

24. Should we amend the rule, as proposed, to impose a limitation on resales by resident purchasers to non-residents based on the date of sale by the issuer to the relevant purchaser rather than based on the date when the offering terminates? Why or why

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93 *See, e.g., Exempted Transactions Under the Securities Act of 1933*, at §4:52. *See also* Section II.B.3 above, discussing related concerns regarding the uncertainty interjected into the offering process by the current 80% requirement as to the issuer's in-state use of proceeds in Rule 147(c)(2)(iii).

94 *See* proposed Rule 147(b). As proposed, current Rule 147(a) would be re-designated as Rule 147(b).

not?

25. Is the proposed nine-month period appropriate? Should it be longer or shorter? If so, what would be the appropriate amount of time (*e.g.*, six months, one year, etc.)?

26. Instead of adopting the limitation on resales proposed in Rule 147(e), should securities issued under amended Rule 147 be considered "restricted securities" under Rule 144(a)(3)?[95] Or is the purpose underlying the limitation on resales in Rule 147 (*i.e.*, that the securities must come to rest in-state before sales to out-of-state residents are permitted) sufficiently distinct from the purpose underlying the limitation on resales of restricted securities such that securities issued in a Rule 147 transaction should not be considered restricted securities? Why or why not?

27. As proposed, should we no longer condition an issuer's ability to satisfy Rule 147 on investor compliance with Rule 147(e)? Why or why not? Are there any risks to investors posed by the proposed revisions to Rule 147(b) that would no longer condition the availability of the rule on an issuer's compliance with Rule 147(e)?

d. Integration

The integration safe harbor of current Rule 147(b)(2) provides that offers or sales of securities that take place either prior to the six-month period immediately preceding, or after the six-month period immediately following, any Rule 147 offering will not be integrated with any offers or sales of securities by the issuer made in reliance on the safe harbor.[96] For offers or sales of securities occurring within the six-month period immediately before or after any offers or sales pursuant to a Rule 147 offering, Preliminary Note 3 to the rule states that the determination

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95 17 CFR 230.144(a)(3).

96 17 CFR 230.147(b)(2); *see also* Rule 147 Adopting Release at 3.

of whether offers and sales of securities are deemed part of the same issue, or should be deemed "integrated," is a question of fact that will depend on the particular circumstances.[97]

Integration safe harbors provide issuers, particularly smaller issuers whose capital needs often change, with valuable certainty about their eligibility to comply with an exemption from Securities Act registration.[98] We believe that, while the existing Rule 147 safe harbor provides issuers with some certainty with respect to the integration of offers or sales of securities within the six-month period immediately preceding and following a Rule 147 offering, amended Rule 147 should reflect the Commission's most recent statements on the subject.[99]

The concept of integration has evolved since the adoption of Rule 147 in 1974,[100] particularly as it relates to the integration of potential offers and sales that occur concurrently with, or close in time with the particular exempt offering being considered.[101] We therefore propose to update the rule's integration provisions by expanding the scope of the current

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97 *See* 17 CFR 230.147 (Preliminary Note 3). Preliminary Note 3 cites to the guidance provided in Release. No. 33-4552, at 3 (Nov. 6, 1962) [27 FR 11316 (Nov. 16, 1962)], in which the Commission describes the traditional five-factor test for integration, and explains that "any one or more of the following factors may be determinative of the question of integration:

1. are the offerings part of a single plan of financing;
2. do the offerings involve issuance of the same class of security;
3. are the offerings made at or about the same time;
4. is the same type of consideration to be received; and
5. are the offerings made for the same general purpose."

98 *See* 2015 Regulation A Release at Section II.B.5. (Integration).

99 *Id.*

100 At the time the Commission adopted Rule 147, the Commission generally deemed intrastate offerings to be "integrated" with those registered or private offerings of the same class of securities made by the issuer at or about the same time. Paragraph (b) of Rule 147 was intended to create greater certainty and to eliminate in certain situations the need for a case-by-case determination of when certain intrastate offerings should be integrated with other offerings, such as those registered under the Act or made pursuant to the exemption provided by Section 3 or 4(a)(2) of the Act. *See* Rule 147 Adopting Release at 3.

101 *See e.g.*, Rule 251(c) of Regulation A [17 CFR 230.251(c)]; 2015 Regulation A Release, at Section II.B.5.; SEC Rel. No. 33-8828, Section II.C.1 (Aug. 3, 2007) [72 FR 45116 (Aug. 10, 2007)]; Rule 701 [17 CFR 230.701].

provision in a manner that is consistent with the Commission's most recently adopted integration safe harbor, Rule 251(c) of Regulation A.[102] We believe that this approach to integration would not only benefit issuers, particularly smaller issuers, by providing valuable certainty as to the availability of an exemption for a given offering, but that such issuers would also benefit from increased consistency in the application of the integration doctrine among the exemptive rules available to smaller issuers.[103]

The proposed Rule 147 safe harbor would include any prior offers or sales of securities by the issuer, as well as certain subsequent offers or sales of securities by the issuer occurring within six months after the completion of an offering exempted by Rule 147. As proposed, offers and sales made pursuant to Rule 147 would not be integrated with:

- Prior offers or sales of securities; or
- Subsequent offers or sales of securities that are:
    - Registered under the Act, except as provided in Rule 147(h);
    - Exempt from registration under Regulation A (17 CFR § 230.251 *et seq.*);
    - Exempt from registration under Rule 701 (17 CFR § 230.701);
    - Made pursuant to an employee benefit plan;
    - Exempt from registration under Regulation S (17 CFR §§ 230.901 through 230.905);
    - Exempt from registration under section 4(a)(6) of the Act (15 U.S.C. 77d(a)(6)); or

102 *See* 17 CFR 230.251(c). Rule 251(c) was originally adopted as an integration safe harbor in 1992. *See* SEC Rel. No. 33-6949 (July 30, 1992) [57 FR 36442 (Aug. 13, 1992)]. The 2015 Regulation A Release did not substantively change Rule 251(c), except for the addition to the safe harbor list of subsequent offers or sales of securities issued pursuant to Securities Act Section 4(a)(6). *See* Rule 251(c)(2)(vi).

- Made more than six months after the completion of an offering conducted pursuant to this rule.[104]

As with Rule 251(c) of Regulation A, the proposed safe harbor from integration provided by proposed Rule 147(g) would expressly provide that any offer or sale made in reliance on the rule would not be integrated with any other offer or sale made either before the commencement of, or more than six months after, the completion of the Rule 147 offering. In other words, for transactions that fall within the scope of the safe harbor, issuers would not have to conduct an independent integration analysis of the terms of any offering being conducted under the provisions of another rule-based exemption in order to determine whether the two offerings would be treated as one for purposes of qualifying for either exemption. This bright-line rule would assist issuers, particularly smaller issuers, in analyzing certain transactions, but would not address the issue of potential offers or sales that occur concurrently with, or close in time after, a Rule 147 offering.

Consistent with the current integration guidance in Preliminary Note 3 to Rule 147, our proposed amendments would clarify that, if the safe harbor does not apply, whether subsequent offers and sales of securities would be integrated with any securities offered or sold pursuant to this rule would depend on the particular facts and circumstances. There would be no presumption that offerings outside the integration safe harbors should be integrated.

An offering made in reliance on Rule 147 would not be integrated with another exempt offering made concurrently by the issuer, provided that each offering complies with the

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[103] *See* Rule 251(c) of Regulation A [17 CFR 230.251(c)]; Rule 701 [17 CFR 230.701].

[104] *See* proposed Rule 147(g).

requirements of the exemption that is being relied upon for the particular offering.[105] For example, an issuer conducting a concurrent exempt offering for which general solicitation is not permitted would need to be satisfied that purchasers in that offering were not solicited by means of the offering made in reliance on amended Rule 147.[106] Alternatively, an issuer conducting a concurrent exempt offering for which general solicitation is permitted would need to comply with the legend and disclosure requirements of proposed Rule 147(f).[107] If the concurrent exempt offering for which general solicitation is permitted imposes additional restrictions on the general solicitation, such as, for example, the limitations imposed on advertising pursuant to Rule 204 of Regulation Crowdfunding, the issuer's general solicitation would not be able to go beyond the more restrictive requirements. Also, an issuer conducting a concurrent Rule 506(c) offering could not include in its Rule 506(c) general solicitation materials an advertisement of a concurrent Rule 147 offering, unless that advertisement also included the necessary disclosure for, and otherwise complied with, Rule 147(f).[108]

Consistent with our approach to integration in Rule 251(c), we are proposing that offers or sales made in reliance on Rule 147 should not be integrated with subsequent offers or sales that are registered under the Securities Act, except as provided under our proposed paragraph (h) to Rule 147, or qualified by the Commission pursuant to Regulation A. While prior offers or sales of securities made in reliance on Rule 147 are currently not integrated with subsequent

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105 We adopted a similar approach to integration in the context of offerings under Regulation A. *See* 2015 Regulation A Release at Section II.B.5.

106 For a concurrent offering under Rule 506(b), an issuer would need to conclude that purchasers in the Rule 506(b) offering were not solicited by means of a general solicitation under amended Rule 147. For example, the issuer may have had a preexisting substantive relationship with such purchasers. Otherwise, the solicitation conducted in connection with the Rule 147 offering may preclude reliance on Rule 506(b). *See also* SEC Rel. No. 33-8828 (Aug. 3, 2007) [72 FR 45116 (Aug. 10, 2007)].

107 *See* proposed Rule 147(f).

108 *See id.*; *see also* discussion in Section II.B.1 above.

Regulation A offerings,[109] we believe that expressly adding subsequent offers or sales of securities made in reliance on Regulation A to the Rule 147 integration safe harbor would provide issuers with clarity and additional certainty about their eligibility to conduct a Rule 147 offering before commencing an offering pursuant to Regulation A. Additionally, we believe that issuers that seek to register offerings under the Securities Act should be encouraged to do so without the risk that prior offers or sales pursuant to Rule 147 could be integrated with such offerings. We are mindful, however, of the risk that offers made pursuant to Rule 147 shortly before a registration statement is filed could be viewed as conditioning the market for that registered offering. Accordingly, proposed Rule 147 would address this risk by excluding from the safe harbor any such offer made to persons other than qualified institutional buyers and institutional accredited investors within the 30-day period before a registration statement is filed with the Commission.[110]

Additionally, subsequent offers or sales pursuant to Securities Act Rule 701 or an employee benefit plan would be included in the proposed Rule 147(g) integration safe harbor. While these types of offerings to employees and to persons that provide similar functions for the issuer may provide the issuer with capital, they are primarily compensatory in nature and benefit the issuer and its employees in a manner that is distinct from other types of securities offerings, such as by aligning employee and company interests. For these reasons, we believe that these types of compensatory employee benefit offerings should be included in the safe harbor, if they occur subsequent to a Rule 147 offering.

109 *See* Rule 251(c)(1) of Regulation A, 17 CFR 230.251(c)(1).

110 In such circumstances, whether an offer made within the thirty-day period before the filing of a registration statement would constitute an impermissible offer for purpose of Securities Act Section 5(c) would be based on the facts and circumstances of such offer.

We also propose to include subsequent offers or sales made pursuant to Regulation S[111] in proposed Rule 147(g), as this exemption is only available for offers and sales of securities that are made outside the United States.[112] Given their offshore character, we do not believe that offerings conducted pursuant to Regulation S should be integrated with previous Rule 147 intrastate offerings.

Additionally, we propose to include in the list of transactions covered by the Rule 147 safe harbor subsequent offers or sales of securities made pursuant to rules we are concurrently adopting today in a companion release for securities-based crowdfunding transactions under Title III of the JOBS Act.[113] Given the unique capital formation method available to issuers and investors in the crowdfunding rules we are adopting and the small dollar amounts involved, we do not propose to integrate offers or sales of such securities issued in federal crowdfunding transactions that occur subsequent to the completion of any offering conducted pursuant to Rule 147.[114]

Request for Comment

28. As proposed, should we include any prior offers or sales of securities made by the issuer before the start of a Rule 147 offering in the Rule 147(g) integration safe harbor? Why or why not?

29. Should the Rule 147(g) integration safe harbor include, as proposed, the list of subsequent offers or sales of securities by the issuer that may be made within six

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111 17 CFR 230.900 through 905.

112 *See* Preliminary Note 6 of Regulation S.

113 *See* Regulation Crowdfunding Adopting Release.

114 *See id.* An issuer contemplating a securities-based crowdfunding transaction pursuant to Section 4(a)(6) subsequent to any offers or sales conducted in reliance on Rule 147, as proposed to be amended, should

months after the termination of the Rule 147 offering without being subject to integration? Why or why not?

30. Should we expand the list of subsequent offers or sales of securities by the issuer that may be made within six months after the termination of the Rule 147 offering without being subject to integration to include other types of offers and sales of securities by the issuer? Alternatively, should we narrow the list of subsequent offers or sales of securities included in the integration safe harbor? Why or why not? Please explain.
31. Should we include language in the rule text expressly stating that an offering made in reliance on Rule 147 would not be integrated with another exempt offering made concurrently by the issuer, provided that each offering complies with the requirements of the exemption that is being relied upon for the particular offering? Why or why not?
32. Should we include a new paragraph (h) to Rule 147, as proposed, concerning offers to investors other than qualified institutional investors and institutional accredited investors within 30 calendar days prior to a registered offering? Why or why not?

e. Other Considerations

Currently, Rule 147(f)(3) requires issuers, in connection with any offers or sales pursuant to the rule, to disclose, in writing, the limitations on resale contained in Rule 147(e)[115] and the requirements for stop transfer instructions for the issuer's transfer agent set forth in Rule 147(f)(1)(i)-(ii).[116] The same requirements apply in connection with the issuance of new certificates for any of the securities that are part of the same issue that are presented for transfer

look to the rules for securities-based crowdfunding transactions to ensure compliance with the advertising provisions of the exemption.

115 17 CFR 230.147(e). *See also* discussion in Section II.B.4.c above.

116 17 CFR 230.147(f)(1)(i)-(ii).

during the period specified in Rule 147(e). We believe that these disclosure requirements provide important protections to investors and issuers alike by helping to ensure that investors understand the limitations and restrictions associated with a purchase of securities pursuant to the rule. Currently, however, the rule does not specifically identify to whom or when such disclosure should be provided.[117] We propose to retain the substance of these requirements, in modified form, in the amended rules, while clarifying the application of the disclosure requirements.[118]

Specifically, we propose to clarify in the text of the amended rule the specific language of the required disclosure and that such disclosure should be prominently provided to each offeree and purchaser at the time any offer or sale is made by the issuer to such person pursuant to the exemption.[119] The rule, however, would no longer require that such disclosure be made in writing in all instances. We propose to amend the current requirement to provide issuers with flexibility by permitting them to provide the required disclosure to offerees in the same manner in which an offer is communicated,[120] while continuing to require written disclosure to all purchasers. We believe that this approach would reduce the compliance obligations of issuers, particularly smaller companies likely to conduct offerings pursuant to the exemption, by no longer requiring disclosure to offerees in writing when offers are communicated orally. As the

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117 *See* 17 CFR 230.147(f)(3).

118 Proposed Rule 147(f)(1)(i) would retain the existing legend requirement for stock certificates but specify the exact language to be provided.

119 Currently, Rule 147(f)(3) requires issuers to disclose the required information "in connection with" any offers or sales of securities but does not specify the time at which such disclosure must be provided to offerees or purchasers. Proposed Rule 147(f)(3) would require issuers to provide the required disclosure to offerees and purchasers at the time of any offers or sales of securities, thereby eliminating the risk that an issuer could, for example, make an offer of securities at one point in time and provide the required disclosures at a later date. *See* proposed Rule 147(f)(3).

120 This proposed approach would be consistent with the treatment of the "testing the waters" legend requirements in Rule 255(b) of Regulation A. *See* 17 CFR 230.255(b).

proposed requirement would apply to every offer of securities by the issuer pursuant to the exemption, including subsequent offers to the same offeree, and in light of the continuing requirement to provide written disclosure to all purchasers of the securities, we do not believe that the easing of the current requirement as it relates to oral offers would result in an increase in risks to investors.

As noted above, we propose to retain the substance of the disclosure requirements of current Rule 147(f)(3), in modified form, in the amended rules. As proposed, Rule 147(f)(3) would require issuers to make specified disclosures to offerees and purchasers about the limitations on resale contained in proposed Rule 147(e) and the legend requirement of proposed Rule 147(f)(1)(i), but would no longer require issuers to disclose to offerees and purchasers the stop transfer instructions provided by an issuer to its transfer agent[121] and the provisions of Rule 147(f)(2) regarding the issuance of new certificates during the Rule 147(e) resale period.[122] Although issuers would have to continue to comply with these requirements,[123] we believe that requiring issuers to disclose that information to offerees and purchasers does not add anything to the existing disclosures under Rules 147(e) and (f)(1), and we therefore propose to eliminate this disclosure requirement from the rule.[124]

Request for Comment

33. As proposed, should we modify the requirements of current Rule 147(f)(3) to require issuers to disclose to offerees and purchasers the resale limitations of Rule 147(e) and

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[121] Rule 147(f)(1)(ii), 17 CFR 230.147(f)(1)(ii).

[122] Rule 147(f)(2), 17 CFR 230.147(f)(2). Additionally, as discussed in Section II.B.1 above, we propose to require issuers in offerings conducted pursuant to Rule 147 to disclose to each offeree in the manner in which any offer is communicated and to each purchaser of a security in writing that sales will be made only to residents of the same state or territory as the issuer. *See* proposed Rule 147(f)(3).

[123] *See* proposed Rule 147(f)(1)(ii) and proposed Rule 147(f)(2).

the legend requirement of Rule 147(f)(1)(i) at the time any such offer or sale is made, but no longer require an issuer to disclose to such persons the stop transfer instructions to its transfer agent, if any, and the provisions of Rule 147(f)(2) regarding the issuance of new certificates during the Rule 147(e) resale period?[125] Or should we preserve the existing rule requirements? Why or why not?

34. As proposed, should we permit the disclosures required by Rule 147(f)(3) to be provided orally? Should we instead require these disclosures to be made in writing, as under the current rule? Alternatively, should we no longer require these disclosures to be provided to offerees, while continuing to require that they be provided to purchasers? Or, prior to making any sales, should we require issuers that only make oral offers to provide, in addition to the required oral disclosure, written disclosure to offerees a reasonable time before any sales are made to such persons? Why or why not?

35. Should the amendments to Rule 147 include a substantial compliance provision, similar to the provision in Rule 508 of Regulation D,[126] or otherwise account for insignificant deviations in a manner that is similar to Rule 260 of Regulation A?[127] In light of the proposal to permit issuers to sell securities pursuant to Rule 147 on the basis of a reasonable belief as to a purchaser's residency status, what additional situations, if any, could a substantial compliance or insignificant deviation rule address? Please explain.

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124 *See* proposed Rule 147(f)(3).

125 *See also* Request for Comment 3 above regarding proposed Rule 147(f)(3) and the requirement that issuers disclose to offerees and purchasers that sales will be made only to residents of the same state or territory as the issuer.

126 17 CFR 230.508.

127 17 CFR 230.260.

36. Should we amend Rule 147 to make the exemption available for secondary distributions? Why or why not?

f. State Law Requirements

We believe the proposed amendments to Rule 147 would facilitate capital formation by smaller companies seeking to raise capital in-state by increasing the utility of the rule while maintaining appropriate protections for resident investors. Consistent with the policy underlying the adoption of objective standards for determining compliance with Section 3(a)(11) in current Rule 147, we believe that the protections afforded to resident investors in an intrastate offering primarily flow from the requirements of state securities law.[128] For example, as with the federal securities laws, states generally require an issuer to register an offering with appropriate state authorities when offers or sales of securities are made to their residents, unless the state has adopted, by rule or statute, an exemption from registration.

As discussed above,[129] in recent years a number of states have adopted and/or enacted provisions in their rules or statutes that generally require an issuer, in addition to complying with various state-specific requirements to qualify for an exemption from registration,[130] to comply with Section 3(a)(11) and Rule 147.[131] Of the states that have adopted and/or enacted provisions that require an issuer to comply with Rule 147, either alone or in conjunction with Section 3(a)(11), no state has adopted and/or enacted a provision with an aggregate offering

128 *See* note 14 above.

129 *See* Section II.A above.

130 *See* note 24 above.

131 *See* note 25 above.

amount that exceeds $4 million.[132] Additionally, almost all of these states have adopted provisions that impose investment limitations on investors.

Rule 147 does not currently have an offering amount limitation and does not currently limit the amount of securities an investor can purchase in an offering pursuant to the rule. Preliminarily, however, we believe that, in light of the proposed changes to Rule 147, which, as noted above, would no longer be a safe harbor for compliance with Section 3(a)(11), a maximum offering amount limitation and investor investment limitations in the rule would provide investors with additional protection and would be consistent with existing state law crowdfunding provisions.[133] As such, we are proposing to limit the availability of Rule 147, as proposed to be amended,[134] to issuers that have registered an offering in the state in which all of the purchasers are resident or that conduct the offering pursuant to an exemption from state law registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in a twelve-month period and that limits the amount of securities an investor can purchase in any such offering.[135] We are particularly interested in getting feedback from the states and market participants, however, and are seeking comment on

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132 *See* http://www.nasaa.org/industry-resources/corporation-finance/instrastate-crowdfunding-resource-center/intrastate-crowdfunding-directory/. Illinois is the only state with a crowdfunding provision allowing for a maximum aggregate offering amount up to $4 million in a twelve-month period. All other states that have adopted some form of a state-based crowdfunding provision limit the aggregate offering amount to between $1 million and $2.5 million. *See* ILLINOIS HOUSE BILL 3429, § 4.T. (2015), *available at*: https://legiscan.com/IL/text/HB3429/id/1257029.

133 States may have non-crowdfunding exemptions for larger offerings and issuers seeking to rely on any such state exemption could continue to conduct the offering pursuant to Section 3(a)(11) or find an alternate federal exemption. *See, e.g.*, Section 202(14) of the Uniform Securities Act of 2002 (exempting transactions to not more than 25 purchasers, other than institutional investors and federal covered investment advisers, that do not utilize a general solicitation or general advertising).

134 *See* discussions in Section II.B.1 through II.B.2.e above for additional limitations and requirements that would apply to offerings conducted pursuant to proposed Rule 147.

135 *See* proposed Rule 147(a).

this issue, including whether additional or alternative requirements should be imposed on offerings conducted pursuant to the proposed rule at the federal level.

State crowdfunding laws allow, and in some states mandate, the use of an intermediary. The intermediary may be a federally registered broker-dealer, or an intrastate broker-dealer that is exempt from federal registration requirements. Section 15(a)(1) of the Exchange Act provides an exemption for a broker-dealer whose business is "exclusively intrastate and who does not make use of any facility of a national securities exchange." In the state crowdfunding context, some intermediaries may be small broker-dealers seeking to only operate intrastate. To the extent that information posted on the Internet in connection with a state crowdfunding offering by an intermediary would be considered an interstate offer of securities, such business would be ineligible for the intrastate broker-dealer exemption. We are seeking comment on these issues, including whether the proposed rule should require issuers to use the services of any such intermediary at the federal level.

Request for Comment

37. Should we limit the availability of Rule 147, as proposed to be amended, to issuers that have registered an offering in the state in which all of the purchasers are resident or that conduct the offering pursuant to an exemption from state law registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in a twelve-month period and the amount of securities an investor can purchase in any such offering? Why or why not?

38. Would the proposed requirements that an issuer conduct the offering pursuant to an exemption from state law registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in a twelve-

month period and that limits the amount of securities an investor can purchase in any such offering provide adequate investor protections at the federal level? Why or why not? Or, are the proposed maximum offering amount and/or investor investment limitations unnecessary at the federal level, in light of the local character of the intrastate offerings that would be conducted pursuant to the proposed rule and the presence of state oversight in such offerings? Please explain.

39. Should Rule 147, as proposed to be amended, specify the maximum offering amount limitation that must be included in a state exemption from registration? Why or why not? Should the proposed $5 million maximum offering amount limitation be adopted at a lower or higher dollar amount? If so, what amount and why? If not, why not?

40. Should Rule 147, as proposed to be amended, itself specify a maximum offering amount limitation for purposes of compliance with the proposed rule at the federal level and, in a change from the proposed rule, no longer require that a maximum offering amount limitation be included in any exemptive provision adopted at the state level? What benefit, if any, is derived from the proposed inclusion of a specified maximum offering amount limitation of not more than $5 million of securities in a twelve-month period at both the state and federal level? Please explain.

41. Should the proposed requirement that a state law exemption from registration impose investment limitations on investors, when the offering is conducted pursuant to proposed Rule 147 at the federal level, include specific maximum dollar amounts that an investor must be subject to or other specific criteria, such as criteria based on an investor's net worth and/or annual income? Why or why not? Please explain.

42. Should Rule 147, as proposed to be amended, include the proposed requirement that a state law exemption include investment limitations in order for the issuer to be able to conduct an intrastate offering pursuant to Rule 147, as proposed to be amended? Why or why not? Please explain.

43. Should we limit the application of the proposed requirement that a state law exemption include investment limitations, in order for the issuer to be able to conduct an intrastate offering pursuant to Rule 147, as proposed to be amended, to non-accredited investors only, while not requiring an accredited investor, as that term is defined in Rule 501(a) of Regulation D,[136] to be subject to an investment limitation? Why or why not?

44. Should the provisions at the federal level allow states to have greater flexibility in drafting exemptive provisions that in their judgment provide sufficient investor protections at the state level, whether or not such state law provisions include a maximum offering amount limitation or investor investment limitations? Why or why not?

45. As an additional or alternative requirement to the current requirements in proposed Rule 147, should we limit the availability of the exemption to issuers that have registered an offering in the state in which all of the purchasers are resident or that conduct the offering pursuant to an exemption from state law registration in such state that requires the use of an intermediary? Why or why not?

46. Should we provide guidance about the operation of the intrastate broker-dealer exemption under the Exchange Act, including with respect to the use of the Internet in connection with offers and sales of securities? Why or why not? Should we permit

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[136] *See* 17 CFR 230.501(a).

intrastate broker-dealers to use the Internet to make interstate offers so long as all sales are limited to intrastate purchasers? Why or why not?

47. Should we adopt any minimum disclosure or delivery requirements for offerings that are conducted pursuant to the proposed rule that are offered pursuant to an exemption from state registration, such as narrative and/or financial statement disclosure and delivery requirements similar to the requirements of Rule 502(b) of Regulation D?[137] Should any potential disclosure or delivery requirements be limited to sales only to non-accredited investors? Why or why not?

48. Whether we adopt the proposed revisions to Rule 147 as amended Rule 147 or as a new rule, should we require a notice filing with the exemption? For example, if we repeal Rule 505 and adopt the exemption as new Rule 505, should we require issuers that conduct offerings pursuant to the new exemption to file offering related information with the Commission on a Form D? Why or why not? Should we instead adopt a new form to file offering related information that is similar to the information disclosed on Form D? If so, what information should that new form elicit?

