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Via email: pubcom@finra.org

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RE: **RN12-34, Crowdfunding Activities**

Integrated Management Solutions USA LLC ("IMS") is pleased to comment on Regulatory Notice 12-34, which seeks comments on the potential regulation by FINRA of "registered funding portals" that become (or, are) FINRA members (the "Notice"). One of the innovative provisions under the Jumpstart Our Business Startups Act (the "JOBS Act") was the exemption from registration under the Securities Act of 1933 (the "Act') of securities offered or sold through "crowdfunding." Intermediaries providing crowdfunding services on behalf of issuers are required to register with the Securities and Exchange Commission (the "SEC") and FINRA as a "funding portals" and become FINRA members.[1] While the SEC is responsible for the implementation of the JOBS Act, the SEC has asked FINRA to consider adopting rules for registered funding portals since they must be FINRA members.[2] The Notice is FINRA's initial attempt to solicit comments on formulating regulations concerning registered funding portals, as well as the crowdfunding activities of broker-dealers.

By way of background, IMS is one of the largest providers of financial, accounting and compliance services to the financial services industry, representing broker-dealers, investment advisers, hedge funds and commodity firms. IMS regularly assists clients with their SRO registration requirements, including filing new member applications ("NMAs") and continuing membership applications ("CMAs"). At any given time, IMS staff is likely to be working on numerous NMAs and/or CMAs. We expect to advise our broker-dealer clients on whether to register as funding portals as part of the services they already offer to their customers.

[1] Under the CROWDFUND Act, all funding portals must become members of a national securities association that is registered under Section 15A of the Exchange Act. FINRA is currently the only national securities association registered under Section 15A of the Exchange Act.
[2] The mandate is to provide rules "written specifically for registered funding portals."

Whatever rules FINRA proposes with respect to crowdfunding should be:

- Simple;
- Inexpensive to comply with; and
- Benefit investors and issuers.

Regrettably, one does not always think of these concepts in connection with FINRA. That is one reason why many, if not most, broker-dealers whose activities are limited to proprietary trading rarely become FINRA members; instead they join another Self Regulatory Organization, such as the CBOE Stock Exchange. We note there is already a National Crowdfunding Association, http://nlcfa.org/sec-committee.html, indicating that business realities, once again, trump regulatory concerns.

We hope that FINRA, in promulgating any rules with respect to crowdfunding keeps in mind the statement made by one of the sponsors of the JOBS Act, Hon. Stephen Lee Fincher of Tennessee, in a speech made in the House of Representatives on Thursday, December 8, 2011:

> Unfortunately, a series of ``one-size-fits-all" laws and regulations have changed the nature of the United States' capital markets and had a disproportionate cost on smaller American public companies. Washington's regulatory oversteps have harmed American workers by eliminating jobs that are created when a start-up company decides to go public. Instead, to avoid costly regulatory requirements, many companies decide to merge with others, which usually results in job cuts.

What is Crowdfunding?

The full name of this part of the JOBS Act is a moniker that only Congress could devise, Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012'' or the ''CROWDFUND Act.'' "Crowdfunding" allows an issuer to raise up to $1 million over a 12-month period without registration of the shares under the Act. One of the hallmarks of crowdfunding is reduced disclosures, including financial disclosures. The crowdfunding exemption requires the intermediary acting on behalf of the issuer (either a funding portal or a broker-dealer) to ensure compliance, among other functions, with strict investor eligibility and sales practice requirements.

What is the Role of the Funding Portal in Crowdfunding?

All crowdfunding transactions must be conducted through a broker-dealer OR funding portal, a newly created entity under the CROWDFUND Act. As a registrant with the SEC and a

FINRA member, each is subject to SEC or FINRA examination, enforcement and rule making.[3] Despite the limited amount of capital that any single issuer can raise through crowdfunding, a funding portal (or broker) is the primary crowdfunding intermediary, acting on behalf of the issuer and charged with providing information to, and vetting, investors. Specifically, the CROWDFUND Act requires the funding portal (or broker) to:

- Provide information to investors;
- Provide and review investor education materials;
- Positively affirm that the investor understands that the investor's entire investment is at risk;
- Establish that the investor understands the level of risk generally applicable to investments in startups, emerging businesses, and small issuers;
- Educate the investor on the risk of illiquidity;
- Protect the privacy of investor information;
- Reduce the fraud risk by analyzing the offering and obtaining 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 represented by such funding portal;
- Vet investors and issuers: single investor can only invest between $2,000 to $100,000 annually, in the aggregate, based on actual income or net worth; conduct AML review;
- 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 the target offering amount; and
- Allow all investors to cancel their commitments to invest.

