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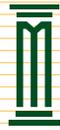


# CROWDFUNDING:

MAXIMIZING THE PROMISE AND  
MINIMIZING THE PERIL

A ROUNDTABLE DISCUSSION

BRADLEY D. BELT, CHRIS BRUMMER,  
AND DANIEL S. GORFINE



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IN PARTNERSHIP WITH GEORGETOWN UNIVERSITY LAW CENTER

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## **About the Milken Institute**

A nonprofit, nonpartisan economic think tank, the Milken Institute works to improve lives around the world by advancing innovative economic and policy solutions that create jobs, widen access to capital, and enhance health. We produce rigorous, independent economic research—and maximize its impact by convening global leaders from the worlds of business, finance, government, and philanthropy. By fostering collaboration between the public and private sectors, we transform great ideas into action.

## Overview

The Center for Financial Markets at the Milken Institute, in partnership with the Georgetown University Law Center, convened a roundtable discussion in July 2012 in Washington, D.C. Participants addressed key questions on the use, impact, and regulation of crowdfunding, specifically through the sale of debt or equity as a mechanism for raising capital (hereinafter “securities crowdfunding”).

The purpose of the roundtable was to help inform the public and the Securities and Exchange Commission’s rulemaking process in advance of the SEC’s statutory deadline of December 31, 2012, for issuing final rules and regulations implementing Title III of the Jumpstart Our Business Startups Act.<sup>1</sup> The JOBS Act, signed into law in April 2012, creates a crowdfunding exemption to current securities laws and registration requirements. The roundtable participants included a diverse group of stakeholders, including a member of Congress, Capitol Hill staff, founders of crowdfunding platforms, regulators, attorneys, leading academics, administration officials, industry leaders, investors and financial experts, entrepreneurs, and consumer advocates.<sup>2</sup>

The roundtable explored creative uses and applications of securities crowdfunding, considered the limits and leading criticisms of the new exemption, and worked through different regulatory approaches that could help to unlock the promise of this new capital-raising mechanism, while minimizing the possibility of fraud and abuse. Although views diverged on the degree to which the SEC should regulate issuers and crowdfunding platforms, participants agreed that the final regulatory regime should not stifle the exemption’s potential to create jobs and spur economic growth. What remains to be seen, however, is whether crowdfunding will mark a major turning point in an ongoing democratization of financial markets, or whether the benefits of the exemption will be muted due to onerous regulatory burdens, concerns about fraud, high startup failure rates, and lack of investor and issuer sophistication.

## Introduction to Securities Crowdfunding

Advances in Internet and social media technologies have helped to aggregate and connect disparate groups of people, often called “the crowd” by social and business commentators. Companies and individuals increasingly approach the crowd through online platforms when they seek creative solutions to social or business problems (crowdsourcing) or when they hope to raise money for a project, venture, or cause (crowdfunding). Crowdfunding, which can more formally be defined as the process by which capital is raised for a project, initiative, or enterprise through the pooling of numerous and relatively small financial contributions or investments, usually via the Internet, is not a new concept.

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1. A full text of Title III appears in Appendix A.

2. See Appendix B for a complete list of roundtable participants.

New ventures have raised thousands and even millions of dollars to create films, recordings, consumer products, smartphone applications, games, and even a sleep mask that can help one learn the art of lucid dreaming.<sup>3</sup> These projects have been funded without the expectation of a financial return in the traditional sense. Instead, they have been financed by the crowd based on hopes of future product delivery (as pre-orders, in effect), public recognition, and even positive psychic return. A recent report from Massolution, which creates crowdsourcing business models, estimates that \$2.8 billion would be raised in 2012 via crowdfunding worldwide, an 87 percent increase from 2011.<sup>4</sup> There are now 450 crowdfunding platforms globally, including in China, which marks a significant increase from 2007, when fewer than 100 platforms existed.<sup>5</sup>