C. Preservation of Section 3(a)(11) Statutory Intrastate Offering Exemption

The proposed amendments, if adopted, would not alter the fact that the Section 3(a)(11) statutory exemption continues to be a capital raising alternative for issuers with local operations seeking local financing. We believe, however, that it is possible that issuers will find it easier to satisfy the requirements of proposed Rule 147 than Section 3(a)(11).

The proposed amendments to Rule 147 would operate prospectively only. If adopted as proposed, Rule 147 would no longer be a safe harbor for conducting a valid intrastate exempt

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137 17 CFR 230.502(b).

offering under Section 3(a)(11). An issuer that attempts to comply with amended Rule 147, but fails to do so, may claim any other exemption that is available. Failure to satisfy the requirements of amended Rule 147, however, would also likely result in a failure to satisfy the statutory requirements for the intrastate offering exemption under Section 3(a)(11) since the requirements of Section 3(a)(11) are more restrictive.

We recognize that none of the existing state crowdfunding provisions contemplate reliance upon the proposed amendments to Rule 147 and that states that have crowdfunding provisions based on compliance with Section 3(a)(11), or compliance with both Section 3(a)(11) and Rule 147, would need to amend these provisions in order for issuers to take full advantage of these amendments.[138] States that have adopted crowdfunding provisions based on current Rule 147 may need to consider the import of any final rule amendments at the federal level. We are seeking comment on how the amendments to Rule 147 would impact these provisions and whether it would be better if the proposed amendments to Rule 147 were adopted as a new exemption from registration, rather than as amendments to current Rule 147.

Request for Comment

49. Should we leave existing Rule 147 in place and unchanged as a safe harbor for compliance with Section 3(a)(11) while adopting the proposed revisions to Rule 147 as a new rule instead? For example, if we were to repeal Rule 505 of Regulation D,[139] should the Commission adopt the proposed revisions to Rule 147 as new Rule 505 of Regulation D? If so, are there any additional changes to the proposed rule that should

[138] *See* note 25 and related discussion in Section II.A above.

[139] 17 CFR 230.505. *See* discussion in Section III.C below.

be made if it were to be adopted instead as a new rule? If so, please explain what changes are needed and why.

50. States that have adopted crowdfunding provisions based on current Rule 147 may need to consider the import of any final rule amendments at the federal level. How would the proposed amendments to Rule 147 impact these provisions? Would the Commission's rulemaking process, which in this case provides for a 60-day comment period, and the additional time before any final rules potentially would be adopted and thereafter become effective, provide sufficient time for states to consider and address the impact of the proposed amendments on their state law provisions? Why or why not? Please explain.

III. PROPOSED AMENDMENTS TO RULES 504 AND 505 OF REGULATION D

A. Overview of Rules 504 and 505

Rule 504[140] of Regulation D provides issuers with an exemption from registration for offers and sales of up to $1 million of securities in a twelve-month period, provided that the issuer is not:

- subject to reporting pursuant to Section 13 or 15(d) of the Exchange Act;[141]
- an investment company;[142] or
- a development stage company that either has no specific business plan or purpose or that has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies ("blank check company").[143]

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140 17 CFR 230.504.

141 17 CFR 230.504(a)(1).

142 17 CFR 230.504(a)(2). Investment companies are companies that are registered or required to be registered under the Investment Company Act of 1940. 15 U.S.C. 80a-1 *et seq*.

Additionally, Rule 504 imposes certain conditions, including limitations on the use of general solicitation or general advertising in the offering and the restricted status of securities issued pursuant to the exemption, with limited exceptions in this regard for offers and sales made:

- exclusively in one or more states that provide for the registration of the securities, and require the public filing and delivery to investors of a substantive disclosure document before sale that are made in accordance with state law requirements;
- in one or more states that have no provision for the registration of the securities or the public filing or delivery of a disclosure document before sale, if the securities have been registered in at least one state that provides for such registration, public filing and delivery before sale, offers and sales are made in that state in accordance with such provisions, and the disclosure document is delivered before sale to all purchasers (including those in the states that have no such procedure); or
- exclusively according to state law exemptions from registration that permit general solicitation and general advertising so long as sales are made only to "accredited investors" as defined in Rule 501(a) of Regulation D.[144]

Rule 504, together with Rules 505 and 506, comprise the Securities Act exemptions of Regulation D.[145] Adopted by the Commission in 1982,[146] Regulation D replaced three previously existing exemptions with a cohesive set of rules designed to:

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143 17 CFR 230.504(a)(3).

144 17 CFR 230.504(b)(1).

145 17 CFR §230.500 through 508. Rules 501 through 503 contain definitions, conditions, and other provisions that apply generally throughout Regulation D. Rules 504, 505 and 506(c) are exemptions from registration under the Securities Act, while Rule 506(b) is a "safe harbor" for compliance for the non-public offering exemption in Section 4(a)(2) of the Securities Act. Rule 507 disqualifies issuers from relying on Regulation D, under certain circumstances, for failure to file a Form D notice. Rule 508 provides a safe harbor for certain insignificant deviations from a term, condition, or requirement of Regulation D.

- simplify existing rules and regulations;
- eliminate any unnecessary restrictions that those rules and regulations placed on issuers, particularly small businesses; and
- achieve uniformity between state and federal exemptions in order to facilitate capital formation consistent with the protection of investors.[147]

Regulation D offerings are exempt from the registration requirements of the Securities Act. Offerings conducted pursuant to Rule 504 or Rule 505, however, must be registered in each state in which they are offered or sold unless an exemption to state registration is available under state securities laws.[148] The vast majority of states require registration of Rule 504 offerings.[149] One state, however, recently adopted a form of state-based crowdfunding that permits the use of general solicitation, but still exempts the issuances of securities from state registration where, in addition to following various state-specific requirements to qualify for the exemption, an issuer also complies with Rule 504 of Regulation D.[150] Additionally, offerings conducted pursuant to Rules 505 and 506 are subject to bad actor disqualification provisions, while offerings conducted pursuant to Rule 504 are not subject to such provisions.[151]

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[146] *See* SEC Rel. No. 33-6389 (Mar. 8, 1982) [47 FR 11251 (Mar. 16, 1982)].

[147] *Id.* at 2.

[148] Section 18(b)(4)(D) of the Securities Act provides "covered security" status to all securities sold in transactions exempt under Commission rules promulgated under Section 4(a)(2), which includes Rule 506 of Regulation D. Covered security status under Section 18 provides for the preemption of state securities laws registration and qualification requirements for offerings of such securities. In comparison, securities issued pursuant to either Rules 504 or 505 are not covered securities as these two exemptions are adopted pursuant to the Commission's authority under Section 3(b)(1) of the Securities Act.

[149] New York and the District of Columbia do not require registration of Rule 504 offerings. *See* SEC Rel. No. 33-7644, 2 n.12 (Feb. 25, 1999) [64 FR 11090 (Mar. 8, 1999)] ("Seed Capital Release").

[150] Of the 29 states and the District of Columbia that have adopted intrastate crowdfunding provisions, only Maine allows an issuer to rely upon Rule 504 of Regulation D. *See* ME. REV. STAT. tit. 32, § 16304(6-A)(D) (2013).

[151] *See* Rule 505(b)(2)(iii), 17 CFR 230.505(b)(2)(iii), and Rule 506(d), 17 CFR 230.506(d), of Regulation D.

B. Proposed Amendments to Rules 504 and 505

We propose to increase the aggregate amount of securities that may be offered and sold in any twelve-month period pursuant to Rule 504 from $1 million to $5 million and to disqualify certain bad actors from participation in Rule 504 offerings. We believe these amendments to Rule 504 will facilitate capital formation, result in increased efficiencies (and potentially lower costs) to issuers and increase investor protection. We also understand that state securities regulators have sought to expedite the state securities law registration process by developing coordinated review programs.[152] We believe these amendments could give state securities regulators greater flexibility to develop regional coordinated review programs that would rely on Rule 504 at the federal level by increasing the maximum amount of capital that can be raised by issuers under such programs and by providing states with assurance that certain bad actors would be excluded from the exemptive regime at the federal level. We further propose a technical amendment to Rules 504 and 505 to account for the re-designation of Securities Act Section 3(b) as Section 3(b)(1) that occurred as a result of the enactment of the JOBS Act in 2012.[153] Additionally, in order to account for the proposed increase in the Rule 504 aggregate offering amount limitation, we propose technical amendments to the notes to Rule 504(b)(2) that would update the current illustrations in the rule regarding how the aggregate offering limitation is calculated in the event that an issuer sells securities pursuant to Rule 504 and Rule 505 within

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[152] For example, in order to address the potential inefficiencies associated with state law review and qualification of Regulation A offering statements, as highlighted by the GAO Report to Congress required under Title IV of the JOBS Act, state securities regulators and NASAA implemented a streamlined coordinated review program for Regulation A offerings that was designed to address many of the perceived concerns of market participants. *See* Factors that May Affect Trends in Regulation A Offerings, GAO-12-839 (July 2012) *available at*: http://www.gao.gov/assets/600/592113.pdf ("GAO Report"). *See also* note 11 above for a brief description of state coordinated review programs.

[153] Pub. L. No. 112-106, 126 Stat. 306.

the same twelve-month period.[154] We also are seeking comment on whether any additional changes to Rule 504 should be made at this time that would further increase issuer capital formation options without any increase in risks to investors.

In light of the proposed changes to Rule 504, we also seek comment on the continued utility of Rule 505 as an exemption from registration. Rule 505 is used far less frequently than Rule 506, and an increase in the Rule 504 offering ceiling from $1 million to $5 million could diminish its utility.

The proposed amendments to Rule 504 would raise the aggregate amount of securities an issuer may offer and sell in any twelve-month period from $1 million to $5 million, which is the maximum statutorily allowed under Section 3(b)(1).[155] The Commission has not raised the 12-month aggregate offering limit in Rule 504 since 1988, when the Commission increased the original Rule 504 offering limit of $500,000 to $1 million.[156] We believe that raising the aggregate offering limitation to the maximum statutorily allowed under Section 3(b)(1) would facilitate issuers' ability to raise capital. The proposed offering limitation would increase the flexibility of state securities regulators to set their own state offering limitations and to consider whether any additional requirements should be implemented at the state level. In addition, it would facilitate state efforts to increase the efficiencies associated with the registration of securities offerings in multiple jurisdictions through regional coordinated review programs.

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[154] *See* Notes 1 and 2 to Rule 504(b)(2). [17 CFR 230.504(b)(2)].

[155] Rules 504 and 505 were adopted pursuant to the Commission's small issues exemptive authority under Section 3(b)(1) of the Securities Act, which gives the Commission authority to adopt an exemption for offerings not exceeding $5 million where the Commission believes registration under the Securities Act is not necessary by reason of the small amount involved or the limited character of the public offering.

[156] *See* SEC Rel. No. 33-6758 (Mar. 3, 1988) [53 FR 7870 (Mar. 10, 1988)]. *See also* discussion in Section V below.

Much like the deference that Congress provided to the states in the intrastate offering exemption under Section 3(a)(11), in adopting Rule 504, the Commission placed substantial reliance upon state securities laws and regulations.[157] As the Commission has stated previously, we believe that the size and local nature of the smaller offerings that are typically conducted by smaller issuers pursuant to Rule 504 does not warrant imposing extensive regulation at the federal level.[158]

The purpose of Rule 504 is to aid small businesses raising "seed capital."[159] Rule 504 permits eligible issuers[160] to offer and sell securities to an unlimited number of persons without regard to their sophistication, wealth or experience and, in certain circumstances, without delivery of any specified information.[161] These offerings are, however, subject to federal antifraud provisions and civil liability provisions[162] Securities issued under the exemption are restricted,[163] and the offering is subject to the prohibition against general solicitation and general advertising,[164] unless the rule's specified conditions permitting the issuance of freely tradable securities and a public offering are met.[165]

Similar to the rationale underlying our proposal to ease the eligibility requirements for issuers under Rule 147, increasing the Rule 504 offering limit to $5 million would create a larger

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157 Seed Capital Release at 1; *see also* SEC Rel. No. 33-6389 (Mar. 8, 1982) [47 FR 11251 (Mar. 16, 1982)].

158 Seed Capital Release, at 2.

159 *Id.* "Seed capital" refers to the initial investments that are typically made in newly formed startup companies in order to assist such companies with the beginning of their operations. These investments are usually relatively small in total dollar amounts.

160 *See* note 143 and related text in the discussion above.

161 Rule 504 permits sales to an unlimited number of accredited and non-accredited investors. *See* note 105 and related text in the discussion above.

162 Seed Capital Release, at 2. 15 U.S.C. 77*l*(a)(2).

163 *See* Rule 504(b)(1) [17 CFR 230.504(b)(1)]; Rule 144(a)(3)(ii) [17 CFR 230.144(a)(3)(ii)].

164 *See* Rule 504(b)(1) [17 CFR 230.504(b)(1)]; Rule 502(c) [17 CFR 230.502(c)].

federal exemptive framework for state regulators to tailor and coordinate among themselves state specific requirements for smaller offerings by smaller issuers that are consistent with their respective sovereign interests in facilitating capital formation and the protection of investors in intrastate and regional interstate securities offerings. Increasing the offering limit from $1 million to $5 million may also make the Rule 504 exemption more attractive to start-up companies seeking capital financing, as compared to alternative financing methods, as the legal and accounting expenses of the offering may be offset by the larger gross proceeds of the offering to the issuer.

In conjunction with our proposed increase to the Rule 504 aggregate offering amount limitation, we are proposing to adopt provisions that would disqualify certain bad actors from participation in offerings conducted pursuant to the exemption.[166] We believe that the proposed disqualification provisions, which are substantially similar to related provisions in Rule 506 of Regulation D,[167] would create a more consistent regulatory regime across Regulation D that would benefit investors in Rule 504 offerings with increased protections. We also believe that our proposed rule amendments may bolster efforts among the states to enter into, or revise existing, regional coordinated review programs that are designed to increase efficiencies associated with the registration of securities offerings in multiple jurisdictions without increasing risks to investors.

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165 *See* note 144 and related text in the discussion above.

166 *See* proposed Rule 504(b)(3).

167 *See* 17 CFR 230.506(d). *See also* Rule 262 of Regulation A, 17 CFR 230.262, and Rule 505(b)(2)(iii) of Regulation D, 17 CFR 230.505(b)(2)(iii).

The proposed Rule 504 disqualification provisions would be implemented by reference to the disqualification provisions of Rule 506 of Regulation D.[168] We believe that creating a uniform set of bad actor triggering events across the various exemptions from Securities Act registration should simplify due diligence, particularly for issuers that may engage in different types of exempt offerings. As proposed, the bad actor triggering events for Rule 504 would be substantially similar to existing provisions in Regulation D,[169] Regulation A,[170] and those adopted today in Regulation Crowdfunding[171] and would apply to the issuer and other covered persons (such as underwriters, placement agents, and the directors, officers and significant shareholders of the issuer). Consistent with the Commission's treatment of disqualification in Rule 506(e), we propose that disqualification would only occur for triggering events that occur after effectiveness of any rule amendments,[172] but disclosure would be required for triggering events that pre-date effectiveness of any rule amendments.[173]

Issuers have overwhelmingly relied upon Rule 506 instead of Rule 504 for offerings of $1 million or less.[174] As discussed more fully in Section V below, data suggests that this may be

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168 *See* proposed Rule 504(b)(3), referencing the disqualification provisions of Rule 506(d), 17 CFR 230.506(d), and note to proposed Rule 504(b)(3), referencing the disclosure provisions of Rule 506(e), 17 CFR 230.506(e).

169 *See* Rules 505(b)(2)(iii) and 506(d) of Regulation D, 17 CFR 230,505(b)(2)(iii), 230.506(d).

170 *See* Rule 262 of Regulation A, 17 CFR 230.262.

171 *See* Rule 503 of Regulation Crowdfunding.

172 *See* proposed Rule 504(b)(3).

173 *See id.*

174 For the period 2009 through 2014, 34,705 Form D filings were made for offerings of less than $1 million, of which 3,719 reported an offering made in reliance upon Rule 504. This represented 11% of all Regulation D offerings raising less than $1 million. During this time period, 30,461 Form D filings reported an offering made in reliance upon Rule 506, representing 88% of all Regulation D offerings raising less than $1million. Only 525 Form D filings reported reliance upon Rule 505, representing only 2% of all Regulation D offerings during this time period raising less than $1 million. *See* Scott Bauguess, Rachita Gullapalli and Vladimir Ivanov, "Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009–2014" (October 2015) ("Unregistered Offerings White Paper"), *available at* http://www.sec.gov/dera/staff-papers/white-papers/unregistered-offering10-2015.pdf.

due to the preemption of state registration requirements, which is available to Rule 506 offerings, but not Rule 504 or 505 offerings.[175] State regulators seeking to modernize and coordinate their regulatory regimes to facilitate early-stage capital financings may benefit from the proposed changes to Rule 504.

We also are seeking public comment on whether additional changes to Rule 504 should be adopted in the final amended rules. In particular, in conjunction with the proposed increase in the Rule 504 offering amount limitation, we are contemplating amending the calculation of the aggregate offering limitation in Rule 504(b)(2).[176] Currently, this rule requires issuers to aggregate all securities sold within the preceding 12 months in any transaction that is exempt under Section 3(b) or in violation of Section 5(a) of the Securities Act for purposes of computing the aggregate offering price under Rule 504.[177] This rule also includes illustrations of how the aggregate offering limitation is calculated in the event that an issuer sells securities pursuant to Rule 504 and Rule 505 within the same twelve-month period.[178]

When the current aggregation provisions in Rules 504 and 505 were originally adopted in Rule 505's predecessor Rule 242, the Commission noted that aggregating offering amounts across offerings conducted pursuant to Section 3(b) was intended to "limit[] the potential for the issuer to raise large sums by circumventing the registration provisions of the Securities Act

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175 *Id.* The data on Regulation D offerings for the period from 2009 through 2014, suggests that the preemption of state securities laws registration and qualification requirements, which is unique to Rule 506 offerings in Regulation D, may be of greater value to issuers than the unique features of either Rules 504 or 505. Data suggests that Rule 506 is the dominant offering method even among those offerings eligible for Rules 504 or 505. Almost 50% of all Rule 506 offerings by non-funds issuers since 2009 were for $1 million or less and therefore may have qualified for the Rule 504 exemption based on offering size. An additional 20% of offerings were for between $1 million and $5 million and therefore could have claimed a Rule 505 exemption based on offering size.

176 We seek comment below on whether, if Rule 505 is retained in the final rules, a corresponding change should be made to Rule 505(b)(2), 17 CFR 230.505(b)(2). *See* Request for Comment 63 below.

177 17 CFR 230.504(b)(2); *see also* 17 CFR 230.505(b)(2).

through multiple offerings pursuant to Section 3(b)."[179] In the intervening years, however, in implementing Congressional mandates,[180] the Commission has increased the potential for issuers, particularly smaller issuers, to raise large sums of capital in offerings that are exempt from registration in a more cost-effective manner, while continuing to provide appropriate safeguards for investors.[181] Therefore, we are seeking comment on whether the current requirements for Rule 504(b)(2), as they relate to the aggregation of offering proceeds across all offerings that are conducted pursuant to Securities Act Section 3(b), should be retained in the amended rules.

The Commission has brought a number of enforcement actions in recent years against persons that have sought to use the provision in Rule 504(b)(1)(iii) permitting conditional use of general solicitation and general advertising to engage in fraudulent offerings.[182] In light of the foregoing, we also are seeking comment on whether we should adopt additional changes to Rule 504 that could potentially increase investor protections in such offerings. In particular, we are considering, and seeking comment on, whether limitations on resale should be imposed on

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178 *See* Notes 1 and 2 to Rule 504(b)(2). [17 CFR 230.504(b)(2)].

179 SEC Rel. No. 33-6180 (Jan. 17, 1980). This provision was subsequently carried over into Rule 505 and adopted into Rule 504 when Regulation D was adopted by the Commission in 1982. *See* SEC Rel. No. 33-6389 (March 8, 1982); SEC Rel. No. 33-6339 (Aug. 7, 1981).

180 *See* JOBS Act, Pub. L. No. 112-106, 126 Stat. 306.

181 *See, e.g.*, Regulation A, 17 CFR 230.251 *et seq.*, providing non-Exchange Act reporting companies with the option to raise up to $20 million annually pursuant to the requirements of Tier 1 and up to $50 million annually pursuant to the requirements of Tier 2.

182 *See, e.g.*, SEC v. Stephen Czarnik, Case No. 10-cv-745 (S.D.N.Y.), Litigation Release No. 21401 (Feb. 2, 2010); SEC v. Yossef Kahlon, a/k/a Jossef Kahlon and TJ Management Group, LLC, Case No. 4:12-cv-517 (E. D. Tex.) (Aug. 14, 2012).

securities sold in reliance on Rule 504(b)(1)(iii) or whether Rule 504(b)(1)(iii) should be repealed.[183]

Lastly, we propose certain technical amendments to Rules 504 and 505. We propose a technical amendment to Rule 504(b)(2), and its related provision in Rule 505(b)(2), that would update the reference to Securities Act Section 3(b) to Section 3(b)(1). This technical revision is necessary in light of the re-designation of Section 3(b) as Section 3(b)(1) that occurred as a result of the Securities Act amendments in Title IV of the JOBS Act.[184] Additionally, we propose technical amendments to the notes to Rule 504(b)(2) that would update the current illustrations of how the aggregate offering amount limitation is calculated in the event that an issuer sells securities pursuant to Rule 504 and Rule 505 within the same twelve-month period.[185] This technical revision is necessary in order to account for the proposed increase to the Rule 504 aggregate offering amount limitation.

Request for Comment

51. As proposed, should we increase the Rule 504 offering limit from a maximum of $1 million of securities in a twelve-month period to a maximum of $5 million of securities in a twelve-month period? Why or why not? Should we adopt a higher or lower aggregate offering limit? If so, what should the aggregate offering limit be and why? For example, should we use our general exemptive authority to adopt a

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183 Any such amendment would not affect the resale status of securities sold under the exemptions in Rules 504(b)(1)(i) and 504(b)(1)(ii), which exempt certain offerings of securities that are registered under a state securities law that requires the public filing and delivery of a disclosure document to investors before sale. As such, the resale limitations of Rule 502(d) would continue not to apply to securities sold in transactions that are exempted by those rules and those securities would not be "restricted securities" for purposes of Rule 144.

184 Pub. L. No. 112-106, 126 Stat. 306, at Sec. 401.

185 *See* Notes 1 and 2 to proposed Rule 504(b)(2).

$20 million annual offering limit in Rule 504 that aligns with the maximum offering limit permitted under Tier 1 of Regulation A?

52. Would the proposed increase in the Rule 504 aggregate offering amount limitation give state securities regulators greater flexibility to develop regional coordinated review programs that would rely on Rule 504 at the federal level? Why or why not? What additional changes, if any, could we make to Rule 504 in order to facilitate efforts by state securities regulators to develop robust coordinated review programs that include appropriate investor protections and encourage capital formation?

53. Should we amend Rule 504, as proposed, to include bad actor disqualification provisions that align with those included in Rule 506(d) of Regulation D? Why or why not?

54. As proposed, should issuers only be disqualified from reliance on Rule 504 for bad actor disqualifying events that occur after the effectiveness of any final rule amendments? Why or why not?

55. If we adopt bad actor disqualification provisions for Rule 504 offerings, should we require issuers to provide disclosure to purchasers of any bad actor disqualifying events that occur before effectiveness of any final rule amendments as proposed? Why or why not?

56. Should we amend the method by which an issuer calculates compliance with the Rule 504 aggregate offering amount limitation to remove the reference to other offerings conducted pursuant to Section 3(b)(1)? Or should we instead continue to require issuers to aggregate Rule 504 offerings with all offerings conducted within the prior twelve-month period pursuant to Section 3(b)(1) and/or in violation of

Section 5(a) when calculating the offering amount limitation? Why or why not? Should offerings made in violation of Section 5(a) be aggregated in all instances?

57. Are there additional changes to Rule 504 that would increase the general utility of the exemption or provide additional investor protections? If so, please explain.

58. Should Rule 504 be available to Exchange Act reporting companies? Why or why not?

59. Should securities sold in reliance on Rule 504(b)(1)(iii) pursuant to a state law exemption that permits general solicitation and general advertising so long as sales are made only to accredited investors be subject to the limitations on resale in Rule 502(d) and, as such, be deemed "restricted securities" for purposes of Rule 144? Alternatively, should we adopt a requirement, similar to proposed Rule 147(e),[186] that would require the securities to come to rest within such state by only prohibiting resales to out of state residents for a period of nine months after such securities are purchased by an investor? Why or why not?

60. Are there other amendments we should make to Rule 504(b)(1)(iii) to address concerns about potential abuse of this provision? Please explain.

61. Should we repeal Rule 504(b)(1)(iii), in light of our proposed revisions to Rule 147? With the exception of the unrestricted status of securities sold pursuant to Rule 504(b)(1)(iii), what value would this rule continue to provide to issuers and investors?

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186 *See* proposed Rule 147(e) and related discussion in Section II.B.4.c above.

C. Continued Utility of Rule 505 as an Exemption from Registration

As noted above, in light of the proposed changes to Rule 504, we also are seeking comment on the continued utility of Rule 505 as an exemption from registration. Rule 505 is used far less frequently than Rule 506, and an increase in the Rule 504 offering ceiling from $1 million to $5 million could diminish its utility. Rule 505 is available to both non-reporting and reporting issuers,[187] so long as the aggregate offering amount does not exceed $5 million in any twelve-month period.[188] An issuer relying upon Rule 505 may not engage in general solicitation or general advertising and securities issued under the exemption are restricted securities.[189]

Issuers relying upon Rule 505 are subject to additional conditions not required under Rule 504, such as the following:

- Sales to no more than 35 non-accredited investors and an unlimited number of accredited investors;[190]
- Delivery of a disclosure document to non-accredited investors[191] that generally contains the same information as included in a Securities Act registration statement.[192]
- Disqualification of felons and other "bad actor" from participating in the offering.[193]

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[187] Rule 505 is available to any issuer that is not an investment company.

[188] As with Rule 504, the aggregate offering price includes proceeds from offers and sales under Section 3(b) or in violation of Section 5(a) of the Securities Act. *See* note 176 above.

[189] *See* Rule 505(b), 17 CFR 230.505(b).

[190] Rule 505(b)(2)(ii), 17 CFR 230.505(b)(2)(ii).

[191] Rule 505(b)(1), 17 CFR 230.505(b)(1). An issuer may decide what information to give to accredited investors, subject to the antifraud provisions of the federal securities laws. If the issuer provides information to accredited investors, it must make this information available to the non-accredited investors as well. As noted in Section III.B above, however, certain offerings conducted pursuant to Rule 504 also require the delivery of a disclosure document to investors, as required under state law.

[192] Financial statements required to be provided to non-accredited investors under Rule 502(b) must be audited by a certified public accountant. As indicated in the note to Rule 502(b)(1), "issuers providing required information to non-accredited investors should also consider providing such information to accredited investors as well, in view of the antifraud provisions of the federal securities laws."