Virtually as long as the list of what a funding portal can do is what it is prohibited from doing under the CROWDFUND Act. A funding portal is prohibited from:

- providing investment advice or recommendations;
- soliciting purchases, sales, or offers to buy securities offered or displayed on its website or portal;
- compensating employees, agents, or others persons for sales;
- holding, managing, possessing, or otherwise handling investor funds or securities;
- compensating promoters, finders, or lead generators for providing the intermediary with the personal identifying information of any potential investor;[4]

[3] Interestingly, regulation by the states under the CROWDFUND Act has been limited. No state may require filing or charge any fees for crowdfunded securities unless 50% or more of the purchasers of such a security are resident in a particular state, nor may a state enforce business restrictions against a funding portal. However, states retain enforcement authority when bad conduct, such as fraud or deceit, occurs. Further, the state where the principal place of business of a funding portal is located does retain jurisdiction over the examination and enforcement of any law applicable to a funding portal that is strictly in conformity with SEC regulations. How these jurisdictional limitations will play out in real time may prove to be needlessly expensive and complicated.

[4] This raises another interesting question. Can a FINRA member, e.g., a broker-dealer, refer a potential investor to another FINRA member, i.e., the funding portal, and receive compensation for the referral, or perhaps vice versa?

- allowing its directors, officers, or partners (or any person occupying a similar status or performing a similar function) to have a financial interest in any issuer using the services of the intermediary; or
- engaging in such other activities as the SEC, by rule, determines appropriate.

FINRA's Regulation of Crowdfunding Intermediaries

In proposing funding portal regulations, FINRA seeks to support the capital-raising objectives of the JOBS Act in a manner consistent with investor protection. Congress' intent in the JOBS Act, in general, and in the CROWDFUND Act, in particular, is to reduce the cost of capital for smaller businesses by attracting a wider set of businesses and investors to the market. Encouraging a robust and vibrant funding environment for smaller businesses is expected to foster future economic growth and recovery.

The Notice seeks comment on the "…possible rules concerning supervision, advertising, anti-money laundering, fraud and manipulation, and just and equitable principles of trade." (Notice, p. 3.) In addition, when a broker-dealer acts as a crowdfunding intermediary, FINRA is concerned with the organizational structure through which the broker-dealer would conduct such activities as well as whether crowdfunding activities create "…special conflicts or concerns for a broker-dealer." (Id.)

Costs

Costs are the elephant in the room. While the limitations listed above are understandable for an entity that is solely a funding portal, given the economics of crowdfunding deals, they also raise troubling questions as to the costs. What should a funding portal be able to charge an issuer without being so cost-prohibitive as to deter the use of crowdfunding? The mandated services of a funding portal apply regardless of the size of the offering; not all such offerings will be for the maximum offering amount of $1 million. Although we firmly believe that such pricing should be left to the marketplace, inevitably there are fixed costs to each such transaction, regardless of the amount raised. For a pure funding portal, compensation cannot be transaction-based, an option available to a broker-dealer.

Clearly, to warrant FINRA registration, even if ultimately FINRA devises a "registration-lite" process,[5] any funding portal would likely have to engage in a volume business to become