In the U.S., capital-raising through crowdfunding has not involved the issuance of equity or debt securities by the sponsoring entity.<sup>6</sup> This is because current federal securities laws generally prohibit the sale of securities to the public unless the offering is formally registered with the SEC and complies with numerous regulatory requirements.<sup>7</sup> Exemptions exist for certain private offerings of securities,<sup>8</sup> but these exemptions would not work well with a crowdfunding model.<sup>9</sup>

Given the promise of non-financial-return crowdfunding in providing entrepreneurs with early-stage capital, policymakers began in 2011 to explore the

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3. See Remeo: The REM Enhancing Lucid Dreaming Mask, at <http://www.kickstarter.com/projects/bitbangerlabs/remee-the-rem-enhancing-lucid-dreaming-mask>. In a recent high-profile crowdfunding campaign, Ouya, the maker of a new videogame console, raised more than \$8.5 million from 63,416 backers. See “OUYA: A New Kind of Video Game Console,” <http://www.kickstarter.com/projects/ouya/ouya-a-new-kind-of-video-game-console>.

4. “Crowdfunding Industry Report: Market Trends, Composition and Crowdfunding Platforms” (May 2012), <http://www.crowdsourcing.org/document/crowdfunding-industry-report-abridged-version-market-trends-composition-and-crowdfunding-platforms/14277> (p. 15); “The Thundering New Herd.” *The Economist* (June 16, 2012), <http://www.economist.com/node/21556973>.

5. “The Thundering New Herd.” *The Economist* (June 16, 2012), <http://www.economist.com/node/21556973>.

6. Notably, securities crowdfunding platforms have already launched around the world, including in the UK, where the first such site, Crowdcube, opened to securities investors in 2011. The early results for Crowdcube appear promising, with £3,902,000 raised for 24 ventures since 2011. See Appendix C and [www.crowdcube.com](http://www.crowdcube.com). Also in the UK, Seedrs Ltd. launched as the first securities crowdfunding platform to gain approval from the country’s regulatory agency, the Financial Services Authority.

7. See generally “The Laws That Govern the Securities Industry,” last modified June 27, 2012, <http://www.sec.gov/about/laws.shtml>.

8. Participants also discussed other exemptions to traditional securities laws and registration requirements, including Section 4(2) of the Securities Act, Regulation A, Regulation D (Rules 504-506), and Section 4(6). Some participants suggested that the new exemption would never overtake the popularity of Rule 506 offerings, given more onerous regulatory requirements, but further analysis of these exemptions was beyond the scope of the roundtable discussion. See “Q&A: Small Business and the SEC,” § 6, last modified Nov. 14, 2009, <http://www.sec.gov/info/smallbus/qasbsec.htm#eod6> for more information on SEC registration exemptions.

9. C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, (Draft Oct. 7, 2011, p. 29) “Unfortunately, none of [the existing SEC registration exemptions] is conducive to crowdfunding.” [http://www.sec.gov/info/smallbus/acsec/bradford\\_crowdfunding.pdf](http://www.sec.gov/info/smallbus/acsec/bradford_crowdfunding.pdf).

creation of an exemption that would allow for securities crowdfunding.<sup>10</sup> The hope was that this new capital-raising mechanism would be capable of securing bipartisan support in Congress and could help to stimulate entrepreneurship, economic growth, innovation, and job creation by increasing the available pool of potential crowdfunding capital. The push for the exemption succeeded on April 5, 2012, when the JOBS Act was signed into law. Pursuant to Title III, a company (the issuer) can now sell securities to the public without formally registering its offering with the SEC. The platform through which the securities are offered must be registered as either a funding portal or a broker/dealer.

The SEC has 270 days from the date of legislative enactment to formulate and implement rules and regulations for the exemption. The agency is expected to adopt a final version by the end of 2012,<sup>11</sup> and issuers and investors will likely have to wait an additional period until the Financial Industry Regulatory Authority (FINRA), the self-regulatory organization of member brokerage firms and exchanges, establishes its own rules for crowdfunding platforms, based on SEC directives.