With the exception of the offering limitation contained in Rule 505, the Rule 505 requirements are substantially similar to the requirements of Rule 506.[194] Nevertheless, issuers have overwhelmingly elected to rely upon Rule 506 instead of 505, including in offerings of up to $5 million.[195] As discussed more fully in Section V below, data from Forms D filed with the Commission suggest that the preemption of state securities law registration and qualification requirements available only to issuers relying upon Rule 506 may offset the unique features of Rule 504 or 505 offerings.[196]

Amending Rule 504 to allow for a larger aggregate offering amount of up to $5 million may reduce the incentives to use Rule 505 by issuers contemplating an exempt offering. Absent additional amendments to Regulation D, if we were to eliminate Rule 505, Regulation D would

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193 Rule 505(b)(2)(iii) refers to the disqualification provisions of Rule 262 of Regulation A. Issuers relying upon Rule 506 of Regulation D are also subject to similar disqualification provisions under Rule 506(d) of Regulation D. While not currently applicable to Rule 504 offerings, we propose to adopt bad actor disqualification provisions for Rule 504 that would be substantially similar to those applicable to Rule 506 offerings. *See* discussion Section III.B above.

194 Unlike Rule 504, Rule 505 is available to companies that are subject to the requirements of Section 13 or 15(d) of the Exchange Act, as well as to development stage companies that either have no specific business plan or purpose or have indicated that their business plan is to engage in a merger or acquisition with an unidentified company or companies. Data suggests, however, that less the 4% of all issuers during the 2009-2014 period that conducted Rule 505 offerings were Exchange Act reporting companies (50 companies out of a total of 1337 companies).

195 For the period 2009 through 2014, 65,514 offerings on Form D were filed for offerings raising less than $5 million, of which 1,368 filings reported an offering made in reliance upon Rule 505 of Regulation D, representing only 2% of all offerings made in reliance upon Regulation D during this time period, and 60,427 Form D filings reported an offering made in reliance upon Rule 506, representing approximately 92% of all offerings reporting reliance upon Regulation D during this time period. Variations in percentages are due to reporting errors and issuers ability to claim more than one exemption on the Form D. Issuers also overwhelmingly relied upon Rule 506 instead of Rule 504 when undertaking offerings for $1 million or less. *See* discussion on the use of Rule 504 in Section V.B.4 below.

196 *See* note 175 and related text in the discussion above. For the period 2009 through 2014, $5.773 trillion was raised under Regulation D of which 0.1% was raised in reliance on Rule 504, 0.1% was raised in reliance on Rule 505, and at least 99.2% was raised in reliance on Rule 506 (we do not have data with respect to the remaining 0.6% of aggregate capital raised under Regulation D). During the same time period, there were 118,846 new and continuing offerings under Regulation D of which 3.3% were made in reliance on Rule 504, 1.2% were made in reliance on Rule 505, and at least 94.8% were made in reliance on Rule 506 (we do not have data with respect to the remaining 0.7% of new and continuing offerings made under Regulation D during this time period). In 2014, Rule 505 offerings represented 1.48% of all new Regulation D offerings and 0.04% of all aggregate capital raised under Regulation D.

be limited to two offering exemptions, Rule 504 and Rule 506. Rule 504 would be available only to non-reporting issuers[197] that are not investment companies[198] or development stage companies[199] for offerings of up to $5 million in a twelve-month period and would permit general solicitation and the issuance of unrestricted securities in certain limited situations. Rule 506 would be available to all issuers without any aggregate offering limitations and would permit the issuance of only restricted securities, while allowing general solicitation under certain limited circumstances.[200] We are seeking comment on the utility of Rule 505 in light of the proposed changes.

Request for Comment

62. Should we repeal Rule 505? Why or why not?

63. If Rule 505 is retained, should it be modified in some manner? For example, if we amend the manner in which the aggregate offering amount limitation is calculated in Rule 504 offerings, should we make a corresponding change to the manner in which the Rule 505 aggregate offering amount limitation is calculated?[201] What additional changes, if any, should be made to the rule?

64. Should Rule 505 be replaced with a new Securities Act exemption having, any, or all, of the following features:

- early-stage capital formation as its primary purpose;
- eligibility only for non-Exchange Act reporting issuers;

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197 *See* 17 CFR 230.504(a)(1).

198 *See* 17 CFR 230.504(a)(2).

199 *See* 17 CFR 230.504(a)(3).

200 In such scenario, Rule 505 of Regulation D would be repealed and reserved.

201 *See* discussion in Section III.B and request for comment 0 above.

- subject to the anti-fraud provisions of the federal securities laws and the civil liability provisions of Section 12(a)(2) of the Securities Act;
- exempting holders of the securities from the registration requirements of Section 12(g) of the Exchange Act;
- a relatively low maximum aggregate offering amount over a 12-month period, such as $100,000;
- a limit on the maximum investment amount per investor, such as $2,000;
- a higher maximum investment amount for more sophisticated investors, based on criteria, such as net worth, net income or some other proxy for investment sophistication;
- "covered security" status under Section 18 of the Securities Act by either enacting a new "safe harbor" pursuant to Securities Act Section 4(a)(2) or by defining purchasers of securities issued in an offering pursuant to the exemption as "qualified purchasers," pursuant to Securities Act Section 18(b)(3);
- additional or alternative criteria?

65. Alternatively, whether or not we repeal Rule 505 and if, as proposed, we increase the aggregate offering amount that may be raised pursuant to Rule 504 to $5 million of securities in a twelve-month period, should the amendments to Rule 504 include some of the provisions currently required by Rule 505? If so, which ones and why? Should any such requirement of current Rule 505 only be required if the Rule 504 offering exceeds a certain aggregate offering amount of securities, such as the Rule 504 current annual offering limit of $1 million or some other amount?

IV. GENERAL REQUEST FOR COMMENT

We solicit comment, both specific and general, on each component of the proposals. We request and encourage any interested person to submit comments regarding:

- the proposals that are the subject of this release;
- additional or different revisions to the rules discussed above; and
- other matters that may have an effect on the proposals contained in this release.

Comment is solicited from the point of view of both issuers and investors, as well as of capital formation facilitators, such as broker-dealers, and other regulatory bodies, such as state securities regulators. Any interested person wishing to submit written comments on any aspect of the proposal is requested to do so. With regard to any comments, we note that such comments are of particular assistance to us if accompanied by supporting data and analysis of the issues addressed in those comments. We urge commenters to be as specific as possible.

V. ECONOMIC ANALYSIS

This section analyzes the expected economic effects of the proposed amendments relative to the current baseline, which is the regulatory framework and state of the market[202] in existence today, including current methods available to potential issuers to raise capital up to $5 million. We are mindful of the costs imposed by, and the benefits obtained from, our proposed amendments. Relative to this baseline, our analysis considers the anticipated benefits and costs for market participants affected by the proposed amendments as well as the impact of the

[202] The term "market" as used throughout this economic analysis refers to capital markets in general, and where discussed in the context of a specific rule, relates to the provisions of the relevant exemption or safe harbor. We refer, for example, to the Rule 147 and Rule 504 exemptions as the Rule 147 and Rule 504 markets because each of those rules' provisions prescribe requirements that determine who can participate and how the participants (issuers/investors/intermediaries) can engage in transactions under each exemption. Participants face different trade-offs when choosing between the markets created by each of the exemptions and safe harbors.

proposed amendments on efficiency, competition, and capital formation.[203] We also analyze the potential benefits and costs stemming from alternatives to the proposed rule amendments that we considered. Many of the benefits and costs discussed below are difficult to quantify, especially when analyzing the likely effects of the proposed amendments on efficiency, competition, and capital formation. For example, it is difficult to precisely estimate the extent to which the proposed amendments to Rule 147 would promote future reliance by issuers on this exemption, or the extent to which future use of Rule 147 would affect the use of other offering methods. Similarly, it is difficult to quantify the effect of the proposed amendments on investor protection. Therefore, much of the discussion in this section is qualitative in nature. However, where possible, we have attempted to quantify the expected effects of the proposed amendments.

A. Baseline

The proposed amendments would primarily impact the financing market for startups and small businesses.[204] The baseline for our economic analysis of the proposed amendments to Rule 147 and Rule 504 — including the baseline for our consideration of the effects of the proposed amendments on efficiency, competition and capital formation — is the regulatory framework and market structure in existence today, in which startups and small businesses seeking to raise capital through securities offerings must register the offer and sale of securities under the Securities Act, unless they can rely on an existing exemption from registration under the federal securities laws. In addition to a description of the type and number of issuers that

[203] Securities Act Section 2(b) requires us, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. *See* 15 U.S.C. 77b(b).

[204] In 2013, there were more than 5 million small businesses defined by the U.S. Census Bureau as having fewer than 500 paid employees. *See* U.S. Department of Commerce, United States Census Bureau,

currently offer and sell securities in reliance on the Rule 147 and Rule 504 exemptions, our analysis includes a description of investors who purchase or may consider purchasing such securities and a discussion of the role of intermediaries in such offerings.

1. Current Market Participants

As discussed above, existing Rule 147 is a safe harbor for complying with the intrastate offering exemption provided by Section 3(a)(11) of the Securities Act. Consistent with the statutory exemption, Rule 147 imposes no offering amount limit but requires that issuers offer and sell securities to residents of the same state or territory in which the issuer is resident. In addition, issuers seeking to rely on the safe harbor must satisfy certain prescriptive threshold requirements to be considered "doing business" in-state. Existing Rule 504 limits the offering amount to $1 million in a 12-month period and permits general solicitation under certain conditions, such as that offers and sales are made exclusively in one or more states that provide for securities registration and the public filing and delivery to investors of a substantive disclosure document before sale.[205] Table 1 summarizes the main characteristics of Rule 147 and Rule 504.

Table 1: Main Characteristics of Existing Rule 147 and Rule 504

Type of Offering	Offering Limit[206]	Solicitation	Issuer and Investor Requirements	Filing Requirement	Restriction on Resale	Blue Sky Law Preemption

Business Dynamics Statistics, Data: Firm Characteristics (2013), *available at* http://www.census.gov/ces/dataproducts/bds/data_firm.html.

205 *See* Section III.A above.

206 Aggregate offering limit on securities sold within a 12-month period.

Type of Offering	Offering Limit[206]	Solicitation	Issuer and Investor Requirements	Filing Requirement	Restriction on Resale	Blue Sky Law Preemption
Rule 147	None	Only intrastate solicitation	All issuers must be incorporated and "doing business" in state. All investors must be residents in state.	None	Interstate resales are restricted for nine months from the later of the last sale in, or the completion of, the offering[207]	No
Rule 504 Regulation D	$1 million	General solicitation permitted in certain cases[208]	Excludes investment companies, blank-check companies, and Exchange Act reporting companies	File Form D[209]	Restricted in some cases[210]	No

The proposed amendments to Rule 147 and Rule 504 would primarily affect securities issuers, particularly startups and small businesses that rely on unregistered offerings under these and other exemptions to raise capital, and accredited and non-accredited investors in unregistered offerings.

a. Issuers

i. Rule 147 Issuers

Under current Rule 147, there are no restrictions on the type of issuers that can utilize the safe harbor, and there is no limit on the amount of capital that can be raised. However, there are

207 Rule 147(e), 17 CFR 230.147(e). Additional resale restrictions may apply under state securities laws, which typically restrict in-state resales for a period of one-year.

208 No general solicitation or advertising is permitted unless the offering is registered in a state requiring the use of a substantive disclosure document or sold under a state exemption for sales to accredited investors with general solicitation.

209 Filing is not a condition of the exemption, but it is required under Rule 503.

210 Restricted unless the offering is registered in a state requiring the use of a substantive disclosure document

in-state residency and eligibility requirements that an issuer must satisfy in order to rely on Rule 147. Eligible issuers are those that are incorporated or organized in-state, have their "principal office" in-state, and can satisfy three 80% thresholds concerning their revenues, assets and use of net proceeds.

While we do not have access to data on the number and size of offerings,[211] the amount of capital raised, and the type of issuers currently relying on the Rule 147 safe harbor, the nature of the eligibility requirements leads us to believe that the rule is currently being used by U.S. incorporated firms that are likely small businesses seeking to raise small amounts of capital without incurring the costs of registering with the Commission.

Currently, issuers that intend to conduct intrastate crowdfunding offerings are required to use Rule 147 by most of the states that have enacted crowdfunding provisions.[212] Based on information from NASAA,[213] as of September 2015, 29 states and the District of Columbia have enacted state crowdfunding provisions, and more states are expected to promulgate similar provisions in the near future. Since December 2011, when the first state (Kansas) enacted its crowdfunding provisions, 118 state crowdfunding offerings have been reported to be filed with the respective state regulator.[214] Of these offerings, 102 were reported to be approved or cleared,

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or sold under a state exemption limiting sales only to accredited investors.

211 Unlike Regulation D, which requires the filing of a Form D, Rule 147 does not require any filing with the Commission, and we thus have no source of reliable data about the prevalence and scope of Rule 147 offerings.

212 *See* http://www.nasaa.org/industry-resources/corporation-finance/instrastate-crowdfunding-resource-center/intrastate-crowdfunding-directory/.

213 *See* NASAA's Intrastate Crowdfunding Resource Center at http://www.nasaa.org/industry-resources/corporation-finance/instrastate-crowdfunding-resource-center/. *See also* http://www.nasaa.org/industry-resources/corporation-finance/instrastate-crowdfunding-resource-center/intrastate-crowdfunding-directory/. .

214 *Id.* The jurisdictions included in the estimate are Alabama, District of Columbia, Georgia, Idaho, Indiana, Kansas, Maine, Maryland, Massachusetts, Michigan, Oregon, Texas, Vermont, Washington and Wisconsin.

as of August 1, 2015. Most of the cleared offerings were in Georgia, Michigan, Oregon, Kansas and Indiana.

Given that almost all the enacted state crowdfunding provisions currently exclude reporting companies and entities defined as an investment company under the Investment Company Act of 1940, we expect that issuers that rely on Rule 147 are likely operating companies ("non-fund issuers"). While information on the size of these issuers is not available, data from NASAA shows that most issuers are from varied industries such as agriculture, manufacturing, business services, retail, entertainment, and technology.

We anticipate that many potential issuers of securities under proposed Rule 147, particularly those utilizing Rule 147 for intrastate crowdfunding, will continue to be small businesses, early stage firms and start-ups that are close to the "idea" stage of the business venture. Some of these issuers may lack business plans that are sufficiently developed to attract venture capitalists (VCs) or angel investors that invest in high risk ventures, or may not offer the profit potential or business model to attract such investors.[215]

ii. Rule 504 and Rule 505 Issuers

Rule 504 of Regulation D provides an exemption from registration under Section 3(b)(1) of the Securities Act for offerings that do not exceed $1 million during a 12-month period. An analysis of Form D filings indicates that reliance on Rule 504 exemptions has been declining over time. As shown in Figure 1, while offerings under Rule 506 of Regulation D grew significantly from 1993 to 2014, offerings under Rule 504 and Rule 505 in 2014 were one quarter of 1993 levels. In addition, while offering activity under Rule 504 has been higher than

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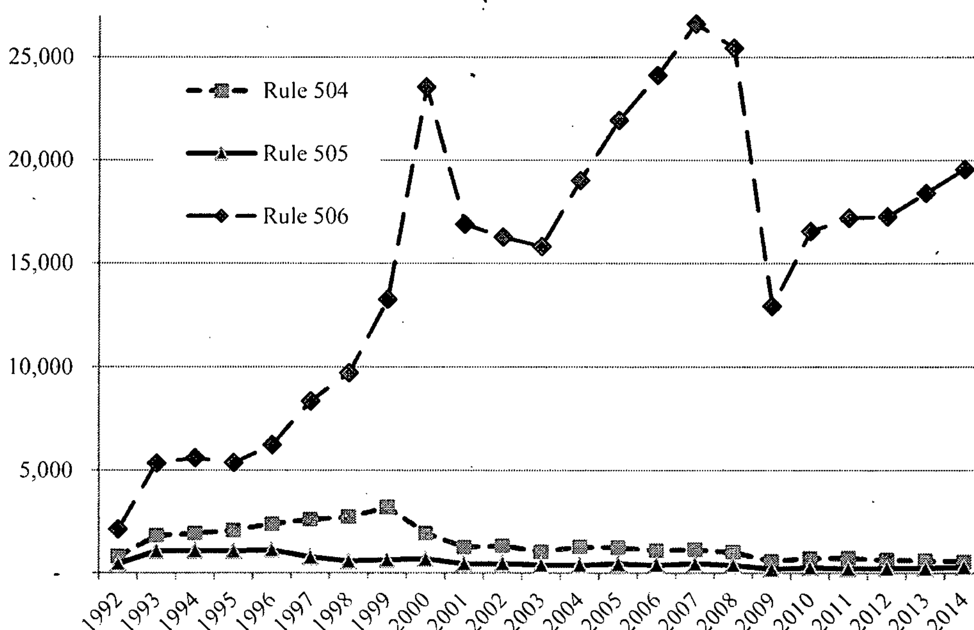
215 In this regard, a study of one large crowdfunding platform revealed that relatively few companies on that platform operate in technology sectors that typically attract VC investment activity. *See* Ethan R. Mollick, *The Dynamics of Crowdfunding: An Exploratory Study* (Working Paper) (June 26, 2013), *available at*

under the Rule 505 exemption, the number of new Rule 504 offerings peaked in 1999, with 3,402 new offerings initiated, and steeply declined afterward. Compared to the early 1990s when Rule 504 offerings constituted approximately 28% of all new Regulation D offerings, the proportion of Rule 504 offerings between 2009 and 2014 ranged between 3% and 4% of all new Regulation D offerings.

Figure 1: Number of New Offerings under Regulation D Exemptions[216]



The current limited use of the Rule 504 exemption and the predominance of Rule 506 are also evident when we consider the total amount raised in offerings under each of these exemptions. Overall, capital formation in the Rule 504 market constituted approximately 0.1%

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http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2088298.

216 Data is not readily available for the period 2002–2008 during which Form D was a paper-based filing. The form became available electronically in March 2009. Since the data for year 2009 is only for the period April to December, the number of new Regulation D offerings shown is underestimated for 2009.

of the capital raised in all Regulation D offerings initiated during 2009–2014.[217] Considering only Regulation D offerings of up to $1 million (the maximum amount that a Rule 504 offering can raise in a year) initiated by non-fund issuers, the share of Rule 504 offerings was slightly higher at 7%.

During the period 2009–2014, issuers relying on the Rule 504 exemption were predominantly non-fund issuers. As shown in Table 2, less than 3% of new Rule 504 offerings during 2009-2014 were initiated by fund issuers.[218] Similarly, between 2009 and 2014, the amounts raised by fund issuers in both new and continuing[219] Rule 504 offerings constituted a small proportion (1% to 6%) of amounts reported to be raised in all Rule 504 offerings.

Table 2: Rule 504 Capital Raising Activity, 2009–2014

	Number of Offerings	Proportion by Non-Fund Issuers	Total Amount Raised ($ million)	Proportion by Non-Fund Issuers
2009	579	98%	91	94%
2010	714	99%	131	99%
2011	721	98%	113	99%
2012	632	98%	109	96%
2013	599	96%	97	94%
2014	544	97%	94	96%

Figure 2 shows the size of Rule 504 issuers during the period 2009–2014.[220] Of all the issuers that disclosed their size in their Form D filings (approximately 80% of all Rule 504

217 *See* Unregistered Offerings White Paper.

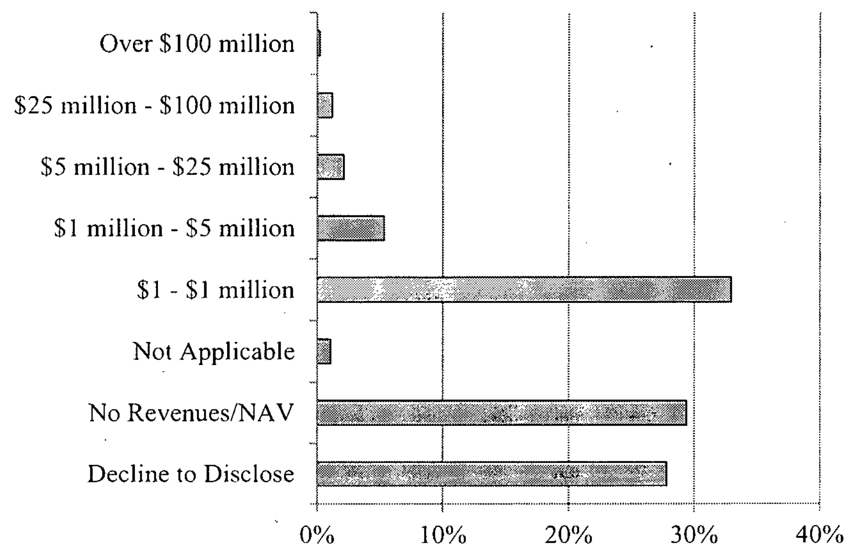
218 Based on an analysis of Form D filings. Our analysis uses the same assumptions and methodologies described in Unregistered Offerings White Paper, note 174 above.

219 These offerings were initiated in previous years and continued raising capital in subsequent years. In order to accurately capture the level of capital formation under the Rule 504 exemption, we consider capital raised during a year by new offerings as well as incremental capital raised during the year by continuing offerings.

220 Based on an analysis of Form D filings.

issuers), more than three quarters of offerings were initiated by issuers that had no revenues, or had revenues or net asset values of less than $1 million. From this reported size, we believe that a vast majority of Rule 504 issuers likely consist of startups and small businesses. The small size of issuers is also reflected in the average age of issuers, as measured by years since incorporation. Based on Form D filings, 51% of Rule 504 issuers initiated their offerings during the year of their incorporation or in the subsequent year. Another 14% of issuers initiated their offerings between two and three years since incorporation.[221]

Figure 2: Size of Rule 504 Issuers, 2009–2014

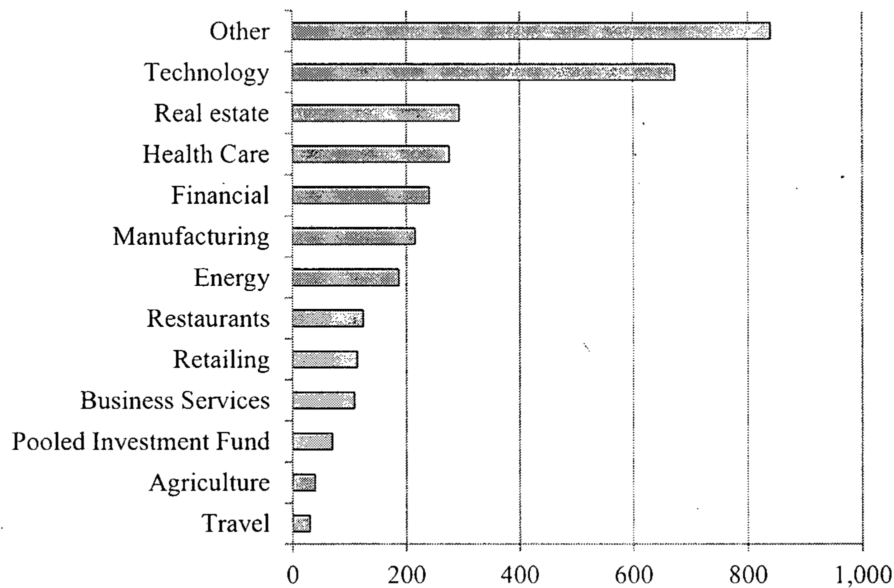


Most Rule 504 issuers in the past five years reported to operate in the technology, real estate or other industry (Figure 3).[222]

[221] *Id.*

[222] *Id.*

Figure 3: Rule 504 Offerings by Industry, 2009-2014



As reported in Form D filings, during the period 2009-2014, Rule 504 issuers had their principal place of business in California (22%), followed by Texas, New York, Florida, Colorado and Illinois, though most were incorporated in Delaware (19%), California (14%) and Nevada (10%). In addition, approximately 32% of the Rule 504 offerings had separate states of incorporation and principal places of business. While only approximately 2% of Rule 504 offerings were initiated by foreign-incorporated issuers, a larger number (5%) reported their principal place of business to be outside the United States. In addition, approximately 90% of issuers in the Rule 504 market initiated only one offering, and approximately 83% of such offerings were of equity securities during the period 2009–2014.

b. Investors

Currently, Rule 147 limits offers and sales to residents of the same state as the issuer. There are no other limitations on who can invest in Rule 147 and Rule 504 offerings. Although the Commission does not track data concerning investors participating in Rule 147 offerings, data from Form D filings provide some insights into the number and type of investors in

Rule 504 offerings.

Table 3 below, shows that almost 31,000 investors participated in new Rule 504 offerings initiated during the period 2009–2014.[223] An analysis of Form D filings indicates that the average and median number of investors in Rule 504 was approximately 11 and 4, respectively.

Table 3: Number and Type of Investors in Rule 504 Offerings, 2009–2014

	Total Investors	Average number of investors	% Offerings with Non-Accredited Investors
2009	4,004	9	53%
2010	5,427	10	54%
2011	5,512	11	57%
2012	6,295	13	58%
2013	5,573	13	61%
2014	3,996	10	60%
2009-2014	30,807	11	57%

Offerings that involved non-accredited investors between 2009 and 2014 were typically smaller and, on average, had fewer investors than those offerings that involved only accredited investors. The presence of non-accredited investors was larger in Rule 504 offerings, where the number of non-accredited investors is not limited, than in Rule 505 or Rule 506 offerings, where the number of non-accredited investors is limited to 35. Table 3 above shows that approximately 57% of Rule 504 offerings during 2009–2014 reported having sold, or intending to sell, to non-accredited investors.[224] These offerings, on average, had 16 investors, compared to 8 investors in Rule 504 offerings that reported not having sold or intending to sell to non-accredited investors.[225]

[223] Based on an analysis of Form D filings. *See also* Unregistered Offerings White Paper.

[224] *Id.*

[225] Based on an analysis of Form D filings.

We believe, given investment limitations under state crowdfunding provisions, that many investors affected by the proposed amendments to Rule 147 would likely be individual retail investors whose broad access to potentially riskier investment opportunities in early-stage ventures is currently limited, either because they do not have the necessary accreditation or sophistication to invest in most private offerings or because they do not have sufficient funds to participate as angel investors. Intrastate crowdfunding offerings may provide retail investors with additional investment opportunities, although the extent to which they invest in such offerings will likely depend on their view of the potential return on investment as well as the potential risks, including fraud.

In contrast, larger, more sophisticated or well-funded investors may be less likely to invest in intrastate crowdfunding offerings. The relatively low offering amount limits, in-state investor residency requirements, and low investment limits for crowdfunding investors under state laws[226] may make these offerings less attractive for professional investors, including VCs and angel investors.[227] While an intrastate crowdfunding offering can bring an issuer to the attention of these investors, it is possible that professional investors would prefer to invest in offerings relying on Rule 506, which are not subject to the investment limitations applicable to crowdfunding.

c. Intermediaries

Issuers of private offerings may use broker-dealers to help them with various aspects of the offering and to help ensure compliance with the ban on general solicitation and advertising

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226 Most state crowdfunding provisions allow up to $2 million offering size, and a maximum investment of $10,000 by non-accredited investors.