[5] There have been other attempts to implement a less burdensome FINRA registration system commensurate with the limited services and risks a particular set of activities generates. See, e.g., the recommendation to create simplified registration rules for private placement broker-dealers; American Bar Association, Report and Recommendations of the Task Force on Private Placement Broker-Dealers (June 20, 2005) (the "ABA Study") www.sec.gov/rules/other/265-23/gvniesar091205.pdf. If FINRA registration of funding portals proves to be a first step in risk-based registration requirements, we believe that would prove to be a welcome development benefitting

economically viable. Any FINRA registration requirements must be risk-based. Since funding portals do not handle client funds or securities or engage in any sales activities, why not simply allow FINRA registration by notice filing? Any type of Member Application Process ("MAP") substantive review by FINRA would, of necessity, be time-consuming and expensive; it would also contradict the very purpose of the legislation, which was enacted with significant bi-partisan support. If FINRA ultimately determines that MAP approval is required, it must be conducted on an expedited basis, preferably in no more than 5-10 business days, with a very clear list from FINRA of the documents and information needed from a prospective funding portal to secure such approval. The burden of a complete submission would be on the funding portal.

All funding portals must provide investor education and vetting services. Disclosure and information templates would, of necessity, have to be created, raising the question of whether FINRA is prepared to accept a one-size-fits-all set of disclosures and investor information. Even if FINRA allows standardized disclosures, it remains to be seen whether they can withstand judicial scrutiny through the inevitable class actions likely to follow an unsuccessful issuer. One solution is for FINRA itself to develop such templates.

One of the authors of this comment letter believes the marketplace would require some kind of insurance for funding portals because if the vetting conducted proves inadequate or worse, would the issuer be required to rescind a particular investor's investment? By when must a vetting problem be discovered? What if that money has already been properly spent by the issuer? FINRA should consider whether either or both a fidelity bond and errors and omissions insurance is needed by funding portals. A standardized fidelity bond is now available to broker-dealers. The same should be made available to funding portals, tailored to their activities, with a specific rider available to broker-dealers who also engage in crowdfunding transactions.

Moreover, the cost of the services provided by a funding portal is a cost of doing business, but will, of necessity, reduce the net proceeds available to the issuer. Obviously, such costs must be disclosed. Does FINRA also want to impose a minimum use of proceeds requirement comparable to that found in Rule 5122 (Private Placements of Securities Issued by Members), with verification by the funding portal that the designated percentage of proceeds has been properly allocated?

We are relieved to note that no regulator, to date, has suggested imposing a net capital requirement on funding portals. Given the limit scope of their functions, and concomitantly, the limited risk such activities pose to the marketplace, no net capital requirement is an appropriate decision. The ABA Study came to a similar conclusion with respect to net capital, for much of

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not only the broker-dealer community, but also issuers and investors. In connection with drafting this comment letter, we also reviewed the Nominated Advisor ("Nomad") requirements used, successfully, by the London Stock Exchange ("LSE"), where a Nomad is required to serve as the primary regulator of an Alternative Investment Market ("AIM") company registered on the LSE. Although AIM has a similar objective of attracting new capital, it is more analogous to a regulatory scheme for OTC registration and of little guidance for funding portals.

the same reasons, for private placement broker-dealers. We hope that FINRA will use this opportunity to conduct a risk-based assessment of broker-dealer activities in general.

Cost-Benefit Analysis

We imagine that the cost to FINRA of regulating funding portals can become significant, especially if the regulatory process becomes too complex. There are practical limitations on the extent to which FINRA could pass such costs on to funding portals should those costs become significant. FINRA's members, which are currently only broker-dealers, should not bear those additional costs. Therefore, FINRA should perform a cost-benefit analysis relating to itself, its current members and funding portals, too, before devising rules that are costly or which in any manner thwart the purpose of the CROWDFUND Act. Please keep it simple.

Examinations, Procedures, Continuing Education

Funding portals are expected to provide supervision, review advertising, vet investors, conduct anti-money laundering screening, prevent fraud and manipulation, and adhere to just and equitable principles of trade. These are all regulated, and well-defined, functions for which licensing and continuing training are required. The similarities to broker-dealer compliance rules and regulations are apparent. Broker-dealers have to take FINRA-approved examinations to qualify to provide such services and ongoing continuing education to maintain their credentials. Presumably, employees of a funding portal would likewise have to be qualified (through licensing examinations) to perform such functions properly, with ongoing training to maintain their knowledge of current and future rules. In other words, who is going to vet the "vetters"? The price of qualified funding portals is a standardized, industry-wide qualification examination, coupled with ongoing training requirements. Such examinations should not be nearly as comprehensive as most current industry examinations. Licensure should not be dependent on continuing association with a FINRA member; instead, continuing licensure should be linked to each individual. Any requirement for continuing training can be dealt with at the individual level.[6] Clearly, this adds to the costs of becoming, and serving, as a funding portal. For most