Some of the key provisions of the crowdfunding exemption include:

- Permitting issuers to sell up to \$1 million in securities in a 12-month period to non-accredited investors (for example, entities and individual investors other than banks, pension funds, institutional investors, and individuals of high net worth) without adhering to traditional SEC registration requirements.
- Capping individual investor annual crowdfunding investments at the greater of \$2,000 or 5 percent of the investor's annual income or net worth, if either the income or net worth of the investor is less than \$100,000; or capping individual

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10. Rep. Patrick McHenry (R-NC), Rep. Carolyn Maloney (D-NY), and the Obama administration led the early charge in promoting a securities crowdfunding exemption. See House Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs of the Committee on Oversight and Government Reform, *Crowdfunding: Connecting Investors and Job Creators*, 112 Cong., 1<sup>st</sup> sess., (Sept. 15, 2011), available at: <http://oversight.house.gov/wp-content/uploads/2012/06/9-15-11-Subcommittee-on-Tarp-Financial-Services-Hearing-Transcript.pdf>; "Rep. Carolyn Maloney Speaks in Support of the Crowdfunding Bill," (Nov. 3, 2011), <http://maloney.house.gov/video/rep-carolyn-maloney-speaks-support-crowdfunding-bill>. The final version of the law included an amendment sponsored by Sen. Jeff Merkley (D-OR) and co-sponsored by Sen. Michael Bennett (D-CO) and Sen. Scott Brown (R-MA). See "Crowdfunding Exciting New Opportunity for Small Businesses and Startups," (April 5, 2012), <http://www.merkley.senate.gov/newsroom/press/release/?id=3eda2a41-a636-4f64-89a9-96fabf492a82>.

11. The SEC recently indicated that it was on schedule to issue the final rules by the statutory deadline. See House Subcommittee on TARP, Financial Services and Bailouts of Public and Private Programs of the Committee on Oversight and Government Reform, *The JOBS Act in Action Part II: Overseeing Effective Implementation of the JOBS Act at the SEC*, 112<sup>th</sup> Cong, 1<sup>st</sup> sess., available at: <http://oversight.house.gov/hearing/the-jobs-act-in-action-part-ii-overseeing-effective-implementation-of-the-jobs-act-at-the-sec/>. Also, the SEC has indicated that it may release draft rules for public comment as early as Wednesday, August 29. See "U.S. SEC delays consideration of JOBS Act rule," Reuters (August 22, 2012), <http://in.reuters.com/article/2012/08/21/financial-regulation-ban-idINL2E8JLCVA20120821>.

investor annual crowdfunding investments at 10 percent of the investor's annual income or net worth, if either the annual income or net worth of the investor is equal to or greater than \$100,000.

- Generally requiring crowdfunding securities to be sold through a registered broker/dealer or a registered funding portal.

As one roundtable participant noted, Title III creates one of the most “momentous” and “rare” exemptions in the securities laws since the Securities Act itself was signed in 1933. The participant added that the 1933 Act established four pillars of securities regulation: (1) disclosure; (2) SEC review of that disclosure; (3) regulation of trading intermediaries; and (4) liability for noncompliance. The crowdfunding exemption would relax three of the four pillars by reducing issuance disclosure requirements, limiting the apparent scope of SEC review, and softening the regulatory oversight of crowdfunding portals as compared to traditional trading intermediaries.

The degree to which these pillars are ultimately relaxed, however, depends on how the SEC implements the legislation. The agency will examine more than two dozen areas of the exemption, including: the kinds of securities that issuers can offer; reporting and registration requirements; rules on portal advertising and the provision of investment advice; CPA review or audit requirements for financial statements; portal due diligence and education requirements; issuer reporting and communication requirements; shareholder voting rights/protections; and the creation of a secondary market for crowdfunding securities.