227 An observer suggests that, unlike angels, VCs may be less interested in crowdfunding because, if VCs rely on crowdfunding sites for their deal flow, it would be difficult to justify charging a 2% management fee and 20% carried interest to their limited partners. *See* Ryan Caldbeck, *Crowdfunding – Why Angels,*

that exists for most private offerings. Private offerings can also involve finders and investment advisers who connect issuers with potential investors for a fee.[228] We do not have information on the extent of intermediary use in Rule 147 offerings; however, an analysis of Form D filings indicates that intermediaries are used less frequently in Rule 504 offerings than in registered offerings. Approximately 20% of Rule 504 offerings reported using an intermediary during the period 2009–2014. The average commissions and fees paid by Rule 504 issuers that reported using an intermediary was approximately 6% of the offer amount.

Although we are unable to predict the use of broker-dealers, transfer agents, investment advisers and finders in private offerings as a result of the proposed rules, data on the use of broker-dealers and finders in the Rule 506 market suggests that they may not currently play a large role in private offerings. Form D filings indicate that approximately 21% of Rule 506 offerings, including 15% of Rule 506 offerings initiated by non-fund issuers, used an intermediary during 2009–2014.[229] The use of a broker-dealer or a finder increased with offering size, while the average total fee declined with offering size.[230] We base these estimates, however, only on available data from the Regulation D market. It is possible that issuers engaging in other types of private offerings, for which data is not available to us, may use broker-dealers and finders more frequently.[231]

Venture Capitalists And Private Equity Investors All May Benefit, FORBES, Aug. 7, 2013.

[228] Depending on their activities, these persons may need to be registered as broker-dealers.

[229] *See* Section IV(c) in Unregistered Offerings White Paper.

[230] *Id.* Intermediaries participated in 16% of Rule 506 offerings of up to $1 million and 30% of offerings of more than $50 million. The average total fee (commission plus finder fee) paid by issuers conducting offerings of up to $1 million was 6.5% while the average total fee paid by issuers conducting offerings of more than $50 million was 1.9%.

[231] A number of states that have enacted crowdfunding provisions require that the offer and sale of securities by means of intrastate crowdfunding be conducted through a funding portal or a broker-dealer. Some intrastate crowdfunding provisions require the offering portals to be registered generally with the state, or as a broker-dealer. Based on FOCUS Reports filed with the Commission, as of December 2014, there were

2. Alternative Methods of Raising up to $5 Million of Capital

The potential economic impact of the proposed amendments, including their effects on efficiency, competition and capital formation, will depend primarily on the extent of use of the amended Rule 147 and Rule 504 exemptions, and how these methods compare to alternative methods that startups and small businesses can use for raising capital.

As the proposed amendments to Rule 504 would permit offerings up to $5 million by all types of issuers, the analysis below discusses alternatives available for startups and small businesses to access up to $5 million in capital. Current state crowdfunding provisions, most of which require issuers to rely on Rule 147 for federal exemption, have offering limits up to $4 million and restrict private funds and investment companies from utilizing crowdfunding provisions. Our analysis below, therefore, also subsumes a discussion of alternative sources for non-fund issuers to raise capital up to $4 million.[232]

Startups and small businesses can potentially access a variety of external financing sources in the capital markets through, for example, registered or unregistered offerings of debt, equity or hybrid securities and bank loans. Issuers seeking to raise capital must register the offer and sale of securities under the Securities Act or qualify for an exemption from registration under the federal securities laws. Registered offerings, however, are generally too costly to be viable alternatives for startups and small businesses. Issuers conducting registered offerings

4,267 registered broker-dealers, with average total assets of approximately $1.1 billion per broker-dealer. The aggregate assets of these registered broker-dealers totaled approximately $4.9 trillion. *See* Crowdfunding Adopting Release for a more detailed discussion of intermediaries in crowdfunding offerings.

232 While offerings greater than $5 million that are registered or exempt under state law, subject to certain conditions, could be raised under amended Rule 147, and fund issuers would not be excluded from using the exemption, we believe that the impact of the proposed amendments on larger offerings and fund offerings is not likely to be significant, given the local nature of offerings and also current state regulations for larger offerings. *See* Section V.B (discussing the impact of the proposed rule amendments is analyzed more in detail)..

must pay Commission registration fees, legal and accounting fees and expenses, transfer agent and registrar fees, costs associated with periodic reporting requirements and other regulatory requirements, and various other fees. Two surveys concluded that the average initial compliance cost associated with conducting an initial public offering is $2.5 million, followed by an ongoing compliance cost for issuers, once public, of $1.5 million per year.[233] Moreover, issuers conducting registered offerings usually pay underwriter fees, which average approximately 7% for initial public offerings, approximately 5% for follow-on equity offerings and approximately 1-1.5% for public bond issuances.[234] Hence, for an issuer seeking to raise less than $5 million, a registered offering typically may not be economically feasible.

a. Exempt Offerings

For startups and small businesses that can potentially access capital under the Rule 147 safe harbor and Rule 504 exemption, offerings under other existing exemptions from registration

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233 *See* IPO Task Force, *Rebuilding the IPO On-Ramp*, at 9 (Oct. 20, 2011) for the two surveys, *available at* http://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf ("IPO Task Force"). The estimates should be interpreted with the caveat that most firms in the IPO Task Force surveys likely raised more than $1 million. The IPO Task Force surveys do not provide a breakdown of costs by offering size. However, compliance related costs of an initial public offering and subsequent compliance related costs of being a reporting company likely have a fixed cost component that would disproportionately affect small offerings.

Title I of the JOBS Act provided certain accommodations to issuers that qualify as emerging growth companies (EGCs). According to a recent working paper, the underwriting, legal and accounting fees of EGC and non-EGC initial public offerings were similar (based on a time period from April 5, 2012 to April 30, 2014). For a median EGC initial public offering, gross spread comprised 7% of proceeds and accounting and legal fees comprised 2.4% of proceeds. *See* Susan Chaplinsky, Kathleen W. Hanley, and S. Katie Moon, 2014, "*The JOBS Act and the Costs of Going Public*," working paper, August 14, 2014, *available at* http://ssrn.com/abstract_id=2492241.

234 *See, e.g.*, Hsuan-Chi Chen and Jay R. Ritter, "*The Seven Percent Solution*," 55 J. FIN. 1105–1131 (2000); Mark Abrahamson, Tim Jenkinson, and Howard Jones, "*Why Don't U.S. Issuers Demand European Fees for IPOs?*" 66 J. FIN. 2055–2082 (2011); Shane A. Corwin, "*The Determinants of Underpricing for Seasoned Equity Offers*," 58 J. FIN. 2249–2279 (2003); Lily Hua Fang, "*Investment Bank Reputation and the Price and Quality of Underwriting Services*," 60 J. FIN. 2729–2761 (2005); Rongbing Huang and Donghang Zhang, "*Managing Underwriters and the Marketing of Seasoned Equity Offerings*," 46 J. FIN. QUANT. ANALYSIS 141–170 (2011); Stephen J. Brown, Bruce D. Grundy, Craig M. Lewis and Patrick Verwijmeren, "*Convertibles and Hedge Funds as Distributors of Equity Exposure*," 25 REV. FIN. STUD. 3077-3112 (2012).

may represent alternative methods of raising capital. For example, startups and small businesses could rely on current exemptions and safe harbors, such as Section 3(a)(11), Section 4(a)(2),[235] Regulation A,[236] and Rule 506 of Regulation D.[237]

Each of these exemptions, however, includes restrictions that may limit its suitability for startups and small businesses seeking to raise capital up to $5 million. Table 4 below lists the main requirements of these exemptions.

Table 4: Other Exemptions Currently Available for Capital Raising

Type of Offering	Offering Limit[238]	Solicitation	Issuer and Investor Requirements	Filing Requirement	Restriction on Resale	Blue Sky Law Preemption
Section 3(a)(11)	None	All offerees must be resident in state	All issuers and investors must be resident in state	None	No[239]	No
Section 4(a)(2)	None	No general solicitation	Transactions by an issuer not involving any public offering[240]	None	Restricted securities	No

235 Securities Act Section 4(a)(2) provides that the provisions of the Securities Act shall not apply to "transactions by an issuer not involving a public offering."

236 Regulation A provides a conditional exemption from registration for certain small issuances. We recently adopted amendments to Regulation A, which became effective on June 19, 2015. *See* 2015 Regulation A Release.

237 Rule 506(b) of Regulation D provides a nonexclusive safe harbor from registration for certain types of securities offerings. Rule 506(c) of Regulation D is a new exemption from registration that the Commission adopted to implement Section 201(a) of the JOBS Act.

238 Aggregate offering limit on securities sold within a twelve-month period.

239 Although Section 3(a)(11) does not have explicit resale restrictions, the Commission has explained that "to give effect to the fundamental purpose of the exemption, it is necessary that the entire issue of securities shall be offered and sold to, and come to rest only in the hands of residents within the state." *See* 1961 Release. State securities laws, however, may have specific resale restrictions. Securities Act Rule 147, a safe harbor under Section 3(a)(11), limits resales to persons residing in-state for a period of 9 months after the last sale by the issuer. [17 CFR 230.147]

240 Section 4(a)(2) of the Securities Act provides a statutory exemption for "transactions by an issuer not involving any public offering." *See SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953) (holding that an offering to those who are shown to be able to fend for themselves is a transaction "not involving any public offering.")

Type of Offering	Offering Limit[238]	Solicitation	Issuer and Investor Requirements	Filing Requirement	Restriction on Resale	Blue Sky Law Preemption
Regulation A	Tier 1: up to $20 million with $6 million limit on secondary sales by affiliates of the issuer; Tier 2: up to $50 million with $15 million limit on secondary sales by affiliates of the issuer	Testing the waters permitted both before and after filing the offering statement	U.S. or Canadian issuers, excluding investment companies, blank-check companies, reporting companies, and issuers of fractional undivided interests in oil or gas rights, or similar interests in other mineral rights[241]	File testing the waters materials, Form 1-A for Tiers 1 and 2 offerings; file annual, semi-annual, and current reports for Tier 2; file exit report for Tier 1 and to suspend or terminate reporting for Tier 2	No	Tier 1: No Tier 2: Yes
Rule 505 Regulation D	$5 million	No general solicitation	Unlimited accredited investors and up to 35 non-accredited investors	File Form D[242]	Restricted securities	No
Rule 506(b) Regulation D	None	No general solicitation	Unlimited accredited investors and up to 35 non-accredited investors	File Form D[243]	Restricted securities	Yes
Rule 506(c) Regulation D	None	General solicitation is permitted, subject to certain conditions[244]	Unlimited accredited investors; no non-accredited investors	File Form D[245]	Restricted securities	Yes

241 The Regulation A exemption also is not available to companies that have been subject to any order of the Commission under Exchange Act Section 12(j) entered within the past five years; have not filed ongoing reports required by the regulation during the preceding two years, or are disqualified under the regulation's "bad actor" disqualification rules.

242 Filing is not a condition of the exemption, but it is required under Rule 503.

243 Filing is not a condition of the exemption. but it is required under Rule 503.

244 General solicitation and general advertising is permitted under Rule 506(c). All purchasers must be accredited investors and the issuer must take reasonable steps to verify accredited investor status.

While we do not have complete data on offerings relying on an exemption under Section 3(a)(11) or Section 4(a)(2), certain data available from Regulation D and Regulation A filings allow us to gauge how frequently issuers seeking to raise up to $5 million use these exemptions. Based on Form D filings from 2009 to 2014, a substantial number of issuers chose to raise capital by relying on Rule 506(b), even though their offering size would qualify for an exemption under Rule 504 or Rule 505.[246] As shown below, in the upper part of Table 5 reporting the number of Regulation D offerings by all types of issuers, most of the issuers made offers for amounts of up to $1 million from 2009 to 2014. Most of the offerings up to $5 million rely on the Rule 506(b) exemption. The lower part of Table 5 shows a similar pattern for the number of offerings by non-fund issuers only. The overwhelming majority of non-fund issuers (approximately 78%) for offerings less than $5 million were five years or younger, and 68% of such issuers were two years or younger, with a median age of approximately one year. More than 93% of the non-fund issuers that made Regulation D offerings with offer sizes of $5 million or less during this period were organized as either a corporation or a limited liability company. Almost 23% reported no revenues, while approximately 21% had revenues of less than $5 million.[247]

245 Filing is not a condition of the exemption, but it is required under Rule 503.

246 *See* Unregistered Offerings White Paper. This tendency could, in part, be attributed to two features of Rule 506: preemption from state registration ("blue sky") requirements and an unlimited offering amount. *See also* GAO Report.

247 These percentages could be higher because almost 45% of the Regulation D issuers declined to disclose their size.

Table 5: Number of Regulation D and Regulation A Offerings By Size, 2009–2014

	Offering size				
	<=$1 million	$1-$2.5 million	$2.5-5 million	$5-50 million	>$50 million
All offerings					
Rule 504	3,719	--	--	--	--
Rule 505	525	450	393	--	--
Rule 506(b)	29,751	15,805	13,562	26,847	11,942
Rule 506(c)	710	304	295	533	161
Total	34,705	16,559	14,250	27,380	12,103
Regulation A	5	4	29		
Non-fund offerings					
Rule 504	3,643	--	--	--	--
Rule 505	501	432	342	--	--
Rule 506(b)	27,106	14,113	11,633	18,670	2,733
Rule 506(c)	588	261	270	419	89
Total	31,838	14,806	12,245	19,089	2,822

Note: Data based on Form D and Form 1-A filings from 2009 to 2014. We consider only new offerings and exclude offerings with amount sold reported as $0 on Form D. Data on Rule 506(c) offerings covers the period from September 23, 2013 (the day the rule became effective) to December 31, 2014. We also use the maximum amount indicated in Form 1-A to determine offering size for Regulation A offerings.

The table above also includes the number of Regulation A offerings by size. From 2009 to 2014, 38 issuers relied on Regulation A for offerings of up to $5 million.[248] This data does not reflect the recent amendments to Regulation A adopted by the Commission on March 25, 2015. The amendments allow issuers to raise up to $50 million over a 12-month period and preempt state registration requirements for certain Regulation A offerings (Tier 2 offerings). As these amendments became effective only recently, more time is needed to assess how the changes in Regulation A will affect capital raising by small issuers.[249]

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[248] We only consider offerings with offering statements that have been qualified by the Commission. For purposes of counting filings, we exclude amendments or multiple 1-A filings by the same issuer in a given year. For purposes of determining the offering size for Regulation A offerings, we use the maximum amount indicated on the latest pre-qualification Form 1-A or amended Form 1-A. We reclassify two offerings that are dividend reinvestment plans with uncertain offering amounts as having the maximum permitted offering amount.

[249] *See* 2015 Regulation A Adopting Release.

b. Regulation Crowdfunding

The analysis above does not include securities-based crowdfunding transactions under the Regulation Crowdfunding exemption. Under these rules, which are not yet in effect, offerings pursuant to Regulation Crowdfunding are limited to a maximum amount of $1 million over a 12-month period and are subject to ongoing disclosure requirements. Securities issued pursuant to these rules can be sold to an unlimited number of investors (subject to certain investment limits), are freely tradable after one year, and can be offered and sold across states without state registration. In addition to the existing regulatory scheme of exemptions and safe harbors described above, Regulation Crowdfunding will provide a new exemption from the registration requirements of the Securities Act. Once effective, this exemption will provide startups and small businesses with an alternate source for raising up to $1 million in capital in a 12-month period through certain securities-based crowdfunding transactions. Unlike intrastate crowdfunding provisions enacted at the state level, the new federal crowdfunding exemption would allow interstate offerings. Table 6 below presents a comparison of the provisions of Regulation Crowdfunding and intrastate crowdfunding that rely on current Rule 147 for federal exemption.

Table 6: Intrastate Crowdfunding and Regulation Crowdfunding Provisions

	State Level Crowdfunding + Current Rule 147[250]	Regulation Crowdfunding[251]
Investor Base	All investors, resident in- state	All investors, all states
State Registration	Exemption provided by state	Preemption
Issuer Incorporation/ Residency Limitations	Issuer should be incorporated and "doing-business" in state	Excludes foreign private issuers
Excluded Issuers	Exchange Act reporting companies, investment companies and blank check companies (under most state provisions)	Exchange Act reporting companies, investment companies, pooled investment funds, and blank check companies
Offering Size Limits	$250,000 - $4 million, depending on state. Average (median) limit: $1.6 ($2) million	Up to $1 million
Security Type	Equity and debt in some states; equity only in other states; any security in some other states	Any security
Audited Financials Requirement	Most states, if offer greater than $1 million	Required for offerings greater than $500,000 with the exception of first-time crowdfunding issuers offering more than $500,000 but not more than $1,000,000, who are permitted to provide financial statements reviewed by an independent accountant, unless the issuer has audited statements otherwise available. Reviewed financial statements are required for offerings greater than $100,000 but not more than $500,000, unless the issuer has audited statements otherwise available.
General Solicitation	Allowed but only to investors resident in state	Allowed with limitations on advertising
Investment Limits	$2,500-$10,000, depending on state, for non-accredited investors. None, in most states, for accredited investors	(a) the greater of $2,000 or 5% of the lesser of the investor's annual income or net worth if either annual income or net worth is less than $100,000, or (b) 10% of the lesser of the investor's annual income or net worth if both annual income and net worth are $100,000 or more, subject to

[250] Information based on provisions reflective of most states that have enacted crowdfunding provisions. *See* http://www.nasaa.org/industry-resources/corporation-finance/instrastate-crowdfunding-resource-center/intrastate-crowdfunding-directory/.

[251] *See* Regulation Crowdfunding Adopting Release.

	State Level Crowdfunding + Current Rule 147[250]	Regulation Crowdfunding[251]
		investment cap of $100,000
Restrictions on Resale	Interstate resales restricted for nine months[252]	12-month resale limitation; resale within one year to issuer and certain investors
Exemption from Section 12(g) Registration Requirements	No exemption	Exempted, provided that the issuer is current in its ongoing annual reports required pursuant to Rule 202 of Regulation Crowdfunding, has total assets as of the end of its last fiscal year not in excess of $25 million, and has engaged the services of a transfer agent registered with the Commission pursuant to Section 17A of the Exchange Act

c. Private Debt Financing

While equity-based financing, including principal owner equity, accounts for a significant proportion of the total capital of a typical small business, other sources of capital for startups and small businesses include loans from commercial banks, finance companies and other financial institutions, business credit cards and credit lines.[253]

For example, a 2014 study reports that startups frequently resort to bank financing early in their lifecycle.[254] The study finds that businesses rely heavily in the first year after formation on external debt sources such as bank financing, mostly in the form of personal and commercial

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252 Rule 147(e), 17 CFR 230.147(e). States may impose additional resale restrictions.

253 Using data from the 1993 Survey of Small Business Finance, one study indicates that financial institutions account for approximately 27% of small firms' borrowings. *See* Allen N. Berger and Gregory F. Udell, *The Economics of Small Business Finance: The Roles of Private Equity and Debt Markets in the Financial Growth Cycle*, 22 J. BANKING & FIN. 613 (1998). *See also* 1987, 1993, 1998 and 2003 Surveys of Small Business Finances, *available at* http://www.federalreserve.gov/pubs/oss/oss3/nssbftoc.htm. The Survey of Small Business Finances was discontinued after 2003. Using data from the Kauffman Foundation Firm Surveys, one study finds that 44% of startups use loans from financial institutions. *See* Rebel A. Cole and Tatyana Sokolyk, *How Do Start-Up Firms Finance Their Assets? Evidence from the Kauffman Firm Surveys* (2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2028176.

254 *See* Robb, A., and D. Robinson, 2014, *The Capital Structure Decisions of New Firms*, Review of Financial Studies 27(1), pp. 153–179 ("*Robb*").

bank loans, business credit cards, and credit lines. Another recent report, however, shows a decline in bank lending to small businesses, which fell by $100 billion from 2008 to 2011.[255] This report also shows that less than one-third of small businesses reported having a business bank loan by 2012. Similarly, an FDIC report shows that, as of June 2014, small business lending, specifically business loans of up to $1 million, by FDIC-insured depository institutions amounted to approximately $590 billion, which is 17% lower than the 2008 level.[256]

An earlier study by Federal Reserve Board staff covering the pre-recessionary period suggests that 60% of small businesses had outstanding credit in the form of a credit line, a loan or a capital lease.[257] These loans were borrowed from two types of financial institutions: depositary and non-depositary institutions (*e.g.*, finance companies, factors or leasing companies).[258] Lines of credit were the most widely used type of credit.[259] Other types included mortgage loans, equipment loans, and motor vehicle loans.[260]

Small businesses may also receive funding from various loan guarantee programs of the Small Business Administration ("SBA"), which makes credit more accessible to small businesses by either lowering the interest rate of the loan or enabling a market-based loan that a lender

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[255] *See* The Kauffman Foundation, *2013 State of Entrepreneurship Address* (Feb. 5, 2013), *available at* http://www.kauffman.org/~/media/kauffman_org/research%20reports%20and%20covers/2013/02/soe%20report_2013pdf.pdf. The report cautions against prematurely concluding that banks are not lending enough to small businesses as the sample period of the study includes the most recent recession.

[256] We define small business loans to include commercial and industrial loans of up to $1 million and loans secured by nonfarm nonresidential properties and commercial and industrial loans of up to $1 million to U.S. addressees. *See* Federal Deposit Insurance Corporation, *Statistics on Depository Institutions Report*, *available at* http://www2.fdic.gov/SDI/SOB/ ("*FDI Statistics*").

[257] *See* Federal Reserve Board, *Financial Services Used by Small Businesses: Evidence from the 2003 Survey of Small Business Finances* (October 2006), *available at* http://www.federalreserve.gov/pubs/bulletin/2006/smallbusiness/smallbusiness.pdf ("2003 Survey").

[258] *See* Rebel Cole, *What Do We Know About the Capital Structure of Privately Held Firms? Evidence from the Surveys of Small Business Finance* (Working Paper) (Feb. 2013), *available at* http://onlinelibrary.wiley.com/doi/10.1111/fima.12015/pdf.

[259] *See* 2003 Survey, note 257 (estimating that 34% of small businesses use lines of credit).

would not be willing to provide, absent a guarantee.[261] SBA loan programs include 7(a) loans,[262] and CDC/504 loans.[263] For example, in fiscal year 2014, the SBA supported approximately $28.7 billion in 7(a) and CDC/504 loans distributed to approximately 51,500 small businesses.[264] SBA guaranteed loans, however, currently account for a relatively small share (18%) of the balances of small business loans outstanding.[265]

Borrowing from financial institutions is, however, relatively costly for many early-stage issuers and small businesses as they may have low revenues, irregular cash-flow projections, insufficient assets to offer as collateral, and high external monitoring costs.[266] Many startups and small businesses may find loan requirements imposed by financial institutions difficult to meet and may not be able to rely on these institutions to secure funding. For example, financial

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260 *Id.*

261 Numerous states also offer a variety of small business financing programs, such as Capital Access Programs, collateral support programs and loan guarantee programs. These programs are eligible for support under the State Small Business Credit Initiative, *available at* http://www.treasury.gov/resource-center/sb-programs/Pages/ssbci.aspx.

262 15 U.S.C. 631 *et seq.* 7(a) loans provide small businesses with financing guarantees for a variety of general business purposes through participating lending institutions.

263 15 U.S.C. 695 *et seq.* The CDC/504 loans are made available through "certified development companies" or "CDCs", typically structured with the SBA providing 40% of the total project costs, a participating lender covering up to 50% of the total project costs and the borrower contributing 10% of the project costs.

264 *See* U.S. Small Business Administration, *FY 2016 Congressional Budget Justification and FY 2014 Annual Performance Report*, available at https://www.sba.gov/content/fiscal-year-2016-congressional-budget-justificationannual-performance-report ("2014 Annual Performance Report"). SBA also offers the Microloan program, which provides funds to specially designated intermediary lenders that administer the program for eligible borrowers. The maximum loan amount is $50,000, but the average is about $13,000. *See* Microloan Program, U.S. Small Business Administration, *available at* http://www.sba.gov/content/microloan-program.

265 As of the end of fiscal year 2014, the SBA guaranteed business loans outstanding (including 7(a) and 504 loans) equaled $107.5 billion. *See Small Business Administration Unpaid Loan Balances by Program, available at* https://www.sba.gov/sites/default/files/files/WDS_Table1_UPB_Report.pdf. This comprises approximately 18% of the approximately $590 billion in outstanding small business loans for commercial real estate and commercial and industrial loans discussed above. In 2014, the SBA expanded eligibility for loans under its business loan programs. *See* SBA *504 and 7(a) Loan Programs Updates* (Mar. 21, 2014) [79 FR 15641 (Apr. 21, 2014)]. In addition to loan guarantees, the SBA program portfolio also includes direct business loans, which are mainly microloans (outstanding direct business loans equaled $137.1 billion), and disaster loans.

institutions generally require a borrower to provide collateral and/or a guarantee,[267] which startups, small businesses and their owners may not be able to provide. Collateral may also be required for loans guaranteed by the SBA.

Other sources of debt financing for startups and small businesses include peer-to-peer and peer-to-business lending,[268] microfinance,[269] and other alternative online lending channels.[270] According to some industry estimates, the global volume of "lending-based crowdfunding," which includes peer-to-peer lending to consumers and businesses, had risen to approximately $11.08 billion in 2014.[271] Technology has facilitated the growth of alternative models of small

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266 *See* Robb.

267 Approximately 92% of all small business debt to financial institutions is secured, and owners of the firm guarantee about 52% of that debt. *See* Berger, A., and G. Udell, 1995, Relationship Lending and Lines of Credit in Small Firm Finance, Journal of Business 68(3), pp. 351–381. Some studies of small business lending also document the creation of local captive markets with higher borrowing costs for small, opaque firms as a result of strategic use of soft information by local lenders. *See* Agarwal, Sumit, and Robert Hauswald, 2010, Distance and Private Information in Lending, Review of Financial Studies 13(7), pp. 2757–2788.

268 Such debt transactions are facilitated by online platforms that connect borrowers and lenders and potentially offer small businesses additional flexibility with regard to pricing, repayment schedules, collateral or guarantee requirements, and other terms. *See* Ian Galloway, *Peer-to-Peer Lending and Community Development Finance*, Federal Reserve Bank of San Francisco (Working Paper) (2009), *available at* http://www.frbsf.org/publications/community/wpapers/2009/wp2009-06.pdf.

269 *See* Craig Churchill and Cheryl Frankiewicz, *Making Microfinance Work: Managing for Improved Performance*, Geneva International Labor Organization (2006). Microfinance consists of small, working capital loans provided by microfinance institutions that are invested in microenterprises or income-generating activities. According to one report, in fiscal year 2012, the U.S. microfinance industry was estimated to have disbursed $292.1 million across 36,936 microloans, and was estimated to have $427.6 million in outstanding microloans (across 45,744 in microloans). *See* FIELD at the Aspen Institute, *U.S. Microenterprise Census Highlights*, FY 2012, *available at* http://fieldus.org/Publications/CensusHighlightsFY2012.pdf.