[6] We note that currently the broker-dealer industry is the only major industry of which we are aware that links licensure to member firms and requires re-examination for those who leave the industry for two or more years. We believe that this practice is reprehensible and can be dealt with better by requirements for demonstrating proficiency through the completion of continuing education regimens. In fact, that is how persons who are currently registered demonstrate that they retain their expertise. We further note that many of the staff and management people of FINRA are licensed attorneys who, while employed by FINRA instead of actively engaged in the practice of law, do not lose their licenses to practice law in the future; instead, they maintain their proficiency by complying with Continuing Legal Education requirements.

broker-dealers, we suspect this would be an incremental cost.[7] For a stand-alone funding portal, this could prove expensive and time-consuming. FINRA would also have ongoing supervisory and monitoring functions of funding portal activities, regardless of what kind of entity provides them.

FINRA clearly also anticipates internal supervision by a funding portal. Does that mean that there will be at least 2 layers of service providers in a funding portal? Certainly, each layer of personnel adds to the cost of doing business. If supervisors are necessary, how does one qualify as a supervisor of a funding portal? Broker-dealers have Series 24 licensed supervisor(s). A corollary of such supervision is the existence of a well-defined set of policies and procedures; at a broker-dealer, these are contained in a firm's Written Supervisory Procedures ("WSPs"). Will a funding portal be subject to similar requirements? Again, the need to prepare and periodically update a supervisory manual increases transaction costs. Or will FINRA provide a simple WSP-comparable template applicable solely to funding portals? Clearly, that would reduce costs for the funding portals and those cost reductions would indirectly benefit the investing public. As a by-product of those savings, FINRA itself would also benefit since it would not need to spend inordinate amounts reviewing WSPs.[8]

Level Playing Field?

Broker-dealers are already subject to ongoing regulatory requirements, monitored and enforced by FINRA and the SEC through the examination process. Will the same level of scrutiny apply to funding portals? We note, however, since funding portals provide limited services and are prohibited from handling customer funds or securities, an SEC or FINRA examination of a funding portal should, of necessity, be limited.

By being granted regulatory authority over a limited function member, FINRA should take this opportunity to review its rules governing members, using both a risk-based and functional approach. Too many FINRA rules are one-size-fits-all, resulting in expensive and time-consuming compliance burdens that often have no substantive impact on the member's business, conduct or financial viability, but for which members are held accountable. Worse yet, some of FINRA's rules have little to do with customer protection or market integrity.

[7] We do not believe that a FINRA registered representative in good standing should be required to take any additional licensing exams to provide funding portal services. In fact, almost any FINRA license should be grandfathered permanently for funding portal services.

[8] We note that there are many instances where standardization has reduced costs, covering such transactions as swaps, securities lending and repurchase agreements. Even FINRA itself reduced costs for its members when it wisely provided a prototype of Business Continuity Plans for its members. In that regard we applaud its efforts.

Conflicts of Interest

We understand why FINRA is concerned about potential conflicts of interest if a broker-dealer acts as both a funding portal and also places securities on behalf of that issuer. The traditional response remains valid: full disclosure that the broker-dealer is acting in both capacities and of the service fees charged by the broker-dealer for its funding portal activities. We strongly suspect funding portal fees will quickly become standardized due to competitive pressures.

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Despite the many implementation issues we raise in this comment letter, we welcome the crowdfunding rules as a fund-raising innovation. Investor protection is part of this mandate. We also hope there is a corollary benefit to FINRA from this evaluation process. FINRA asserts that its regulation is risk-based. Funding portal regulations could prove to be a first step in implementing risk-based licensing and examination rules throughout the securities industry.

Thank you for the opportunity to comment on this matter. Should you have any further questions, feel free to call Howard Spindel at 212-897-1688 or Cassondra Joseph at 212-897-1687, or by e-mail at hspindel@intman.com or cjoseph@intman.com, respectively.

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