270 Several models of online small business lending have emerged: online lenders raising capital from institutional investors and lending on their own account (for example, short-term loan products similar to a merchant cash advance); peer-to-peer platforms; and "lender-agnostic" online marketplaces that facilitate small business borrower access to various loan products, from term loans and lines of credit to merchant cash advances and factoring products, from traditional and alternative lenders. *See* Karen Gordon Mills and Brayden McCarthy, *The State of Small Business Lending: Credit Access during the Recovery and How Technology May Change the Game*, Harvard Business School Working Paper 15-004 (2014), *available at* http://ssrn.com/abstract=2470523 ("Mills-McCarthy 2014).

271 *See* Massolution, *2015CF Crowdfunding Industry Report: Market Trends, Composition and Crowdfunding Platforms*, *available at* http://reports.crowdsourcing.org/index.php?route=product/product&product_id=54 ("Massolution 2015") at 56. The Massolution 2015 report refers to peer-to-peer lending to consumers and

business lending. According to one academic study,[272] the outstanding portfolio balance of online alternative lenders has doubled every year, albeit this market represents less than $10 billion in outstanding loan capital. According to the 2014 Small Business Credit survey,[273] 18% of all small businesses surveyed applied for credit with an online lender.[274]

Family and friends are also sources through which startups and small businesses can raise capital. This source of capital is usually available early in the lifecycle of a small business, before the business engages arm's-length, more formal funding channels.[275] Among other things, family and friends may donate funds, loan funds or acquire an equity stake in the business. A recent study finds that most of the capital supplied to startups by friends and family is in the form of loans.[276] Family and friends, however, may be able to provide only a limited amount of capital compared to other sources. We do not have data available on these financing sources that could allow us to quantify their magnitude and compare them to other current sources of capital.

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peer-to-business lending to small businesses as "lending based" crowdfunding. Our discussion refers to peer-to-peer lending more broadly in a sense synonymous with "lending-based" crowdfunding.

272 *See* Mills McCarthy 2014.

273 The survey was conducted by the Federal Reserve Banks of New York, Atlanta, Cleveland, and Philadelphia between September and November of 2014. It focused on credit access among businesses with fewer than 500 employees in Alabama, Connecticut, Florida, Georgia, Louisiana, New Jersey, New York, Ohio, Pennsylvania, and Tennessee. The survey authors note that since the sample is not a random sample, results were reweighted for industry, age, size, and geography to reduce coverage bias. *See* Federal Reserve Banks of New York, Atlanta, Cleveland and Philadelphia, *Joint Small Business Credit Survey Report* (2014); *available at* http://www.newyorkfed.org/smallbusiness/SBCS-2014-Report.pdf.

274 *Id.* The survey also showed differences in the use of online lenders by type of borrower: 22% of small businesses categorized in the survey as "startups" (i.e. businesses that have been in business for less than five years) applied for credit with online lenders. By comparison, 8% of small businesses categorized in the survey as "growers" (i.e. businesses that were profitable and experienced an increase in revenue) applied with online lenders, and 3% of small businesses categorized in the survey as "mature firms" (i.e. businesses that have been in business for more than five years, had over ten employees, and had prior debt), applied with an online lender. The latter two categories of small businesses were more likely to apply for credit with bank lenders than with online lenders.

275 *See* Paul Gompers and Josh Lerner, The Venture Capital Cycle (MIT Press 2006).

276 *See* Robb at 1219.

B. Analysis of Proposed Rules

1. Introduction

In general, the proposed amendments to Rule 147 and Rule 504 are intended to expand the capital raising options available to startups and small businesses, including through the use of intrastate and regional securities offering provisions that have been enacted or could be enacted by various states, and thereby promote capital formation within the larger economy.

Securities-based crowdfunding is a relatively new and evolving capital market which provides startups and small businesses an alternative mechanism of raising funds using the Internet, by selling small amounts of securities to a large number of investors. Title III of the JOBS Act directed the Commission to establish rules for an exemption that would facilitate this market at the federal level. Around the same time, some states began enacting intrastate crowdfunding statutes and rules that provide issuers with exemptions from state registration. Most state crowdfunding rules require issuers to comply with the requirements of Section 3(a)(11) and Rule 147, while one state currently provides issuers with the option of utilizing Rule 504 or another Regulation D exemption.

By modernizing the existing requirements under Rule 147, the proposed amendments would facilitate capital formation through intrastate crowdfunded offerings as well as through other state registered or state exempt offerings. By raising the offering amount limit under Rule 504 from $1 million to $5 million, the proposed amendments may facilitate offerings, including those registered or exempt in a state, or regional offerings made pursuant to the implementation of regional coordinated review programs.[277] Such programs, when implemented, may enable

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277 *See* http://www.nasaa.org/industry-resources/corporation-finance/coordinated-review/. *See also* the "Reciprocal Crowdfunding Exemption" proposed by the Massachusetts Securities Division *available at*

Rule 504 issuers to register their offering in any one of the several states where they make the offering, instead of registering in all the states of solicitation, thereby saving time and money for issuers.

As discussed below, the effects of the proposed amendments on capital formation would depend, first, on whether issuers that currently raise or plan to raise capital would choose to rely on securities offerings pursuant to amended Rules 147 and 504 in lieu of other methods of raising capital, such as Regulation Crowdfunding and Rule 506 of Regulation D. To assess the likely impact of the proposed amendments on capital formation, we consider the features of amended Rules 147 and 504 that potentially could increase the use of securities offerings by new issuers and by issuers that already rely on other private offering options.

Second, to the extent that securities offerings under amended Rule 147 and Rule 504 provide capital raising options for issuers that currently do not have access to capital, the proposed amendments could enhance the overall level of capital formation in the economy in addition to any reallocation of demand for capital amongst the various capital raising options that could arise from issuers changing their capital raising methods.

Third, to the extent that states currently have residency and eligibility requirements in addition to prescriptive threshold requirements that correspond to existing Rule 147 provisions, the impact of the proposed amendments to Rule 147 on capital formation would significantly depend on whether states choose to modernize their provisions to align with the amended Rule 147. Any changes to the intrastate and regional securities offering provisions that may be enacted would, in turn, affect the expected use of amended Rule 504. For instance, while current

http://www.sec.state.ma.us/sct/crowdfundingreg/Reciprocal%20Crowdfunding%20Exemption%20-%20MA.PDF.

intrastate crowdfunding provisions in most states require issuers to rely on Rule 147 for the federal exemption, to the extent the amended state provisions require the offerings to comply with either Rule 147 or Rule 504 in the future, the choice between reliance on these two exemptions could depend on issuers' preferences with respect to general solicitation, target investor base, and investor location. For example, while Rule 147 offerings would be restricted to in-state investors, Rule 504 offerings would be available to investors in more than one state, thus making regional offerings feasible. At the same time, there is no limit on the maximum offering amount under proposed Rule 147 for an offering that is registered with a state, while the proposed amendments under Rule 504 limit the maximum amount that can be sold over a twelve-month period to $5 million.[278]

Finally, the impact of the proposed amendments on aggregate capital formation also would depend on whether new investors are attracted to the Rule 147 and Rule 504 markets or whether investors reallocate existing capital among various types of offering options. For example, if the amended exemptions allow issuers to reach a category of potential investors significantly different from those that they can reach through other offering methods, capital formation, in aggregate, could increase. However, if the amended exemptions are viewed by investors as substantially similar to alternate exemptions, investors may simply reallocate their capital from other markets to the Rule 147 or Rule 504 markets. Investor demand for securities offered under amended Rule 147 and Rule 504 could, in particular, depend on the extent to which expected risk, return and liquidity of the offered securities compare to what investors can

278 While the proposed amendments to Rule 147 would limit the availability of the federal exemption to offerings of $5 million or less that are conducted pursuant to an exemption under state law, we believe the impact of this provision may not be significant given that existing crowdfunding state exemptions do not permit offerings greater than $4 million. States may have non-crowdfunding exemptions for larger

obtain from securities in other exempt offerings and in registered offerings.

Investor demand also would depend on whether state offering reporting requirements are sufficient to enable investors to evaluate the aforementioned characteristics of Rule 147 and Rule 504 offerings. For example, investors may be less willing to participate in intrastate crowdfunding or regional offerings that are made in reliance on exemptions from both state registration under state crowdfunding provisions and registration with the Commission under Rule 147 and Rule 504 and that are subject to lower reporting requirements. Alternatively, the state registration requirement for using general solicitation in Rule 504 offerings, the proposed amendment to disqualify certain bad actors from participation in Rule 504 offerings, the maximum offering amount for state exempt offerings that rely on Rule 147, and the reporting requirements for larger intrastate crowdfunding offerings under state provisions may mitigate some of these investor protection concerns. For example, in a number of states, current intrastate crowdfunding provisions require issuers for offerings greater than $1 million to submit audited financial statements.[279]

The proposed amendments to Rule 147 and Rule 504 would remove or reduce certain burdens identified by market observers.[280] We believe that the potential use of amended Rule 147 and Rule 504 depends largely on how issuers perceive the trade-off between the costs of disclosure requirements, if any under state regulation, and the benefits of access to accredited and non-accredited investors. Some issuers may prefer to offer securities under amended Rule 147 or Rule 504 because of the potentially limiting features associated with other exemptions.

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offerings and issuers seeking to rely on any such state exemption could continue to conduct the offering pursuant to Section 3(a)(11) or find an alternate federal exemption.

279 *See* NASAA's Intrastate Crowdfunding Resource Center at http://www.nasaa.org/industry-resources/corporation-finance/instrastate-crowdfunding-resource-center/, retrieved in June 2015.

For instance, relative to Regulation Crowdfunding, the use of amended Rule 147 and Rule 504 in intrastate crowdfunding offerings would depend on whether the benefits of a larger offering size and fewer reporting requirements outweigh the costs of a more geographically limited investor base, compliance with issuer residency provisions under state crowdfunding laws and the potential for registration under Section 12(g) of the Exchange Act. Compared to amended Rules 147 and 504, other exemptions could remain attractive to issuers. For example, securities sold pursuant to the exemptions from registration under Rule 506 of Regulation D, which account for a significant amount of exempt offerings,[281] are subject to limits on participation by non-accredited investors. In contrast, issuers relying on amended Rule 147 or amended Rule 504 could sell securities to an unlimited number of non-accredited investors at the federal level, which would allow for a more diffuse investor base. General solicitation is currently permitted under Rule 506(c) of Regulation D, and issuers relying on Rule 506(c) can more easily reach institutional and accredited investors, making it less necessary for them to seek capital from a broader non-accredited investor base, especially if trading platforms aimed at accredited investors in privately placed securities continue to develop.[282] In addition, offerings under Rule 506 that are limited only to accredited investors have no disclosure requirements, except for a notice filing. Finally, relative to the Regulation A exemption, amended Rules 147 and 504 would have fewer disclosure and other regulatory requirements at the federal level. However, unlike Regulation A securities, which are freely resalable, Rule 147 and Rule 504 securities

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280 *See* ABA Letter.

281 *See* discussion in Section V.2 above.

282 For example, "NASDAQ Private Market's affiliated marketplace is an electronic network of Member Broker-Dealers who provide accredited institutions and individual clients with access to the market. Companies use a private portal to enable approved parties to access certain information and transact in its securities." *See* NASDAQ Private Market overview, *available at*: https://www.nasdaqprivatemarket.com/market/overview.

could be less liquid due to their resale restrictions.

Overall, the proposed amendments to Rule 147 and Rule 504 could increase the aggregate amount of capital raised in the economy if used by issuers that have not previously conducted offerings using the provisions or other exemptions, or registered offerings. The impact of the proposed amendments on capital formation could also be redistributive in nature by encouraging issuers to shift from one to another capital raising method. This potential outcome may have a significant net positive effect on capital formation and allocative efficiency by providing issuers with access to capital at a lower cost than alternative capital raising methods and by providing investors with additional investment opportunities. The net effect also would depend on whether investors find the rules' disclosure requirements and investor protections to be sufficient to evaluate the expected return and risk of such offerings and to choose between offerings reliant on Rule 147, Rule 504 and other exempt offerings.

As these proposed amendments are not currently in effect, the data does not exist to estimate the effect of the proposed rules on the potential rate of substitution between alternative methods of raising capital and the overall expansion (or decline, if any) in capital raising by potential issuers affected by the proposed amendments. However, we anticipate that the proposed amendments would result in an increased use of the Rule 147 exemption for intrastate offerings, including for intrastate crowdfunding as more states enact provisions facilitating such offerings. Similarly, we expect the proposed amendments would increase the use of the Rule 504 exemption, especially by facilitating efforts among state securities regulators to implement regional coordinated review programs that would enable regional offerings. Although it is not possible to predict the extent of such increase or the type and size of the issuers that would conduct intrastate crowdfunding offerings, the current number of businesses

pursuing similar levels of financing through alternative capital raising methods, as discussed in the baseline section, provide an upper bound for Rule 147 and Rule 504 usage.[283] Nevertheless, the baseline data show that the potential number of issuers that might seek to offer and sell securities in reliance on amended Rules 147 and 504 is large, particularly when compared to the current number of approximately 9,000 reporting companies.[284]

We recognize that the proposed amendments to Rules 147 and 504 could raise investor protection concerns. For instance, as we discuss in detail further in this section, allowing Rule 147 issuers to have more dispersed assets and revenues could reduce oversight of issuers by in-state securities regulators. However, we believe such concerns are mitigated by the continuing applicability of state regulatory requirements that may impose additional eligibility conditions, as well as the residency requirements for investors and issuers under the amended rule provisions.[285] As discussed above, in adopting Rules 147 and 504, the Commission placed substantial reliance upon state securities laws and regulations on the rationale that the size and local nature of smaller offerings conducted pursuant to these exemptions does not warrant imposing extensive regulation at the federal level.[286] State legislators and securities regulators could determine the specific additional rule requirements, if any, that should be required to

283 We believe the numbers in the baseline provide an upper bound because unlike Rule 147 offerings, investors from multiple states are permitted to invest in Regulation D offerings, which attracts more issuers, especially those that want to raise larger amounts. Similarly, unlike Rule 504, Rule 506 provides state preemption and permits unlimited offer amounts, which appears to make Rule 506 offerings more attractive for issuers.

284 *See* U.S. Securities and Exchange Commission, *FY 2016 Congressional Budget Justification, 2016 Annual Performance Plan, FY 2014 Annual Performance Report*, *available at* http://www.sec.gov/about/reports/secfy16congbudgjust.pdf.

285 By requiring offerings to be sold only to residents of the state in which the issuer has its principal place of business, amended Rule 147 would help ensure that issuers and investors are sufficiently local in nature so as to allow effective oversight by state regulators. Further, most states require Rule 504 offerings to be registered under state securities laws, which enables states to regulate capital raising activity in this market.

regulate local offerings and provide additional investor protections.[287] In this regard, the proposed amendments could provide greater flexibility to states in designing regulations that would work best for issuers and investors in their state. We believe that such latitude could improve the efficiency of local capital markets and could lead to competition between states for attracting issuers to locate in their jurisdictions.

In addition to state regulations, the proposed amendments that condition the availability of the amended Rule 147 exemption on states having an exemption that limits the maximum offering size and includes investment limits, and the proposed amendments to Rule 504 to disqualify certain bad actors from participation in Rule 504 offerings, could help to address such investor protection concerns. Finally, it should be noted that the Commission would retain authority under the antifraud provisions of the federal securities laws to pursue enforcement action against issuers and other persons involved in such offerings. Nevertheless, if investors demand higher returns because of a perceived increase in the risk of fraud as a result of less extensive federal regulation, issuers may face a higher cost of capital. We are unable to predict if or how the proposed amendments would affect the incidence of fraud in Rules 147 and 504 offerings.

In the sections below, we analyze in more detail the potential costs and benefits stemming from the specific amendments proposed today, as well as their impact on efficiency, competition and capital formation, relative to the baseline discussed above.

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286 *See* Seed Capital Release, Executive Summary and Rule 147 Adopting Release. *See also* discussion in Sections II.A and III.B above.

287 According to the NASAA Enforcement Report for 2013, securities violations related to unregistered securities sold by unlicensed individuals, including fraudulent offerings marketed through the Internet, remain an important enforcement concern. The report does not detail the number and category of violations by type of exemption from registration. *See* NASAA Enforcement Report, *available at*: http://www.nasaa.org/wp-content/uploads/2011/08/2014-Enforcement-Report-on-2013-Data_110414.pdf.

2. Analysis of Proposed Amendments to Rule 147

The proposed amendments to Rule 147 would facilitate intrastate offerings of securities by local companies, including offerings relying upon crowdfunding provisions under state securities laws. The proposed amendments seek to modernize Rule 147 to align with contemporary business practices, while retaining the underlying intrastate character of Rule 147 that permits local issuers to raise money from investors within their state without having to register the securities at the federal level.

a. Elimination of Limitation on Manner of Offering

Currently, offers pursuant to Rule 147 must be limited to state residents only. The proposed amendments to Rule 147 would allow an issuer to make offers to out-of-state residents, as long as sales are made only to residents of the issuer's state or territory.[288] In addition, the proposed amendments would require issuers to include disclosure on all offering materials stating that sales will be made only to residents of the same state or territory as the issuer, while also disclosing that the securities being sold are unregistered securities and have resale restrictions for a nine-month period.[289]

The proposed amendments would enable Rule 147 issuers to engage in broad-based solicitations, including on publicly accessible websites, in order to successfully locate potential in-state investors. For example, for a New Jersey-based Rule 147 offering, issuers would be permitted under proposed Rule 147 to advertise and disseminate offering information through online media to reach New Jersey residents that work in New York, even though such information can be viewed by New York residents. This is not permitted under the current rule.

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288 *See* Proposed Rule 147(b).

289 *See* Proposed Rule 147(f).

Hence, the proposed amendments to Rule 147 would provide issuers with the flexibility to utilize a wider array of options to advertise their offerings, taking advantage of modern communication technologies such as the Internet and other social media platforms that allow investors inside and outside the issuer's state of residence to openly access offering information. In this regard, we expect the proposed amendments to be particularly effective at facilitating state-based crowdfunding offerings that rely heavily on online platforms to bring issuers and investors together.[290]

The proposed amendments would thus make it easier for issuers to rely upon Rule 147 to conduct their offerings. Online advertising provides a cheaper and more efficient means of communicating with a more diffused base of prospective investors. Consequently, the elimination of offering limitations to residents should result in lower search costs for issuers. The amended provisions also may reduce issuers' uncertainty about compliance as they would not need to limit advertising or take additional precautions to ensure that only in-state residents could view the offering.

The inclusion of legends on certificates or other documents evidencing the security and other mandatory disclosures in offering materials would inform investors, especially out-of-state investors, about the intrastate nature of the offering. At the same time, as a greater number of investors become aware of a larger and more diverse set of investment opportunities in private offerings, the proposed amendments may enable investors to diversify their investment portfolio and allocate their capital more efficiently. Further, such broadly advertised Rule 147 offerings would be able to more effectively compete for potential investors with Rule 504, Rule 506(c), and Regulation A offerings, where general solicitation is also permitted. The proposed

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[290] *See* Massolution 2015.

amendments could thus heighten competition between unregistered capital markets, which may result in a more optimal flow of capital between investors and issuers, thereby enhancing the overall allocative efficiency of those markets.

However, as issuers utilizing amended Rule 147 advertise more widely and freely, the likelihood of out-of-state investors purchasing into the offering could increase. The inclusion of legends and other mandatory disclosures may mitigate this concern and provide a certain measure of investor protection, although out-of-state investors in their desire to avail themselves of an attractive investment opportunity may overlook the legends or disclosures or may even disregard them. While issuers are required to have a reasonable belief that all their purchasers are resident within the state, the probability of violating the intrastate sale provisions could increase (relative to the baseline), at least in resale transactions that occur within the restrictive period for intrastate resales. Broader advertising of Rule 147 offerings could also impact the effectiveness of state oversight as regulators may not have adequate resources to track the conduct of such offerings on mass media.

b. Ease of Eligibility Requirements for Issuers

i. Incorporation and Residency Requirements

The proposed amendments to Rule 147 would eliminate the requirement that issuers need to be incorporated in the state where the offering is conducted and would revise the current residency requirement to focus on the issuer's "principal place of business" rather than its "principal office." The former would be defined as the location from which officers, partners, or managers of the issuer primarily direct, control and coordinate the activities of the issuer.[291]

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[291] Proposed Rule 147(c)(1). *See also* note 55 above.

The proposed elimination of the requirement that the issuer be registered or incorporated in the state where the offering is being conducted would align the rule's provisions with modern business practices, thereby making it easier for a greater number of issuers to utilize the exemption. A significant number of companies are incorporated in states other than where their principal place of business is located.[292] Most of these companies have chosen to incorporate in places where corporate laws, including corporate tax laws, comport with modern business practices or are more permissive. For example, according to one academic study, corporate laws affect firm value, even after controlling for firm size, diversification, profitability, investment opportunities and industry.[293] Thus, firms have strong incentives to select favorable local regimes such as Delaware.[294] These studies and industry practices indicate that firms' choice of state of incorporation depends on the economic benefits derived from the regulatory environment in which the firm is organized, and as such the choice of legal home state may not be substantially related to where the business operations of the firms are located.

The practice of incorporating in certain states extends beyond public companies to private and smaller companies. As discussed in our baseline analysis above, data from Form D filings for the period 2009–2014 indicates that a significant percentage of Rule 504 and Rule 505 issuers were incorporated in Delaware and had separate states of incorporation and principal

292 Based on an analysis of data from Thomson Reuters' Compustat North America, approximately 74% of Exchange Act reporting companies indicated that, in 2014, they had separate state of location of headquarters and state of incorporation.

293 Daines, Robert, "Does Delaware Law Improve Firm Value?" *Journal of Financial Economics*, Volume 62, Issue 3 (2001): 525-558.

294 *See* Scott D. Dyreng, Bradley P. Lindsey, Jacob R. Thornock, "Exploring the Role Delaware Plays as a Domestic Tax Haven," *Journal of Financial Economics*, Volume 108, Issue 3, (2013):751-772 (explaining that Delaware's tax laws play an economically important role in U.S. firms' decision to locate in Delaware).

places of business.[295] While smaller firms are less likely than larger firms to have separate states of incorporation and primary places of business, the Form D data described in the baseline indicates that a considerable number of small businesses are currently unable to meet the state of incorporation requirement in order to use the existing Rule 147 safe harbor. Since geography of investment and employment is aligned more closely with the principal place of business of a firm than with place of incorporation, replacing the current incorporation and residency tests with a principal place of business test would be consistent with the intrastate objective of Rule 147 and make it easier for more issuers to utilize the exemption.

Eliminating the requirement to be incorporated in-state also would enable foreign incorporated issuers that have their principal place of business in a U.S. state to access the Rule 147 capital market. This would create a uniform basis for firms that are operating in similar local fashion, irrespective of their country or state of incorporation, to utilize the Rule 147 exemption. Form D filings for the period 2009–2014 reported that approximately 3% of Regulation D offerings (approximately 3,000 offerings) were initiated by issuers that were incorporated outside of the United States and had their principal place of business in a U.S. state.

We recognize the potential for issuers to switch their principal place of business to a different state in order to conduct Rule 147 offerings in multiple states. To mitigate such concerns, the proposed amendments limit issuers that change their principal place of business from utilizing the exemption to conduct another intrastate offering in a different state for a period of nine months from the date of last sale of securities under the prior Rule 147 offering. This would be consistent with the duration of the resale limitation period during which sales to out-of-

[295] The data indicates that approximately 66% of all Rule 506 offerings initiated during 2009–2014 reported different states of incorporation and operations.

state residents are not permitted. As we discuss in detail below, such a provision should help to deter issuers from misusing the amended residency requirements to change their principal place of business in order to sell to residents in multiple states.

ii. "Doing Business" In-State Requirements

The proposed amendments to Rule 147 would modify the current "doing business" in-state tests for issuers by requiring them to have a principal place of business in-state and to satisfy one of four specified tests. The proposed amendments would include a new alternative test whereby issuers can qualify if a majority of their employees are located in the state. Consequently, under proposed Rule 147, in order to be deemed "doing business" in a state, issuers would have to have a principal place of business in-state and satisfy at least one of the following requirements:

- 80% of the issuer's consolidated assets are located within such state or territory;
- 80% of the issuer's consolidated gross revenues are derived from the operation of a business or of real property located in or from the rendering of services within such state or territory;
- 80% of the net proceeds from the offering are intended to be used by the issuer, and are in fact used, in connection with the operation of a business or of real property, the purchase of real property located in, or the rendering of services within such state or territory; or
- A majority of the issuer's employees are in such state or territory.

The proposed modifications to the existing "doing business" in-state tests would provide greater flexibility to potential Rule 147 issuers and thereby ease their burden in complying with

the exemption, while also better aligning the regulation with modern business practices. Issuers could use the test that best reflects the local nature of their business operations.

As currently required, satisfying all the existing "doing business" in-state tests may be burdensome even for small businesses that are largely located in one state. For example, by restricting issuers' operations and capital investments substantially to one state, the existing requirement to qualify under all these tests may have adverse effects on the growth and survival of startups and early stage ventures that rely on the exemption.[296] Moreover, in recent years new business models have emerged that may make satisfying all the eligibility tests ill-suited for relying on the Rule 147 exemption as a capital raising option. For example, businesses that use new technologies (*e.g.*, *e*-businesses) to make their operations more efficient tend to be more geographically distributed in their operations or revenues than what is permitted under current Rule 147. According to an academic study, advances in computing and communications have fundamentally changed how information can be stored, distributed, modified or assimilated, which has enabled businesses to become more geographically dispersed and modular rather than centralized into discrete units.[297] Similarly, the growth of modern technologies has made it easier for firms, through *e*-commerce and shared logistical networks, to reach a larger and more diffused customer base, leading to more dispersed revenue streams.

Requiring an issuer to own a majority of its assets in one state, invest most of the capital raised in one state, and obtain revenue mostly from in-state sales could create inefficient constraints for startups and small businesses to operate and grow. While the original intent of

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[296] For example, an e-commerce company may need to invest in distribution facilities outside their state to meet needs of customers who are more likely to be resident outside the state. Under current rule provisions, they may be able to invest only a small part (less than 20%) of the capital raised in a Rule 147 offering outside their principal state of business.

[297] *See* Mohanbir Sawhney and Deval Parikh, "Where Value Lives in A networked World," Harvard Business

Section 3(a)(11) and Rule 147 was to ensure that investors and issuers are located in the same state so that they are potentially familiar with each other,[298] current business practices of issuers, consumption habits of customers, and the set of available investment opportunities of investors have expanded greatly since Rule 147 was adopted in 1974. In view of these economic and social changes, we believe that the proposed principal place of business requirement and the modification to require an issuer to satisfy at least one additional test that demonstrates that that issuer does business in-state would more effectively establish the local nature of an offering pursuant to Rule 147.

The proposed amendments, by easing the eligibility and residency requirements for issuers, would enable a greater number of firms to use Rule 147 to raise capital. Such new issuers could be those entities that are currently accessing capital through an alternate private capital market, or they could be issuers that could not previously raise capital in any market but would be able to use amended Rule 147 to meet their funding needs. In addition, to the extent raising capital in the Rule 147 market is cheaper than raising capital in alternate capital markets, issuers would benefit from such lower costs. Easier access to local capital would enable issuers to finance investment opportunities in a timely manner, thereby accelerating firm growth, which could consequently promote state employment and economic growth.

As more firms become eligible or are willing to raise capital pursuant to amended Rule 147, the set of investment opportunities for investors would also increase in a corresponding manner, resulting in greater allocative efficiency and higher capital formation. To the extent the use of Rule 147 increases because of substitution out of other capital markets, the

Review, 2001.

298 *See* Rule 147 Adopting Release.

economy-wide increase in capital formation may not be significant while competition amongst private capital markets would be higher.[299] To the extent that amended Rule 147 attracts new issuers, capital formation levels would increase in the economy. We also believe that, by facilitating intrastate crowdfunding, amended Rule 147 would likely finance new firm growth and consequently would lead to an overall increase in capital formation. Further, amended Rule 147 could also lead to higher capital formation by facilitating offerings, including those with offer sizes greater than what is allowed for intrastate crowdfunding offerings, under other state exempted or state-registered offerings. However, since we do not have data on the existing use of Rule 147, we are unable to quantify or predict the extent of any increase in offering activity in non-crowdfunding offerings under amended Rule 147.

At the same time, allowing issuers with a different state of incorporation to raise capital in another state under amended Rule 147 could result in fewer incorporations for the state where the offering is being conducted, if this proposed amendment results in more issuers relocating to jurisdictions with perceived legal and tax advantages. Moreover, if issuers with widely-distributed assets and operations over more than one state make use of amended Rule 147, state oversight of such issuers could weaken, with a consequent decrease in investor protection. For example, if a majority or a significant proportion of an issuer's assets is located out-of-state, it could be more difficult for state regulators to assess whether any disclosures to investors about such assets are fair and accurate. However, state enforcement actions for protecting in-state investors can extend to issuers whose assets are located beyond the boundaries of the state, which could potentially deter issuers from engaging in fraudulent intrastate offerings. We also

[299] We note that issuers that meet current requirements under existing Rule 147 would also be eligible to rely on amended Rule 147.

believe that qualifying under any one of the four "doing business" in-state tests and requiring an issuer to have an in-state principal place of business, such that the officers and managers of the issuer primarily direct, control and coordinate the activities of the issuer in the state, would provide a state regulator with a sufficient basis from which to regulate an issuer's activities and enforce state securities laws for the protection of resident investors. In addition, if the proposed amendments to Rule 147 are adopted, state regulators may choose to amend their state regulations to comport with amended Rule 147, which would allow them to consider any additional requirements, including qualification tests, for issuers to comply with state securities offerings regulations.

At the same time, even under the proposed amendment requiring issuers to qualify under one of the specified "doing business" in-state tests, the high threshold levels specified in such tests may preclude certain issuers that use modern business models (*e.g.*, some *e*-commerce entities) from relying on the exemption, as such issuers could have widely distributed operations that may not allow them to qualify under any of the four tests.[300]

Additionally, the proposed amendment to limit the ability of issuers for a period of nine months from the date of last sale of securities under a Rule 147 offering to conduct a new Rule 147 offering in a different state would discourage issuers from altering their principal place of business to raise capital through multiple state offerings. The duration of this proposed restriction is consistent with the period in which resales to out-of-state investors would not be permitted. In this regard, the proposed amendment could help mitigate some of the concerns relating to investor protection that may arise from the amended residency requirements. To the extent a change in principal place of business to a new state is motivated by business needs, this

amendment could affect the capital raising prospects of firms by forcing them to delay their intrastate offerings. For example, certain start-ups and small businesses that could potentially change their principal place of business at lower costs could be affected by the proposed amendment. Issuers located in a greater metropolitan area (*e.g.*, New Jersey and New York City) that spans multiple states also may be likely to consider switching their principal place of business to raise capital from residents of another state, and may be also impacted by the proposed amendment.

We note that, under the integration provisions of current and proposed Rule 147, an issuer that conducts a Rule 147 offering in one state within six months of having offered or sold securities pursuant a Rule 147 offering in another state would have such offers and sales integrated for the purpose of compliance with the federal rule. In this respect, we believe that the proposed nine-month period during which an issuer would be prohibited from conducting an intrastate offering pursuant to the proposed rule after having completed sales of securities pursuant to the proposed rule in a different state would have the effect of extending by three months the six-month period of time during which issuers cannot make sales in another state or territory.

c. Maximum Offering Amount and Investment Limitations for Offerings with Exemption from State Registration

The proposed amendments would limit the availability of the exemption at the federal level to offerings that are either registered in the state in which all of the purchasers are resident or conducted pursuant to an exemption from state law registration in such state that limits the amount of securities an issuer may sell pursuant to such exemption to no more than $5 million in

[300] Market participants, state regulators and other commenters have expressed similar concerns about the prescriptive threshold requirements for these tests. *See* note 11.

a twelve-month period and imposes an investment limitation on investors. These proposed limits would provide additional protections at the federal level and could mitigate investor protection concerns that may arise from the proposed modernization of Rule 147. Specifically, the proposed availability of amended Rule 147 to exempt offerings of up to $5 million in a twelve-month period could provide greater investor protection by reducing the scale of fraudulent offerings, especially those that may be directed towards non-accredited investors and do not have significant state oversight. Similarly, the proposed limitation on the availability of the amended rule, as it relates to offerings that are exempt from state registration, to offerings that are conducted pursuant to a state law exemption that includes investment limitations could reduce the individual exposure of investors to potential fraud or loss of investment in a state-exempt offering pursuant to amended Rule 147.

The proposed amendments would not alter existing state provisions that rely on, or the ability of states to adopt provisions that require issuers to comply with, Section 3(a)(11) and that may not impose a limitation on the maximum aggregate offering amount an issuer can raise or include investment limitations. As Rule 147 would no longer be a safe harbor for compliance with Section 3(a)(11), however, some states would need to update their existing provisions in order to effectively realize the benefits of the proposed amendments to Rule 147. These updates could be limited to removing existing references to Section 3(a)(11) and/or adopting additional provisions that comport with the proposed rule. In the interest of expanding capital raising opportunities, some state regulations may be overly permissive, leading to a "race-to-the-bottom" that could ultimately impair investor protection. Given that state regulators have economic and reputational incentives to provide local issuers and investors with capital markets that are viable over the long run, it is unclear how significant this "race-to-the-bottom" would be.

Current intrastate crowdfunding provisions provide exemptions for offerings of less than $5 million and most of these state provisions have investment limits for non-accredited investors. For example, the highest maximum offering limit that any intrastate crowdfunding provisions currently permit is in Illinois, for crowdfunded offerings up to $4 million. As shown in the baseline, the median (average) offering size limit is $2 million ($1.6 million) in all the states that currently permit crowdfunding transactions. The impact of the proposed amendments on states regulatory flexibility is therefore moderated by the current absence of an intrastate crowdfunding exemption that permits offerings greater than $5 million. In addition, while the proposed amendment relating to investment limits only permits issuers to conduct their offerings pursuant to the proposed rule in states that have included investment limitations, it does not specify what such limitations should be.

However, such limitations at the federal level could unduly restrict capital raising options of issuers, especially those issuers that sell primarily to accredited investors. A limit on the maximum offering amount could also restrict legitimate state interests in permitting larger offerings within their jurisdictions that otherwise rely on Rule 147 at the federal level. To the extent competition between states to enact securities laws to attract issuers to their territories results in better regulations that promote effective functioning of local financial markets, the proposed amendments would limit state regulators' opportunities to customize provisions that better suit the interests of issuers and investors in their state, rather than using a "one-size fits all," or uniform, approach at the federal level that may work better for issuers and investors in some states than others.

3. Additional Amendments to Rule 147

The proposed rules would include a number of additional amendments to Rule 147,

including removing the requirement that an issuer obtain investor representations as to residency status and establishing a reasonable belief standard for determining whether a purchaser is a state resident at the time of the sale of the securities. This proposed amendment would be conceptually consistent with similar requirements in Regulation D offerings and would provide greater certainty to issuers as to their compliance with the conditions of the exemption, potentially encouraging greater reliance on the amended rule. In addition, providing a reasonable belief standard for ascertaining the in-state residency of investors would provide greater flexibility for Rule 147 issuers who currently are required to obtain a written representation from investors about their residency, and who are provided no relief under the rules for sales to persons that are not, in fact, in-state residents. This, in turn, could increase the number of issuers that rely on the amended Rule 147 exemption. At the same time, such provisions may result in issuers selling to investors who are not, in-fact, residents of the state, with a corresponding decline in investor protection. We believe this decline would be somewhat mitigated by any additional requirements that state securities laws may prescribe, as well as the reasonable belief standard and the mandatory disclosures and legends required under the proposed rule amendments.

Moreover, the proposed rules would add a provision to define the residence of a purchaser that is a legal entity—such as a corporation, partnership, trust or other form of business organization—as the location where, at the time of the sale, the entity has its principal place of business. This definition would create consistency in defining the place of residence of entity investors with that of the issuer while also helping to ensure that investors are sufficiently local by nature. Such uniformity would also help to alleviate the rule's compliance burden by providing greater certainty.

The proposed rule also would include a provision to amend the limitation on resales in Rule 147(e) to provide that resales can be made only to in-state residents during the nine-month period from the date of sale by the issuer. By amending the start date for the restricted period from "date of *last* sale" to "date of sale" for the particular security in question, investors will be able to sell before the entire offering is completed, while preserving the intent of restricting resales during a nine-month holding period to provide assurance that the securities have come to rest in-state before out-of-state sales begin to occur. The amendment would thus provide greater liquidity for Rule 147 securities, making them more attractive to investors, which could lead to greater investor participation and an increase in the supply of capital available in the Rule 147 market. Further, it could improve price discovery and lead to lower capital raising costs for issuers.

Additionally, the proposed approach not to condition the availability of the exemption on the issuer complying with provisions relating to resale restrictions would provide greater certainty to issuers. For example, issuers would not need to be concerned about potentially losing the exemption when the resale provisions are violated under circumstances that are beyond their control. At the same time, given that issuers would continue to be subject to other compliance conditions such as in-state sales limitations, mandatory offeree and purchaser disclosures, and stop transfer instructions, as well as federal antifraud and civil liability provisions, we believe, that this proposed amendment would not significantly increase risk of investor harm.

The proposed amendment to Rule 147(f) to require disclosure regarding the limitations on resale to every offeree, in the manner in which the offering is communicated, would provide greater flexibility to issuers and ease compliance burdens in cases of oral offerings. Similarly,

the proposed amendments to remove the requirement to disclose to offerees and purchasers the stop transfer instructions provided by an issuer to its transfer agent and the provisions of Rule 147(f)(2) regarding the issuance of new certificates during the Rule 147(e) resale period, would also ease compliance burdens for issuers. These changes together would lower the regulatory burden for issuers, especially smaller issuers, but may adversely impact the information provided to potential investors (offerees), who may not receive such information in writing, prior to making their investment decision. This impact is somewhat mitigated by the continuing requirement to provide the disclosure regarding resale restrictions, in writing, to every purchaser.

Finally, the proposed rule would expand the current Rule 147 integration safe harbor such that offers and sales pursuant to Rule 147 would not be integrated with: (i) any prior offers or sales of securities, (ii) any offers or sales made more than six months after the completion of the offering, or (iii) any subsequent offer or sale of securities that is either registered under the Securities Act, exempt from registration pursuant to Regulation A, Regulation S, Rule 701, or Section 4(a)(6) or made pursuant to an employee benefit plan. The expansion of the integration safe harbor would provide issuers with greater certainty that they can engage in other exempt or register offerings either prior to or near in time with an intrastate offering without risk of becoming ineligible to rely on the Rule 147 exemption. Similarly, the addition of Section 4(a)(6) to the list of exempt offerings which will not be integrated with a Rule 147 offering would provide certainty to issuers that they can conduct concurrent crowdfunding offerings as per the provisions of the respective exemptions. This flexibility and ensuing certainty would be especially beneficial for small issuers who likely face greater challenges in relying on a single financing option for raising the desired amount of capital. However, such expansion of the

integration safe harbor could result in fewer investor protections than if the offerings were integrated. The proposed rule, however, provides for non-integration only to the extent that the issuer meets the requirements of each of the other offering exemptions that are used to raise capital. Furthermore, requiring an issuer to wait at least 30 calendar days between its last offer made in reliance on Rule 147 and the filing of a registration statement with the Commission would provide additional protection to investors in registered offerings who might otherwise be influenced by an earlier intrastate offering. Therefore, we do not believe that the proposed adoption of the integration safe harbor would result in a significantly increased risk to investors.

4. Analysis of Proposed Amendments to Rule 504

The proposed amendments to Rule 504 would raise the maximum aggregate amount that could be raised under a Rule 504 offering, in a 12-month period, from $1 million to $5 million and would disqualify certain bad actors from participation in Rule 504 offerings. Additionally, in order to account for the proposed increased to the Rule 504 aggregate offering amount limitation, we propose technical amendments to the notes to Rule 504(b)(2) that would update the current illustrations in the rule regarding how the aggregate offering limitation is calculated in the event that an issuer sells securities pursuant to Rule 504 and Rule 505 within the same twelve-month period.[301] All other provisions of current Rule 504 of Regulation D would remain unchanged.

As shown in our baseline analysis above, use of Rule 504 offerings has been declining over the past decade, in absolute terms as well as relative to Rule 506 of Regulation D. Relative to Rule 504 offerings, Rule 506 offerings have the advantage of preemption from state registration. Thus, even though Rule 506(b) offerings, unlike Rule 504 offerings, are limited to

[301] *See* Notes 1 and 2 to Rule 504(b)(2). [17 CFR 230.504(b)(2)].

accredited investors and up to only 35 non-accredited investors, capital raising activity during the last two decades suggests that the benefits of state preemption outweigh unrestricted access to non-accredited investors. With the adoption of Rule 506(c), which allows for general solicitation, the comparative advantage of current Rule 504 has further diminished.

The current $1 million maximum amount was set by the Commission in 1988 and was meant to provide "seed capital" for small and emerging businesses.[302] Given the costs of raising capital from public sources, the unregistered offerings market has expanded significantly in the past twenty-five years. The growth of angel investors and VCs, who invest primarily through unregistered offerings, has also increased seed capital available for investment at the initial stages of a firm. Angel investments in 2014 amounted to approximately $24 billion in 2014 and the average angel deal size was approximately $328,500.[303] According to PWC MoneyTree, in 2008, U.S. VCs made $1.5 billion of seed investments in 440 companies.[304] That is an average seed investment of $3.5 million per company. While the involvement of VCs at the seed stage has been increasing over the years, it is reported that some angel deals at the seed stage have included investments as large as $2.5 million per entity.[305] Given these changes, amending the Rule 504 offer size from $1 million to $5 million would better comport regulation with market

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302 *See* "Seed Capital" Release.

303 According to a recent report, angel investments amounted to $24.1 billion in 2014, with approximately 73,400 entrepreneurial ventures receiving angel funding and approximately 316,600 active angel investors. Seed/startup stage deals accounted for approximately 25% of the $24 billion. *See* Jeffrey Sohl, *The Investor Angel Market in 2014: A Market Correction in Deal Size, Center for Venture Research*, May 14, 2015, *available at* https://paulcollege.unh.edu/sites/paulcollege.unh.edu/files/webform/2014%20Analysis%20Report.pdf.

304 *See* PricewaterhouseCoopers, Investment by Stage of Development, available at: https://www.pwcmoneytree.com/CurrentQuarter/BySoD.

305 *See* Fenwick & West Survey 2012 (March 2013), available at https://www.fenwick.com/publications/Pages/Seed-Finance-Survey-2012.aspx. The survey defines a "seed" financing as the first round of financing by a company in which the company raises between $250,000 and $2,500,000, and in which professional investors play a lead role.

trends that indicate larger seed capital infusions.

Four parallel developments may further change the regulatory landscape surrounding existing Rule 504. First, the use of current Rule 504 could be overshadowed by interstate crowdfunding offerings pursuant to Section 4(a)(6), which also allows issuers to raise up to $1 million over a 12-month period with unlimited access to non-accredited investors and unrestricted use of general solicitation, in addition to preemption from state regulation and exemption from the registration requirements under Section 12(g). Second, at least 29 states and the District of Columbia have enacted and several other states are in the process of enacting their own crowdfunding exemptions where the maximum amount that can be raised in a 12-month period ranges from $250,000 to $4 million, depending on the state (up to $2 million for all but three states). The maximum offering amounts for intrastate crowdfunding thus exceed the current offer limit under Rule 504. While most state crowdfunding exemptions require use of Rule 147, currently two states allow issuers to conduct their intrastate crowdfunding under the Rule 504 exemption. Third, state regulators have been working to implement regional coordinated review programs in order to facilitate regional offerings that could potentially save issuers time and money. Additionally, at least one state is in the process of enacting reciprocal crowdfunding provisions, which may allow issuers to conduct interstate crowdfunding under state regulation.[306] Since Rule 147 is restricted to intrastate offerings, Rule 504 would be the most likely federal exemption that could be used for such regional offerings. Fourth, Tier 1 of amended Regulation A, which became effective in June 2015 and has a similar eligible issuer universe as Rule 504, allows offerings up to $20 million without any restrictions on resale of

[306] *See* http://www.nasaa.org/industry-resources/corporation-finance/coordinated-review/. See also, the 'Reciprocal Crowdfunding Exemption' proposed by the Massachusetts Securities Division.

securities.

In light of these developments, the increase in the maximum amount that can be raised in Rule 504 offerings to $5 million could help make this market more attractive for startups and small businesses while also facilitating intrastate and regional offerings greater than $1 million.

A higher offering amount limit for Rule 504 offerings could increase the number of issuers that seek to utilize the exemption. To the extent that amended Rule 504 permits issuers to raise larger amounts of capital at lower costs than other unregistered capital markets, the proposed amendment could also lower issuer cost of capital and facilitate intrastate crowdfunding and the regional offerings market as it evolves. In addition to new issuers raising capital for the first time, it is likely that some issuers currently using other unregistered capital markets may switch to the amended Rule 504 market. Such movement would increase competition for supply of and demand for capital between the different unregistered markets, especially exemptions pursuant to amended Rule 147, Rule 506 of Regulation D, Regulation A, Regulation Crowdfunding, and other Section 4(a)(2) and Section 3(a)(11) exemptions. Further, modernizing our exemptive scheme in order to provide issuers, and especially small businesses, with more options for capital raising could foster an environment that encourages new market participants to enter the capital markets, thereby enhancing the overall level of capital formation in the economy.

The proposed increase in the Rule 504 offering amount limit could also increase the number of investors, including non-accredited investors that can access a wider array of investment opportunities to diversify their investment portfolios with positive effects on the

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http://www.sec.state.ma.us/sct/crowdfundingreg/Reciprocal%20Crowdfunding%20Exemption%20-%20MA.PDF.

supply of capital and the allocative efficiency of unregistered capital markets. At the same time, increased access by non-accredited investors to Rule 504 offerings could raise investor protection concerns. Incidence of fraud could be higher under regional offerings relying on the Rule 504 exemption due to reduced oversight by states that may rely on reciprocal registration or coordinated review programs in the alternate state. The Commission's experience with the elimination of the prohibition against general solicitation for Rule 504 offerings in 1992[307] and its subsequent reinstatement in 1999 as a result of heightened fraudulent activity[308] illustrates the potential for fraud in the Rule 504 market. It should be noted, however, that in 1999 we concluded that the increase in fraud occurred as a result of the prohibition on *unrestricted* general solicitation being removed and because securities issued under Rule 504 offerings were unrestricted.[309] As a result, a non-reporting company could sell up to $1 million of unrestricted securities in a 12-month period and be subject only to the antifraud and civil liability provisions of the federal securities laws. In contrast, the proposed amendments would only increase the aggregate offering amount limitation of Rule 504, thereby leaving existing restrictions on general solicitation and the restricted securities status of the securities unchanged. State registration requirements may also mitigate the risk for investor abuse in Rule 504 offerings.

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307 *See* Adoption of Small Business Initiatives, SEC Release No. 33-6949 (July 30, 1992).

308 *See* Seed Capital Release.

309 *Id.* As the Commission noted at the time it proposed to eliminate the unrestricted nature of securities issued under Rule 504, securities issued in these Rule 504 offerings may have facilitated a number of fraudulent secondary transactions in the over-the-counter markets. The Commission also noted that these securities were issued by "microcap" companies, characterized by thin capitalization, low share prices and little or no analyst coverage. As the freely-tradable nature of the securities facilitated the fraudulent secondary transactions, we proposed to "implement the same resale restrictions on securities issued in a Rule 504 transaction as apply to transactions under the other Regulation D exemptions," in addition to reinstating the prohibition against general solicitation. Although we recognized that resale restrictions would have "some impact upon small businesses trying to raise 'seed capital' in bona fide transactions," we believed at the time that such restrictions were necessary so that "unscrupulous stock promoters will be less likely to use Rule 504 as the source of the freely tradable securities they need to facilitate their fraudulent activities in the secondary markets." *See* Proposed Revision of Rule 504 of Regulation D, the "Seed Capital"

Recent enforcement cases involving Rule 504 offerings could also raise concerns regarding the potential for increased incidence of fraud under the proposed amendments. Most of these cases have involved promoters who engaged in secondary market sales of unrestricted securities that were previously issued in reliance on Rule 504(b)(1)(iii), defrauding investors and in some cases unsophisticated issuers.[310] Securities issued in reliance on Rule 504(b)(1)(iii) are exempt from state registration, and are permitted to use general solicitation. While the incidence of enforcement cases in this market has since declined, we recognize that an increase in the maximum offering size could increase the risk of investor harm, at least in offerings that are exempt from state registration.

Some of these investor concerns could be mitigated by the proposed amendments to Rule 504(b)(2) and the proposed amendment to extend bad actor disqualification provisions to Rule 504, consistent with other rules under Regulation D. As described above, the proposed amendment to Rule 504(b)(2) would update the current illustrations of how the aggregate offering limitation is calculated in the event that an issuer sells securities pursuant to Rule 504 and Rule 505 within the same twelve-month period. By enabling market participants to calculate more easily the amounts permitted to be sold, this amendment would provide greater clarity as to issuer compliance with the proposed increased aggregate offering limitation.

The proposed amendments to Rule 504 would include bad actor disqualification provisions that are substantially similar to related provisions in Rule 506 of Regulation D.[311] Consistent with Rule 506(d), the proposed amendments would require that the covered person's

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Exemption, No. 33-7541 (May 21, 1998) [63 FR 29168 (May 28, 1998)], Executive Summary.

310 *See, e.g.*, SEC v. Stephen Czarnik, Case No. 10-cv-745 (S.D.N.Y.), Litigation Release No. 21401 (Feb. 2, 2010); SEC v. Yossef Kahlon, a/k/a Jossef Kahlon and TJ Management Group, LLC, Case No. 4:12-cv-517 (E. D. Tex.) (Aug. 14, 2012).

status be assessed at the time of the first sale of securities. As in Rule 506(d), the proposed disqualification provisions would not preclude the participation of bad actors whose disqualifying events occurred prior to the effective date of the final amendments, which could expose investors to the risks that arise when bad actors are associated with an offering. However, issuers would be required to disclose disqualification events that occurred prior to the effectiveness of the proposed amendments. The risks to investors from participation of covered persons with prior disqualifying events may therefore be partly mitigated as investors would have access to relevant information that could inform their investment decisions. Disclosure of prior disqualifying events may make it more difficult for issuers to attract investors, and issuers may experience some or all of the impact of disqualification as a result. Some Rule 504 issuers may accordingly choose to exclude involvement by prior bad actors to avoid such disclosures.

We expect that the bad actor disqualification provisions could help reduce the potential for fraud in these types of offerings and thus strengthen investor protection. If disqualification standards lower the risk premium associated with the risk of fraud due to the presence of bad actors in securities offerings, they could also reduce the cost of capital for issuers that rely on the amended Rule 504 exemption. In addition, the requirement that issuers determine whether any covered persons are subject to disqualification might reduce the need for investors to conduct their own due diligence and could therefore increase efficiency. While fraud can still occur without prior incidence of disqualification on the part of the issuer or covered persons, these provisions could mitigate some of the concerns relating to incidence of fraud in offerings pursuant to amended Rule 504, including offerings pursuant to regional coordinated review

[311] *See* Rules 505(b)(2)(iii) and 506(d) of Regulation D, 17 CFR 230.505(b)(2)(iii), 230.506(d).

programs, that could be registered in one jurisdiction but offered and sold in multiple jurisdictions.

The disqualification provisions could also impose costs on issuers and covered persons. Issuers that are disqualified from using amended Rule 504 may experience an increased cost of capital or a reduced availability of capital, which could have negative effects on capital formation. In addition, issuers may incur costs related to seeking disqualification waivers from the Commission and replacing personnel or avoiding the participation of covered persons who are subject to disqualifying events. Issuers also might incur costs to restructure their share ownership to avoid beneficial ownership of 20% or more of the issuer's outstanding voting equity securities by individuals subject to disqualification.

As discussed above, the proposed amendments would provide, by reference to Rule 506(d), a reasonable care exception as applicable for other exemptive rules under Regulation D. A reasonable care exception could facilitate capital formation by encouraging issuers to proceed with Rule 504 offerings in situations in which issuers otherwise might have been deterred from relying on Rule 504 if they risked potential liability under Section 5 of the Securities Act for unknown disqualifying events. At the same time, this exception also could increase the potential for fraud, by limiting issuers' incentives to determine whether bad actors are involved with their offerings. We also recognize that some issuers might incur costs associated with conducting and documenting their factual inquiry into possible disqualifications. The rule's flexibility with respect to the nature and extent of the factual inquiry required could allow an issuer to tailor its factual inquiry as appropriate to its particular circumstances, thereby potentially limiting costs. Finally, we note that extending the disqualification provisions to Rule 504 would create a more

consistent regulatory regime under Regulation D that would simplify due diligence requirements and thereby benefit issuers and investors that participate in different types of exempt offerings.

C. Alternatives

1. Rescind Rule 505 Exemption

As discussed in our baseline analysis above, over the past 20 years, the use of the Rule 505 exemption has declined steadily and to a greater extent than the decline in the use of the Rule 504 exemption, in terms of the number of new offerings and amount of capital raised. During 2014, Rule 505 offerings raised less than 0.02% of capital raised in the Regulation D market, and approximately 2% of all capital raised by Regulation D offerings of less than $5 million, Rule 506 which has state preemption clearly dominates the market due to the lower regulatory burden associated with this provision, relative to Rules 504 and 505.

Further, we believe that by allowing offerings up to $5 million, amended Rule 504 would be preferable to existing Rule 505 for issuers currently eligible for both exemptions because it would provide access to an unlimited number of non-accredited investors and restricted general solicitation. Other unregistered markets may also provide a comparable market for potential Rule 505 issuers to raise the desired capital.[312] Rescinding Rule 505 would therefore simplify the existing scheme of exemptive rules and regulations for unregistered offerings by making it easier for issuers and investors to choose between different capital markets.

To the extent that issuers are not able to switch to an alternate market or raise a sufficient amount of capital, however, rescinding Rule 505 could cause overall capital formation in the

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312 For example, Rule 506(b) enables issuers to raise unlimited amounts along with providing preemption from state regulation; however, Rule 506(b) offerings are limited to 35 non-accredited investors who must be sophisticated, either individually or through a purchaser representative. In contrast, while Regulation A offerings have greater disclosure requirements, they provide unlimited access to non-accredited investors with the added benefit of unrestricted resales of securities.

economy and allocative efficiency of capital markets to decline. For example, reporting companies and investment companies cannot utilize the Rule 504 exemption. However, very few reporting companies (8 out of 289) or fund issuers (11) used the Rule 505 exemption during 2014,[313] and these issuers can switch to a Rule 506 offering with little or no costs. We, therefore, believe that most Rule 505 issuers would likely be able to utilize other exemptions.

The impact of repealing Rule 505 would also depend on investor willingness and ability to switch from an investment in a Rule 505 offering to an investment in an alternate unregistered capital market. Overall, we believe that repealing Rule 505 would not have a significant, or any, impact on capital formation because issuers would likely be successful at finding commensurate capital supply in an alternate unregistered capital market.

[313] Based on an analysis of Form D filings. The numbers were similar during 2009-2013.

2. Lower Qualifying Thresholds under "Doing Business" In-State Tests

An alternative to the proposed amendments relating to the four alternative criteria an issuer must satisfy in order to demonstrate it is doing business in-state could be to lower the percentage thresholds for the current or proposed 80% threshold requirements. For example, compared with the current 80% threshold requirements, requiring issuers to have the majority of their assets, derive the majority of their revenue, or use the majority of their offering proceeds in-state could better comport with modern business practices, provide greater flexibility and make it less burdensome for issuers to satisfy these requirements. Such a change would also align Rule 147 with other tests, including the proposed majority employees test, and also those tests that use a majority threshold for determining issuer status, for example for determining foreign private issuers.[314]

Lowering the prescriptive threshold requirements, while retaining the requirement to satisfy all or some of the criteria that provide indicia of in-state business, would help balance issuer compliance obligations with the need to align the locus of Rule 147 capital raising more closely with issuer operations. At the same time, if issuers with widely-distributed operations over more than one state are able to make greater use of amended Rule 147 under such lower thresholds, state oversight of such issuers could weaken, with a consequent decrease in investor protection. Some of these concerns could be mitigated by continuing to restrict sales to in-state residents and the inclusion of the principal place of business requirement, by the ability of states to extend their enforcement activities to issuers whose assets are located beyond state borders, and by the availability of federal authority to pursue enforcement action under the antifraud provisions of the federal securities laws.

[314] *See* Securities Act Rule 405 and Exchange Act Rule 3b.

3. Eliminate "Doing Business" In-State Tests

As another alternative to the proposed rules we considered eliminating the proposed requirement to qualify under any of the "doing business" tests. This alternative would significantly ease the burden for potential Rule 147 issuers in complying with the exemption, while also modernizing regulations to align with modern business practices. As described above, in recent years new business models have emerged that may make the eligibility tests ill-suited for relying on the Rule 147 exemption as a capital raising option. Requiring an issuer to own a significant proportion of its assets, have a majority of its employees in one state, invest most of the capital raised in one state, or derive revenue mostly from in-state sales could create inefficient constraints for startups and small businesses to operate and grow. In view of these broad changes in business practices, the principal place of business requirement may be sufficiently effective in establishing the local nature of an offering pursuant to Rule 147 for purposes of compliance with the "doing business" in-state requirement at the federal level. Relative to the proposed approach, this alternative approach would provide more flexibility to state regulators to enact their own eligibility and residency requirements that better suit the interests of issuers and investors in their state, rather than using a "one-size-fits all," or uniform, approach at the federal level that may work better for issuers and investors in some states than others.

At the same time, under such alternative, as issuers with widely-distributed assets and operations over more than one state make use of amended Rule 147, state oversight of such issuers could weaken, with a consequent decrease in investor protection. For example, if a majority or a significant proportion of an issuer's assets is located out-of-state, it could be more difficult for state regulators to assess whether any disclosures to investors about such assets are

fair and accurate. At the same time, state enforcement actions for protecting in-state investors can extend to issuers whose assets are located beyond the boundaries of the state. Additionally, under this alternative, the principal place of business requirement would replace the prescriptive "doing business" in-state requirements and could help mitigate investor protection concerns related to the local nature of the offering.

4. Decreasing or Increasing Rule 504 Maximum Offering Limit

The offer limit under Rule 504 was last increased from $500,000 to $1 million in 1988. Adjusted for inflation, the $1 million in 1988 would be worth approximately $2 million today.[315] Additionally, offering amount limits under various state crowdfunding provisions generally are set around $2 million for most jurisdictions, with $4 million being the highest offering limit in one state. As an alternative to the proposed rule, the offering limit under Rule 504 could be raised to less than $5 million. Increasing the maximum Rule 504 offering to an amount less than $5 million could help alleviate concerns about a decrease in investor protection from unlimited access to non-accredited investors. At the same time, this alternative would restrict capital raising options for issuers, especially if Rule 505 (which permits offering amounts up to $5 million) is rescinded.

Alternately, the maximum offering limit under amended Rule 504 could be raised to an amount greater than $5 million. One example could be to align the maximum offering limit to that of the Tier I offer limit ($20 million) under amended Regulation A. This could allow for more cost-effective state registration, while also providing a competitive alternative to eligible issuers in Tier 1 of the Regulation A market. However, unlike the Regulation A market, non-

[315] Annual inflation rates (1988-2014) based on consumer price index data, for all urban consumers, obtained from the Bureau of Labor Statistics.

accredited investors have no investment limits under the Rule 504 provisions. Moreover, recent enforcement cases have highlighted instances of investor abuse in offerings that are sold only to accredited investors in reliance on Rule 504(b)(1)(iii). A higher maximum offering amount would thus lead to greater investor protection concerns.

5. Additional Amendments to Rule 504

In light of concerns about potential abuses involving securities issued in reliance on Rule 504(b)(1)(iii),[316] imposing resale restrictions on such securities could increase investor protection by helping to ensure that securities initially sold pursuant to the exemption are only resold by initial purchasers after the passage of a fixed period of time. However, these restrictions would reduce the liquidity of Rule 504(b)(1)(iii) securities, which could increase the cost of capital for issuers seeking to raise capital in reliance on this rule provision. At the same time, increasing investor protection through resale restrictions could attract greater investor interest and lower the expected risk premium, which would mitigate, to some extent, the higher costs arising from less liquid securities.

Additionally, Rule 504 could be amended to include additional disclosures to address investor protection concerns arising from the increase in the maximum offering size. While such disclosures could mitigate some of these concerns, they would increase the compliance burden for Rule 504 issuers and may also overlap or extend similar requirements under state law provisions in the jurisdiction in which such Rule 504 offering is registered.

D. Request for Comment

We request comments regarding our analysis of the potential economic effects of the proposed amendments and other matters that may have an effect on the proposed rule. We

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[316] *See* note 182 and related discussion in Section III.B and SectionV.B.4 above.

request comment from the point of view of issuers, investors and other market participants. With regard to any comments, we note that such comments are of particular assistance to us if accompanied by supporting data and analysis of the issues addressed in those comments. For example, we are interested in receiving estimates and data on all aspects of the proposal and, in particular, on the expected size of the Rule 147 and Rule 504 markets (number of offerings, number of issuers, size of offerings, number of investors, etc., as well as information comparing these estimates to our baseline), overall economic impact of the proposed amendments, and any other aspect of this economic analysis. We also are interested in comments on the benefits and costs we have identified and any benefits and costs we may have overlooked as well as the impact of the proposed amendments on competition.

66. What type (size, industry, age, etc.) and how many issuers have relied on Rule 147 during the years 2013 and 2014? In what states were these offerings conducted? How many of these were state-registered offerings? How many claimed an exemption from registration under state laws?

67. What types of issuers (size, industry, age, etc.) would most likely rely on intrastate or regional offerings pursuant to amended Rules 147 and 504?

68. As proposed, would amended Rules 147 and 504 attract startups and small businesses that are considering an offering pursuant to Regulation Crowdfunding? What types of issuers (size, industry, age, etc.) would prefer to conduct an intrastate crowdfunding offering to an interstate crowdfunding offering?

69. How similar is a securities-based intrastate crowdfunding offering to a securities-based offering under Regulation Crowdfunding? How would the cost of an interstate crowdfunding offering compare with the cost of an intrastate crowdfunding offering?

How would the expected incidence of success, failure, fraud and other outcomes of an interstate crowdfunding offering compare to the cost of an intrastate crowdfunding offering?

70. Are issuers more likely to use the exemption under amended Rule 147 or the exemption under amended Rule 504 for intrastate offerings if they have a choice under state regulation? Would the cost of raising capital be lower under amended Rule 147 or under amended Rule 504?

71. As proposed, would the amended Rules 147 and 504 attract issuers that are considering offerings under Rule 506(b) or Rule 506(c) of Regulation D or Regulation A? What would the costs and benefits be from relying on the amended rules, compared to the costs and benefits from relying on Rule 506(b) or Rule 506(c) of Regulation D or Regulation A? Please provide estimates, where possible.

72. What would be the economic effect of the proposed modification of the "doing business" in-state tests on Rule 147 offerings? What types of issuers and investors are most likely to be affected by the proposed amendments to the "doing business" tests?

73. What would be the economic effect of the elimination of all "doing business" in-state tests on Rule 147 offerings? What types of issuers and investors are most likely to be affected by the existing "doing business" in-state requirements? Would the elimination of all "doing business" in-state tests decrease investor protection? What would be the economic effect of retaining some or all of the tests with lower qualifying thresholds?

74. What are the economic effects of requiring a maximum offering amount and investment limits for Rule 147 offerings that are exempt from state registration? Will issuers be likely to use Rule 147 if these proposed amendments relating to state-exempt offerings are adopted?

75. How would amended Rule 147 affect other state registered and state exempt offerings? What type of issuers (size, age, industry, etc.) would rely on amended Rule 147 pursuant to state registration or a state exemption other than intrastate crowdfunding? What would be the typical offering sizes?

76. Would the amended Rules 147 and 504 attract accredited and/or non-accredited investors to intrastate and regional offerings? How would the costs and benefits of the amended requirements compare to the costs and benefits of state preemption that currently exists for securities offered under Rule 506 of Regulation D? How would the costs and benefits compare to other exempt offering methods, such as Regulation A or Regulation Crowdfunding? Please provide estimates, where possible.

77. Would the amended Rule 147 and 504 exemptions attract intermediaries (*e.g.*, crowdfunding portals, broker-dealers or underwriters) to intrastate or regional offerings markets? How would the presence of intermediaries change the cost structure for Rule 147 and Rule 504 issuers? Would the presence of intermediaries likely increase the chances that a wider variety of investors would participate in Rule 147 and 504 offerings?

78. To what extent would additional resale restrictions on securities issued in reliance of Rule 504(b)(1)(iii) decrease the liquidity of such securities?

79. How would a decrease in the Rule 504 offering amount limitation to, for example, $2.5 million in a 12-month period affect the use of Rule 504 exemption? Would it be sufficient to efficiently address capital raising needs of issuers and effectively address investor protection concerns? Would the costs of state registration be feasible under a smaller Rule 504 offering limitation?

80. How would an increase in the Rule 504 offering amount limitation to, for example, $20 million in a 12-month period affect the use of Tier 1 of Regulation A? How would issuers benefit from the increased offering limitation? Would any such increase in the offering limitation have an adverse effect on investor protection?

81. In the case of a repeal of Rule 505, which alternate exemption would Rule 505 issuers be most likely to utilize? How would the costs of capital for such issuers be affected?

82. What would the cost be for an issuer that issues securities under state crowdfunding provisions and crosses the Section 12(g) thresholds for registering with the Commission? Please provide quantitative estimates, where available.

83. What would be the economic impact of alternatives to the proposed rule amendments that have been discussed above?

VI. PAPERWORK REDUCTION ACT

The proposed amendments to Rule 147 do not contain a "collection of information" requirement within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[317] Accordingly, the PRA is not applicable to the proposed amendments to Rule 147 and no PRA

[317] 44 U.S.C. 3501 *et seq*. Although amended Rule 147(f) would require a legend on stock certificates and certain other disclosures to be made to offerees and purchasers, the proposed rule would prescribe the precise form of disclosure to be provided to the public, and thus the proposed amendments would not require issuers to obtain or compile information for purposes of compliance with this provision. *See* 5 CFR 1320.3(c)(2).

analysis is required.

The proposed amendments to Rule 504 of Regulation D contain "collection of information" requirements within the meaning of the PRA. There are two titles for the collection of information requirements contemplated by the proposed amendments. The first title is: "Form D" (OMB Control No. 3235-0076), an existing collection of information.[318] The second title is: "Regulation D Rule 504(b)(3) Felons and Other Bad Actors Disclosure Statement," a new collection of information. Although the proposed amendments to Rule 504 do not alter the information requirements set forth in Form D, the proposed amendments are expected to increase the number of new Form D filings made pursuant to Regulation D. Additionally, the mandatory bad actor disclosure provisions that would be required under proposed Rule 504 would contain "collection of information" requirements within the meaning of the PRA. We are submitting the proposed amendments to the Office of Management and Budget ("OMB") for review and approval in accordance with the PRA and its implementing regulations.[319]

The information collection requirements related to the filing of Form D with the Commission are mandatory to the extent that an issuer elects to make an offering of securities in reliance on the relevant exemption. Responses are not confidential, and there is no mandatory retention period for the information disclosed. The hours and costs associated with preparing and filing forms and retaining records constitute reporting and cost burdens imposed by the collection of information requirements. We are applying for an OMB control number for the proposed new collection of information in accordance with 44 U.S.C. 3507(j) and 5 CFR 1320.13, and OMB has not yet assigned a control number to the new collection. Responses to

[318] Form D was adopted pursuant to Sections 2(a)(15), 3(b), 4(a)(2), 19(a) and 19(c)(3) of the Securities Act (15 U.S.C. 77b(a)(15), 77c(b), 77d(a)(2), 77s(a) and 77s(c)(3)).

[319] 44 U.S.C. 3507(d); 5 CFR 1320.11.

the new collection of information would be mandatory. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information requirement unless it displays a currently valid OMB control number.

Form D (OMB Control No. 3235-0076)

The Form D filing is required for issuers as a notice of sales without registration under the Securities Act based on a claim of exemption under Regulation D or Section 4(a)(5) of the Securities Act. The Form D must include basic information about the issuer, certain related persons, and the offering. This information is used by the Commission to observe use of the Regulation D exemptions and safe harbor.

As we are not proposing to alter the information requirements of Form D, our proposed amendments will not affect the paperwork burden of the form, and the burden for responding to the collection of information in Form D will be the same as before the proposed amendments to Form D. However, we estimate that our proposed amendments to increase the aggregate amount of securities that may be offered and sold in any 12-month period in reliance on Rule 504 will increase the number of Form D filings that are made with the Commission.

The table below shows the current total annual compliance burden, in hours and in costs, of the collection of information pursuant to Form D. For purposes of the PRA, we estimate that, over a three-year period, the average burden estimate will be four hours per Form D. Our burden estimate represents the average burden for all issuers. This burden is reflected as a one hour burden of preparation on the company and a cost of $1,200 per filing. In deriving these estimates, we assume that 25% of the burden of preparation is carried by the issuer internally and that 75% of the burden of preparation is carried by outside professionals retained by the issuer at an average cost of $400 per hour. The portion of the burden carried by outside professionals is

reflected as a cost, while the portion of the burden carried by the issuer internally is reflected in hours.

Table 1. Estimated paperwork burden under Form D, pre-amendment to Rule 504

	Number of responses (A)[320]	Burden hours/form (B)	Total burden hours (C)=(A)*(B)	Internal issuer time (D)	External professional time (E)	Professional costs (F)=(E)*$400
Form D	25,300	4	101,200	25,300	75,900	$30,360,000

For the year ended 2014, 19,717 issuers made 22,004 new Form D filings. The annual number of new Form D filings rose from 13,764 in 2009 to 22,004 in 2014, an average increase of approximately 1,648 Form D filings per year, or approximately 10%. Assuming the number of Form D filings continues to increase by 1,648 filings per year for each of the next three years, the average number of Form D filings in each of the next three years would be approximately 25,300.

We estimate that the proposed amendments to Rule 504 would result in a much smaller annual increase in the number of new Form D filings than the average annual increase that has occurred over the past five years. To estimate how the proposed amendments to Rule 504 would impact the number of new Form D filings, we used as a reference point the impact of a past rule change on the market for Regulation D offerings. In 1997, the Commission amended

[320] Although the number of responses for Form D is reported as 21,824 in the OMB's Inventory of Currently Approved Information Collections, available at http://www.reginfo.gov/public/do/PRAMain;jsessionid=D37174B5F6F9148DB767D63DF6983A65, we are preparing a new estimate based on the historical trend of the annual number of new Form D filings. Based on an average increase of approximately 1,648 new Form D filings per year over the past five years, we believe that the average number of new Form D filings in each of the next three years would be approximately 25,300.

Rule 144(d) under the Securities Act[321] to reduce the holding period for restricted securities from two years to one year,[322] thereby increasing the attractiveness of Regulation D offerings to investors and to issuers. Prior to amending Rule 144(d), there were 10,341 Form D filings in 1996, which was followed by a 20% increase in the number of Form D filings in each of the subsequent three calendar years, reaching 17,830 by 1999. Although it is not possible to predict with any degree of certainty the increase in the number of Rule 504 offerings following the proposed amendments, we estimate for purposes of the PRA that there would be a similar 20% increase in the number of new Form D offerings that currently rely on either Rule 504 or 505.[323] In 2014, there were 544 new Form D filings reporting reliance on Rule 504 and 289 new Form D filings reporting reliance on Rule 505. We estimate that there will be an additional approximately 200 new Form D filings in each of the next three years attributable to the proposed amendments.[324]

Based on these increases, we estimate that the annual compliance burden of the collection of information requirements for issuers making Form D filings after amending Rule 504 to increase the aggregate offering amount from $1 million to $5 million would be an aggregate 25,500 hours of issuer personnel time and $30,600,000 for the services of outside professionals per year.

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321 17 CFR 230.144(d).

322 *See*, SEC Rel. No. 33-7390 (Feb. 20, 1997) [62 FR 9242].

323 We include the number of new Form D filings that rely on Rule 505 in these estimates since Rule 505 provides an alternative Regulation D exemption for an issuer to rely upon with a maximum offering limitation of no more than $5 million in a twelve month period.

324 We estimate the number of new Form D filings attributable to the proposed amendments over the next three years as follows: 833 new Form D filings in 2014 relying on either Rules 504 or 505, multiplied by 20% equals 166.6. Rounding 166.6 to the nearest hundredth provides us with an estimate of 200 new Form D filings attributable to the proposed amendments.

Table 2. Estimated paperwork burden under Form D, post-amendment to Rule 504

	Number of responses (A)[325]	Burden hours/form (B)	Total burden hours (C)=(A)*(B)	Internal issuer time (D)	External professional time (E)	Professional costs (F)=(E)*$400
Form D	25,500	4	102,000	25,500	76,500	$30,600,000

<u>Regulation D Rule 504(b)(3) Felons and Other Bad Actors Disclosure Statement (a proposed new collection of information)</u>

As proposed, the amendments to Rule 504 would disqualify issuers from reliance on Rule 504 if such issuer would be subject to disqualification under Rule 506(d) of Regulation D.[326] Consistent with the requirements of Rule 506(e), we proposed to require that the issuer in a Rule 504 offering furnish to each purchaser, a reasonable time prior to sale, a written description of any matters that occurred before effectiveness of any amendments to the rule that may be adopted and within the time periods described in the list of disqualification events set forth in Rule 506(d)(1) of Regulation D,[327] in regard to the issuer or any other "covered person" associated with the offering. For purposes of the mandatory disclosure provision described in the note to proposed Rule 504(b)(3),[328] issuers would be required to

[325] The information in this column is not based on the number of responses for Form D of 21,824, as reported in the OMB's Inventory of Currently Approved Information Collections, but rather on a new estimate of the average number of new Form D filings in each of the next three years. We prepared this estimate based on the historical trend of the annual number of new Form D filings. *See* text accompanying note 320 above. Based on an average increase of approximately 1,648 new Form D filings per year over the past five years, we estimate that the number of new Form D filings after the proposed amendment to Rule 504 would be the average number of new Form D filings we estimate in each of the next three years of 25,300, plus the additional 200 filings we estimate would be filed as a result of the proposed amendment to Rule 504.

[326] *See* proposed Rule 504(b)(3); *see also* 17 CFR 230.506(d).

[327] 17 CFR 230.506(d)(1).

[328] *See* note to proposed Rule 504(b)(3).

ascertain whether any disclosures are required in respect of covered persons involved in their offerings, prepare any required disclosures and furnish them to purchasers.

The Commission would adopt the proposed Regulation D Rule 504(b)(3) Felons and Other Bad Actors Disclosure Statement under the Securities Act. The Regulation D Rule 504(b)(3) Felons and Other Bad Actors Disclosure Statement that would be required to be furnished to investors does not involve submission of a form filed with the Commission and is not required to be presented in any particular format, although it must be in writing. The hours and costs associated with preparing and furnishing the Regulation D Rule 504(b)(3) Felons and Other Bad Actors Disclosure Statement to investors in the offering constitute reporting and cost burdens imposed by the collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

The disclosure or paperwork burden imposed on issuers appears in a note to proposed Rule 504(b)(3) and pertains to events that occurred before effectiveness of the final rules but which would have triggered disqualification had they occurred after effectiveness. Issuers relying on proposed Rule 504 would be required to furnish disclosure of any relevant past events that would have triggered disqualification under proposed Rule 504(b)(3) that relate to the issuer or any other covered person. If there are any such events, a disclosure statement would be required to be furnished, a reasonable time before sale, to all purchasers in the offering. The disclosure requirement would serve to protect purchasers by ensuring that they receive information regarding any covered persons that were subject to such disqualifying events.

The disclosure requirement would not apply to triggering events occurring after the effective date of the proposed rule amendments, if adopted, because those events would result in

disqualification from reliance on Rule 504 (absent a waiver or other exception provided in Rule 506(d)), rather than any disclosure obligation.

The steps that issuers would take to comply with the proposed disclosure requirement are expected to mirror the steps they would take to determine whether they are disqualified from relying on Rule 504. We expect that issuers planning or conducting a Rule 504 offering would undertake a factual inquiry to determine whether they are subject to any disqualification. Disqualification and mandatory disclosure would be triggered by the same types of events in respect of the same covered persons, with disqualification arising from triggering events occurring after the adoption and effectiveness of any amended rules and mandatory disclosure applicable to events occurring before that date. Therefore, we would expect that factual inquiry into potential disqualification could simply be extended to cover the period before any amended rules so adopted become effective. On that basis, we would expect that the factual inquiry process for the disclosure statement requirement would impose a limited incremental burden on issuers.

We expect that the size of the issuer and the circumstances of the particular Rule 504 offering would determine the scope of the factual inquiry and require tailored and offering-specific data gathering approaches. We do not anticipate that it would generally be necessary for any issuer or any compensated solicitor to make inquiry of any covered individual with respect to ascertaining the existence of events that require disclosure more than once, because the proposed period to be covered by the inquiry would end with the effective date of any new disqualification rules (so future events would be unlikely to affect the inquiry or change the disclosures that would have to be made). We do, however, expect that issuers may be required to revise their factual inquiry for each Rule 504 offering due to changes in management or

intermediaries, other changes to the group of covered persons or if questions arise about the accuracy of previous responses. We also would expect that the disclosure requirement may serve the additional function of helping issuers develop processes and procedures for the factual inquiry required to establish reasonable care under the disqualification provisions of Rule 506(d).

We anticipate that the Regulation D Rule 504(b)(3) Felons and Other Bad Actors Disclosure Statement would result in an incremental increase in the burdens and costs for issuers that rely on the Rule 504 exemption by requiring these issuers to conduct factual inquiries into the backgrounds of covered persons with regard to events that occurred before effectiveness of the final bad actor disqualification provisions. For purposes of the PRA, we estimate the total annual increase in paperwork burden for all affected Rule 504 issuers to comply with our proposed collection of information requirements would be approximately 830 hours of company personnel time and approximately $9,600 for the services of outside professionals. These estimates include the incremental time and cost of conducting a factual inquiry to determine whether the Rule 504 issuers have any covered persons with past disqualifying events. The estimates also include the cost of preparing a disclosure statement that issuers would be required to furnish to each purchaser a reasonable time prior to sale.

In deriving our estimates, consistent with those assumptions used in the PRA analysis for the Rule 506 bad actor disqualification provisions,[329] we assume that:

Approximately 750 Rule 504 issuers[330] relying on Rule 504 of Regulation D would spend on average one additional hour to conduct a factual inquiry to determine whether any covered

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329 *See* SEC Rel. No. 33-9414 (July 10, 2013).

330 Filing data reviewed by the staff of the Commission's Division of Economic and Risk Analysis indicate that for 2014, 544 issuers claimed Rule 504 and 289 issuers claimed Rule 505 in their Form D filings with the Commission. *See* Figure 1 in Section V.1 above. For purposes of the PRA estimates, and based on the data provided for Rule 504 and Rule 505 offerings in 2014, we assume that approximately 750 issuers

persons had a disqualifying event that occurred before the effective date of the rule amendments; and

On the basis of the factual inquiry, approximately eight issuers (or approximately 1%) would spend ten hours to prepare a disclosure statement describing matters that would have triggered disqualification under Rule 504(b)(3) of Regulation D had they occurred on or after the effective date of the rule amendments; and

For purposes of the disclosure statement, approximately eight Rule 504 issuers would retain outside professional firms to spend three hours on disclosure preparation at an average cost of $400 per hour.

The increase in burdens and costs associated with conducting the proposed factual inquiry for the disclosure statement requirement should pose a minimal incremental effort given that issuers are simultaneously required to conduct a similar factual inquiry for purposes of determining disqualification from the Rule 506 exemption.

It is difficult to provide any standardized estimates of the costs involved with the factual inquiry. There is no central repository that aggregates information from all federal and state courts and regulators that would be relevant in determining whether a covered person has a disqualifying event in his or her past. In this regard, we are currently unable to accurately estimate the burdens and costs for issuers in a verifiable way. We expect, however, that the costs to issuers may be higher or lower depending on the size of the issuer and the number and roles of covered persons. We realize there may be a wide range of issuer size, management structure, and

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would file a Form D indicating reliance on Rule 504 after the effectiveness of any rule amendments proposed today. This figure includes issuers that, before the adoption of any potential amendments to Rule 504 proposed today, would have conducted offerings pursuant to Rule 505, but that after the adoption of any such amendments would likely conduct their offerings pursuant to Rule 504.

offering participants involved in Rule 504 offerings and that different issuers may develop a variety of different factual inquiry procedures.

Where the issuer or any covered person would be subject to an event covered by Rule 504(b)(3) that existed before the effective date of these rules, the issuer would be required to prepare disclosure for each relevant Rule 504 offering. The estimates include the time and the cost of data gathering systems, the time and cost of preparing and reviewing disclosure by in-house and outside counsel and executive officers, and the time and cost of delivering or furnishing documents and retaining records.

Issuers conducting ongoing or continuous offerings would be required to update their factual inquiry and disclosure as necessary to address additional covered persons. The annual incremental paperwork burden, therefore, depends on an issuer's Rule 504 offering activity and the changes in covered persons from offering to offering. For example, some issuers may only conduct one Rule 504 offering during a year while other issuers may have multiple, separate Rule 504 offerings during the course of the same year involving different financial intermediaries, may hire new executive officers or may have new 20% shareholders, any of which would result in a different group of covered persons. In deriving our estimates, we recognize that the burdens would likely vary among individual companies based on a number of factors, including the size and complexity of their organizations. We believe that some companies would experience costs in excess of this estimated average and some companies may experience less than the estimated average costs.

Request for Comment

We request comment on our approach and the accuracy of the current estimates. Pursuant to 44 U.S.C. 3506(c)(2)(A), the Commission solicits comments to: (1) evaluate

whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) evaluate the accuracy of the Commission's estimate of burden of the collection of information; (3) determine whether there are ways to enhance the quality, utility and clarity of the information to be collected; and (4) evaluate whether there are ways to minimize the burden of the collection of information on those who are required to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and send a copy to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-22-15. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-22-15, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street, NE, Washington, DC 20549-1090. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is assured of having its full effect if OMB receives it within 30 days of publication.

VII. INITIAL REGULATORY FLEXIBILITY ACT ANALYSIS

The Regulatory Flexibility Act ("RFA")[331] requires the Commission, in promulgating rules under Section 553 of the Administrative Procedure Act,[332] to consider the impact of those

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[331] 5 U.S.C. 601 *et seq.*

[332] 5 U.S.C. 553.

rules on small entities. The Commission has prepared this Initial Regulatory Flexibility Analysis ("IRFA") in accordance with Section 603 of the RFA.[333] This IRFA relates to the proposed amendments to Securities Act Rules 147 and 504.

A. Reasons for, and Objectives of, the Action

The primary reason for, and objective of, the proposed amendments to Rule 147 is to establish a new Securities Act exemption for intrastate offerings of securities by local companies, including offerings relying upon newly adopted and proposed crowdfunding provisions under state securities laws. Market participants and state regulators have indicated that the combined effect of Section 3(a)(11)'s statutory limitation on offers and the prescriptive issuer eligibility requirements of Rule 147 unduly restrict the availability of the exemption for local companies that would otherwise conduct intrastate offerings in a manner that is consistent with the original intent of Section 3(a)(11). These commenters have also indicated that the current requirements of Rule 147 make it difficult for issuers to take advantage of recently adopted state crowdfunding provisions. The proposed amendments to Rule 147 would ease these limitations in the rule and would allow an issuer to engage in any form of general solicitation or general advertising, including the use of publicly accessible Internet websites, to offer and sell its securities, so long as all purchasers of such securities are residents of the same state or territory in which the issuer's principal place of business is located. We propose to amend Rule 147 pursuant to our general exemptive authority under Section 28 of the Securities Act.

The primary reason for, and objective of, the proposed amendments to Rule 504 is to facilitate capital formation by increasing the flexibility of state securities regulators to implement regional coordinated review programs that would facilitate regional offerings. The proposed

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[333] 5 U.S.C. 603.

amendments to Rule 504 would raise the aggregate amount of securities an issuer may offer and sell in any 12-month period from $1 million to $5 million and disqualify certain bad actors from participating in Rule 504 offerings. We believe that raising the aggregate offering limitation and disqualifying certain bad actors would maximize the flexibility of state securities regulators to implement regional coordinated review programs and provide for greater consistency across Regulation D.

B. Legal Basis

We are proposing the amendments pursuant to Sections 3(b)(1), 4(a)(2), 19 and 28 of the Securities Act.

C. Small Entities Subject to the Proposed Amendments

For purposes of the RFA, under our rules, an issuer, other than an investment company, is a "small business" or "small organization" if it has total assets of $5 million or less as of the end of its most recent fiscal year and is engaged or proposing to engage in an offering of securities which does not exceed $5 million.[334] For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[335]

While we lack data on the number and size of Rule 147 offerings[336] or the type of issuers currently relying on the Rule 147 safe harbor, the nature of the eligibility requirements and other restrictions of the rule lead us to believe that it is currently being used by U.S. incorporated businesses that are likely small businesses seeking to raise small amounts of capital without

334 17 CFR 230.157.

335 17 CFR 270.0-10(a).

incurring the costs of registering with the Commission.

Currently, issuers that intend to conduct intrastate crowdfunding offerings are required to use the Rule 147 exemption by most of the states that have enacted crowdfunding provisions. Since December 2011, when the first state enacted crowdfunding provisions, 106 state crowdfunding offerings have been reported to be filed with the respective state regulators.[337] Of these offerings, 91 were reported to be approved or cleared, as of June 2015. We expect that almost all of the entities conducting these offerings were small issuers.

The proposed amendments to Rule 504 would affect small issuers that rely on this exemption from Securities Act registration. All issuers that sell securities in reliance on Regulation D are required to file a Form D with the Commission reporting the transaction. For the year ended December 31, 2014, 19,717 issuers made 22,004 new Form D filings, of which 495 issuers relied on the Rule 504 exemption. Based on the information reported by issuers on Form D, there were 146 small issuers[338] relying on the Rule 504 exemption in 2014. This number likely underestimates the actual number of small issuers relying on the Rule 504 exemption, however, because 38% of issuers that are not pooled investment funds and 50% of issuers that are pooled investment funds declined to report on their Form D filed with the Commission their amount of revenues or assets.

D. Projected Reporting, Recordkeeping and Other Compliance Requirements

The proposed amendments to Rule 147 would not impose any reporting or recordkeeping

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336 *See* note 211 above.

337 Based on estimates provided by NASAA.

338 Of this number, 140 of these issuers are not pooled investment funds, and 6 are pooled investment funds. We also note that issuers that are not pooled investment funds disclose only revenues on Form D, and not total assets. Hence, we use the amount of revenues as a measure of issuer size for non-pooled investment funds and net asset value as a measure of issuer size for pooled investment funds.

requirements, but would require that issuers conducting offerings in reliance on the rule make certain specific disclosures to each offeree and purchaser in the offering. These disclosures would be made to each offeree in the manner in which any such offer is communicated and to each purchaser of a security in the offering in writing. The proposed amendments to Rule 147 would also require that issuers place a specific legend on the certificate or other document evidencing the securities that are being offered in reliance on the rule.

In order to comply with proposed Rule 147(d), issuers would need to have a reasonable belief that a prospective purchaser resides within the state or territory of which the issuer has its principal place of business. The steps required to establish reasonable belief would vary with the circumstances. For example, an issuer may need to consider facts and circumstances, such as the existence of a pre-existing relationship between the issuer and the prospective purchaser providing the issuer with insight and knowledge as to the primary residence of the prospective purchaser. An issuer may also consider other facts and circumstances establishing the residency of a prospective purchaser, such as evidence of the home address of the prospective purchaser, as documented by a recently dated utility bill, pay-stub, information contained in a state or federal tax returns, or any state-issued documentation, such as a driver's license or identification card.

The proposed amendments to Rule 504 would increase the aggregate offering ceiling from $1 million to $5 million and disqualify certain bad actors from participating in Rule 504 offerings. Issuers would need to comply with all the current requirements of Rule 504, including the filing of a Form D.[339] Also, as it is the case under current Rule 504, issuers relying on the rule that wish to engage in general solicitation and issue freely tradable securities may also be

[339] Rule 503 requires an issuer relying on any exemption under Regulation D to file a Form D within 15 calendar days after the first sale of securities in the offering.

required to register their offering with at least one state regulator. The proposed amendments to Rule 504 would also impose a disclosure requirement with respect to bad actor disqualifying events that occurred before the effective date of any of the proposed disqualification provisions, if adopted, and would have triggered disqualification had they occurred after that date.[340] Such disclosure would be required to be in writing and furnished to each purchaser a reasonable time prior to sale. There would be no prescribed form that such disclosure must take.

In addition, we would expect that issuers would exercise reasonable care to ascertain whether a disqualification exists with respect to any covered person, and document their exercise of reasonable care. The steps required would vary with the circumstances, but we anticipate would generally include making factual inquiry of covered persons and, where the issuer has reason to question the veracity or completeness of responses to such inquiries, further steps such as reviewing information on publicly available databases. In addition, issuers would have to prepare any necessary disclosure regarding preexisting events. We would expect that the costs of compliance would vary depending on the size and nature of the offering but that they would generally be lower for small entities than for larger ones because of the relative simplicity of their organizational structures and securities offerings and the generally smaller numbers of individuals and entities involved.

E. Overlapping or Conflicting Federal Rules

We believe that there are no federal rules that conflict with the proposed amendments to Rule 147 and Rule 504 of Regulation D. As discussed above,[341] Rule 147, as proposed to be amended, would encompass offerings that are exempt under Securities Act Section 3(a)(11).

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340 *See* proposed Rule 504(b)(3).

341 *See* discussion in Section II.B above.

Amended Rule 147, however, also would extend to certain other offerings that do not meet the requirements for the statutory exemption, such as those offered on publicly accessible Internet websites. As discussed above,[342] Rule 504, as proposed to be amended, would have the same offering limitation as current Rule 505 and include bad actor disqualification provisions, which would reduce the distinctions between these rules across Regulation D if the amendments to the rules are adopted as proposed.

F. Significant Alternatives

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objectives of our amendments, while minimizing any significant adverse impact on small entities. Specifically, we considered the following alternatives: (1) establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) clarifying, consolidating or simplifying compliance and reporting requirements for small entities under the rule; (3) using performance rather than design standards; and (4) exempting small entities from coverage of all or part of the proposed amendments.

With respect to clarification, consolidation and simplification of the rule's compliance and reporting requirements for small entities, the proposed amendments to Rule 147 do not impose any new reporting requirements. To the extent the proposed amendments may be considered to create a new compliance requirement to have a reasonable belief that a prospective purchaser is a resident of the state or territory in which the issuer has its principal place of business, the precise steps necessary to meet that requirement will vary according to the circumstances, and this flexible standard will be applicable to all issuers, regardless of size. We

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342 *See* discussion in Section III.C above.

believe our proposals are designed to streamline and modernize the rule for all issuers, both large and small. Nevertheless, we request comment on ways to clarify, consolidate, or simplify any part of the proposed amendments to Rule 147, including whether we should retain the current safe harbor under Rule 147.

In connection with our proposed amendments to Rule 147, we do not think it feasible or appropriate to establish different compliance or reporting requirements or timetables for small entities. The proposed amendments are designed to facilitate access to capital for both large and small issuers, but particularly smaller issuers who may satisfy their financing needs by limiting the sales of their securities only to residents of the state or territory in which they have their principal place of business. The proposed amendments do not contain any reporting standards and the compliance requirements it does include are minimal and designed with the limited resources of smaller issuers in mind. For example, the proposed rule would eliminate the current requirement to obtain an investor representation as to residency status because we do not believe such a requirement would be necessary in all circumstances. Similarly, we do not believe it is necessary to clarify, consolidate or simplify reporting or compliance requirements for small entities as the proposed rule contains more streamlined requirements for all issuers, both large and small. For example, the proposed amendments simplify the doing business in-state determination by amending the current rule requirements so that an issuer's ability to rely on the rule would be based on the location of the issuer's principal place of business and its ability to satisfy an additional criterion that we believe would provide further assurance of the in-state nature of the issuer's business within the state in which the offering takes place. With respect to using performance rather than design standards, we note that our proposed amendment establishing a "reasonable belief" standard for the determination of a prospective purchaser's

residency status is a performance standard. Rather than prescribe specific steps necessary to meet such a standard, such as requiring written representations from investors, the proposed rules recognize that reasonable belief can be established in a variety of ways (*e.g.*, through pre-existing knowledge of the purchaser, obtaining supporting documentation, or using other appropriate methods). We believe that the use of a performance standard accommodates different types of offerings and purchasers without imposing overly burdensome methods that may be ill-suited or unnecessary to a particular offering or purchaser, given the facts and circumstances.

With respect to exempting small entities from coverage of the proposed amendments to Rule 147, we believe such changes would be impracticable. These proposed amendments are designed to facilitate an issuer's access to capital, regardless of the size of the issuer. We have endeavored throughout these proposed amendments to minimize the regulatory burden on all issuers, including small entities, while meeting our regulatory objectives. We believe exempting small entities from our proposals would increase, rather than decrease, their regulatory burden. Nevertheless, we request comment on ways in which we could exempt small entities from coverage of any unduly onerous aspects of our proposed amendments.

In connection with our proposed amendments to Rule 504 of Regulation D, we do not think it is feasible or appropriate to establish different compliance or reporting requirements or timetables for small entities. Our proposals are intended to facilitate issuers' access to capital and are particularly designed for smaller issuers who are not subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act and who are offering no more than $5 million of their securities in any twelve month period. The proposed amendments are also designed to exclude "felons and other 'bad actors' " from involvement in Rule 504 securities

offerings, which we believe could benefit small issuers by protecting them and their investors from bad actors and increasing investor trust in such offerings. Increased investor trust could potentially reduce the cost of capital and create greater opportunities for small businesses to raise capital. Exempting small entities from our proposals would increase, rather than decrease, their regulatory burden. Nevertheless, we request comment on whether it is feasible or appropriate for small entities to have different requirements or timetables for compliance with our proposals.

With respect to clarification, consolidation and simplification of the compliance and reporting requirements for small entities, the proposed amendments do not impose any new reporting requirements. To the extent the proposed amendments may be considered to create a new compliance requirement to exercise reasonable care to ascertain whether a disqualification exists with respect to any offering and to furnish a written description of preexisting triggering events, the precise steps necessary to meet that proposed requirement would vary according to the circumstances. In general, we believe the requirement would more easily be met by small entities than by larger ones because we believe that their structures and securities offerings would be generally less complex and involve fewer participants. Nevertheless, we request comment on ways to clarify, consolidate, or simplify any part of our proposed rule amendments for small entities.

With respect to the use of performance or design standards, we note that our proposed amendments to Rule 504 relating to increasing the aggregate offering amount that may be offered and sold in any 12-month period from $1 million to $5 million would use design rather than performance standards. We note, however, that the "reasonable care" exception would be a performance standard. With respect to exempting small entities from coverage of these proposed amendments, we believe that such an approach would be impracticable. Regulation D was

designed, in part, to provide exemptive relief for smaller issuers. Exempting small entities from bad actor provisions could result in a decrease in investor protection and trust in the private placement and small offerings markets. We have endeavored to minimize the regulatory burden on all issuers, including small entities, while meeting our regulatory objectives, and have proposed to include a "reasonable care" exception and waiver authority for the Commission to give issuers and other covered persons additional flexibility with respect to the application of these amendments.

G. General Request for Comment

We encourage comments with respect to any aspect of this initial regulatory flexibility analysis. In particular, we request comments regarding:

- The number of small entities that may be affected by the proposals;
- The existence or nature of the potential impact of the proposals on small entities discussed in the analysis; and
- How to quantify the impact of the proposed amendments.

Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposals are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

VIII. SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),[343] the Commission must advise the OMB as to whether a proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in:

- an annual effect on the economy of $100 million or more (either in the form of an increase or a decrease);
- a major increase in costs or prices for consumers or individual industries; or
- significant adverse effects on competition, investment or innovation.

If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review.

We request comment on whether our proposed amendments would be a "major rule" for purposes of SBREFA. We solicit comment and empirical data on:

- the potential effect on the U.S. economy on an annual basis;
- any potential increase in costs or prices for consumers or individual industries; and
- any potential effect on competition, investment or innovation.

We request those submitting comments to provide empirical data and other factual support for their views to the extent possible.

IX. STATUTORY BASIS AND TEXT OF PROPOSED RULES

The amendments contained in this release are being proposed under the authority set forth in Sections 3(b)(1), 4(a)(2), 19 and 28 of the Securities Act of 1933, as amended.

TEXT OF PROPOSED AMENDMENTS

Lists of Subjects

17 CFR 230

Reporting and recordkeeping requirements, Securities.

PART 230 – GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The authority citation for part 230 continues to read in part as follows:

Authority: 15 U.S.C. 77b, 77b note, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78o-7 note, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, and Pub. L. 112-106, sec. 201(a), sec. 401, 126 Stat. 313 (2012), unless otherwise noted.

* * * * *

2. § 230.147 is revised to read as follows:

§ 230.147 Intrastate sales exemption

(a) *Scope of the exemption.* Offers and sales by or on behalf of an issuer of its securities made in accordance with all of the provisions of this section (§ 230.147) are exempt from section 5 of the Act (15 U.S.C. 77e) if the issuer:

(1) registers the offer and sale of such securities in the state in which all purchasers of the securities are resident; or

(2) conducts the offer and sale of such securities pursuant to an exemption from registration in the state in which all purchasers of the securities are resident that limits the amount of securities:

(i) an issuer may sell pursuant to such exemption to no more than $5 million in a twelve--month period; and

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[343] Pub. L. No. 104-121, Tit. II, 110 Stat. 857 (1996).

(ii) an investor may purchase in such offering (as determined by the appropriate authority in such state).

(b) *Manner of offers and sales.* An issuer, or any person acting on behalf of the issuer, may rely on this exemption to make offers and sales using any form of general solicitation and general advertising, so long as the issuer complies with the provisions of paragraphs (c), (d), and (f) through (h) of this section.

(c) *Nature of the issuer.* The issuer of the securities shall at the time of any offers and sales pursuant to this section:

(1) Have its principal place of business within the state or territory in which all purchasers of the securities are resident. The issuer shall be deemed to have its principal place of business in a state or territory in which the officers, partners or managers of the issuer primarily direct, control and coordinate the activities of the issuer; and

(2) Meet at least one of the following requirements:

(i) The issuer derived at least 80% of its consolidated gross revenues from the operation of a business or of real property located in or from the rendering of services within such state or territory;

(ii) The issuer had at the end of its most recent semi-annual fiscal period prior to an initial offer of securities in any offering or subsequent offering pursuant to this section, at least 80% of its assets and those of its subsidiaries on a consolidated basis located within such state or territory;

(iii) The issuer intends to use and uses at least 80% of the net proceeds to the issuer from sales made pursuant to this section (§ 230.147) in connection with the operation of a

business or of real property, the purchase of real property located in, or the rendering of services within such state or territory; or

(iv) A majority of the issuer's employees are based in such state or territory.

NOTE 1 TO PARAGRAPH (C)(1). An issuer that has previously conducted an intrastate offering pursuant to this section (§ 230.147) may not conduct another intrastate offering pursuant to this section (§ 230.147), based upon satisfaction of the principal place of business definition contained in paragraph (c)(1) of this section (§ 230.147(c)(1)) in a different state or territory, until the expiration of the time period specified in paragraph (e) of this section (§ 230.147(e)), calculated on the basis of the date of the last sale in such offering.

NOTE 1 TO PARAGRAPH (C)(2)(i). Revenues must be calculated based on the issuer's most recent fiscal year, if the first offer of securities pursuant to this section is made during the first six months of the issuer's current fiscal year, and based on the first six months of the issuer's current fiscal year or during the twelve-month fiscal period ending with such six-month period, if the first offer of securities pursuant to this section is made during the last six months of the issuer's current fiscal year.

(d) *Residence of purchasers.* Sales of securities pursuant to this section (§ 230.147) shall be made only to persons that the issuer reasonably believes at the time of sale are residents of the state or territory in which the issuer has its principal place of business. For purposes of determining the residence of purchasers:

(1) A corporation, partnership, limited liability company, trust or other form of business organization shall be deemed to be a resident of a state or territory if, at the time of sale to it, it has its principal place of business, as defined in paragraph (c)(1) of this section, within such state or territory.

(2) Individuals shall be deemed to be residents of a state or territory if such individuals have, at the time of sale to them, their principal residence in the state or territory.

(3) A corporation, partnership, trust or other form of business organization, which is organized for the specific purpose of acquiring securities offered pursuant to this section (§ 230.147), shall not be a resident of a state or territory unless all of the beneficial owners of such organization are residents of such state or territory.

(e) *Limitation on resales.* For a period of nine months from the date of the sale by the issuer of a security pursuant to this section (§ 230.147), any resale of such security by a purchaser shall be made only to persons resident within the purchaser's state or territory of residence, as determined pursuant to paragraph (d) of this section.

Instruction to Paragraph (e): In the case of convertible securities, resales of either the convertible security, or if it is converted, the underlying security, could be made during the period described in paragraph (e) only to persons resident within such state or territory. For purposes of this paragraph (e), a conversion in reliance on section 3(a)(9) of the Act (15 U.S.C. 77c(a)(9)) does not begin a new period.

(f) *Precautions against interstate sales.* (1) The issuer shall, in connection with any securities sold by it pursuant to this section:

(i) Place a prominent legend on the certificate or other document evidencing the security stating that: "Offers and sales of these securities were made under an exemption from registration and have not been registered under the Securities Act of 1933. For a period of nine months from the date of the sale by the issuer of these securities, any resale of these securities (or the underlying securities in the case of convertible securities) by a purchaser shall be made only to persons resident within the purchaser's state or territory of residence."; and

(ii) Issue stop transfer instructions to the issuer's transfer agent, if any, with respect to the securities, or, if the issuer transfers its own securities, make a notation in the appropriate records of the issuer.

(2) The issuer shall, in connection with the issuance of new certificates for any of the securities that are sold pursuant to this section (§ 230.147) that are presented for transfer during the time period specified in paragraph (e), take the steps required by paragraphs (f)(1)(i) and (ii) of this section.

(3) The issuer shall, at the time of any offer or sale by it of a security pursuant to this section (§ 230.147), prominently disclose to each offeree in the manner in which any such offer is communicated and to each purchaser of such security in writing the following: "Sales will be made only to residents of the same state or territory as the issuer. Offers and sales of these securities are made under an exemption from registration and have not been registered under the Securities Act of 1933. For a period of nine months from the date of the sale by the issuer of the securities, any resale of the securities (or the underlying securities in the case of convertible securities) by a purchaser shall be made only to persons resident within the purchaser's state or territory of residence."

(g) *Integration with other offerings.* Offers or sales made in reliance on this section will not be integrated with:

(1) Prior offers or sales of securities; or

(2) Subsequent offers or sales of securities that are:

(i) Registered under the Act, except as provided in paragraph (h) of this section;

(ii) Exempt from registration under Regulation A (§ 230.251 *et seq.*);

(iii) Exempt from registration under Rule 701 (§ 230.701);

(iv) Made pursuant to an employee benefit plan;

(v) Exempt from registration under Regulation S (§§ 230.901 through 230.905);

(vi) Exempt from registration under section 4(a)(6) of the Act (15 U.S.C. 77d(a)(6));

or

(vii) Made more than six months after the completion of an offering conducted pursuant to this section.

Note to Paragraph (g): If none of the safe harbors applies, whether subsequent offers and sales of securities will be integrated with any securities offered or sold pursuant to this section (§ 230.147) will depend on the particular facts and circumstances.

(h) *Offerings limited to qualified institutional buyers and institutional accredited investors.* Where an issuer decides to register an offering under the Securities Act after making offers in reliance on Rule 147 limited only to qualified institutional buyers and institutional accredited investors referenced in Section 5(d) of the Securities Act, such offers will not be subject to integration with any subsequent registered offering. If the issuer makes offers in reliance on Rule 147 to persons other than qualified institutional buyers and institutional accredited investors referenced in Section 5(d) of the Securities Act, such offers will not be subject to integration if the issuer (and any underwriter, broker, dealer, or agent used by the issuer in connection with the proposed offering) waits at least 30 calendar days between the last such offer made in reliance on Rule 147 and the filing of the registration statement with the Commission.

* * * * *

3. In § 230.504, the section heading and paragraph (b)(2) are revised, and paragraph (b)(3) is added, to read as follows:

§ 230.504 Exemption for limited offerings and sales of securities not exceeding $5,000,000.

* * * * *

(b) * * *

(2) The aggregate offering price for an offering of securities under this § 230.504, as defined in § 230.501(c), shall not exceed $5,000,000, less the aggregate offering price for all securities sold within the twelve months before the start of and during the offering of securities under this § 230.504, in reliance on any exemption under section 3(b)(1), or in violation of section 5(a) of the Securities Act.

Note 1 to paragraph (b)(2): The calculation of the aggregate offering price is illustrated as follows:

If an issuer sold $900,000 on June 1, 2013 under this § 230.504 and an additional $4,100,000 on December 1, 2013 under §230.505, the issuer could only sell $900,000 of its securities under this §230.504 on June 1, 2014. Until December 1, 2014, the issuer must count the December 1, 2013 sale towards the $5,000,000 limit within the preceding twelve months.

Note 2 to paragraph (b)(2): If a transaction under § 230.504 fails to meet the limitation on the aggregate offering price, it does not affect the availability of this §230.504 for the other transactions considered in applying such limitation. For example, if an issuer sold $5,000,000 of its securities on January 1, 2014 under this § 230.504 and an additional $500,000 of its securities on July 1, 2014, this § 230.504 would not be available for the later sale, but would still be applicable to the January 1, 2014 sale.

(3) *Disqualifications*. No exemption under this section shall be available for the securities of any issuer if such issuer would be subject to disqualification under § 230.506(d) of this section on or after [INSERT DAY 60 DAYS AFTER DATE OF PUBLICATION IN THE

FEDERAL REGISTER]; provided that disclosure of prior "bad actor" events shall be required in accordance with § 230.506(e).

NOTE TO PARAGRAPH (B)(3). For purposes of disclosure of prior "bad actor" events pursuant to § 230.506(e), an issuer shall furnish to each purchaser, a reasonable time prior to sale, a description in writing of any matters that would have triggered disqualification under this paragraph (b)(3) but occurred before [INSERT DAY 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

* * * * *

4. In § 230.505, paragraph (b)(2)(i) is revised to read as follows:

§ 230.505 Exemption for limited offers and sales of securities not exceeding $5,000,000.

* * * * *

(b) * * *

(2) *Specific conditions*—(i) *Limitation on aggregate offering price.* The aggregate offering price for an offering of securities under this § 230.505, as defined in § 230.501(c), shall not exceed $5,000,000, less the aggregate offering price for all securities sold within the twelve months before the start of and during the offering of securities under this section in reliance on any exemption under section 3(b)(1) of the Act or in violation of section 5(a) of the Act.

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By the Commission.

Jill M. Peterson
Assistant Secretary

Dated: October 30, 2015.