## **Discussion**

The roundtable participants began their discussion with an assessment of securities crowdfunding: Who would likely use it, and to what end, and with whose money? The group also looked at the limits to this kind of capital-raising and the most significant downside risks and criticisms. The final segment included an assessment of regulatory models and recommendations.

### ***A. Creative Uses and Applications of Securities Crowdfunding***

The participants set the stage for their discussion by noting significant ongoing capital access problems for U.S. startups and small businesses. Not only is a lack of available credit affecting the startup rate, it may also be contributing to higher-than-average failure rates by choking off existing businesses that require additional funding. Nearly two-thirds of the businesses lining up to raise capital through securities crowdfunding on one equity-crowdfunding platform are existing businesses rather than startups, seeking to raise on average \$260,000 to finance additional team building, marketing, and product development.

Securities crowdfunding was cited as a potential solution to early-stage capital-raising challenges, particularly in a difficult economic environment. It could bring

long-term equity capital into the market to fund startups and small businesses, which have historically played a large role in labor markets. It could also enable the sale of debt securities to the crowd, an approach that can draw from early successes of peer-to-peer lending models. Either way, securities crowdfunding could have a notable impact on economic growth and job creation.

Participants offered a number of reasons why an entrepreneur/issuer might take advantage of the crowdfunding exemption, including:

- Frustration with the costs and burdens of traditional methods of raising capital;
- Lack of access to venture or angel capital due to participation in a non-high-growth sector or industry;
- Lack of access to venture or angel capital due to rural location;
- Lack of access to bank lending;
- Need for gap-financing;
- Risk mitigation through determining public interest or demand for a product or service at an early stage;
- Product or service marketing and validation;
- Promotion, advertising, and publicity;
- Relationship and network-building with a support base that includes valuable crowd feedback and data capture;
- Capital access without giving up ownership control to a VC firm or angel.

They also listed reasons, beyond the obvious goal of securing a financial return, why investors might find securities crowdfunding attractive:

- Personal interest in the product or idea;
- Psychic reward, including financial support for a cause or initiative with social purpose;
- Sense of network or community;<sup>12</sup>
- Ability to fund friends and social network contacts;
- Ability to engage in entrepreneurial venture;
- Potential to participate in newly democratized angel/venture capital opportunities.

The participants further set the context for securities crowdfunding by discussing general market conditions that render this new capital-raising mechanism so intriguing. According to one participant, only 2 percent of businesses that seek venture capital or angel funding obtain it. This may be the case because a business is too early in its development or has not been able to market-test a good or service. Other explanations may be that the business is not in a high-growth tech sector or

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12. See Elizabeth M. Gerber, Julie S. Hui, and Pei-Yi Kuo, "Crowdfunding: Why People Are Motivated to Participate," Northwestern University, Segal Design Institute (2012), [http://www.mech.northwestern.edu/egerber/www.mech.northwestern.edu/Research\\_files/Gerber\\_Hui\\_Kuo\\_Crowdfunding.pdf](http://www.mech.northwestern.edu/egerber/www.mech.northwestern.edu/Research_files/Gerber_Hui_Kuo_Crowdfunding.pdf).

may not be located in an urban tech-corridor, often necessary to attract VC and angel funding. For businesses in these situations, it does not mean that the enterprise lacks a viable business plan capable of generating growth and job creation with appropriate funding, possibly from securities crowdfunding. Or the approval of the crowd and the ability to crowdfund a product prototype may be all that an angel or venture capitalist would need to induce an investment into that business. Thus, crowdfunding could have a positive impact on the set of viable enterprises that falls just outside of the 2 percent of businesses fortunate enough to receive angel or VC funding.<sup>13</sup>

Securities crowdfunding, including from the sale of debt, could also play an important gap-filling role as businesses work to satisfy their capital needs. For example, a business requiring \$900,000 to hire staff and rent plant and equipment might be able to combine a \$600,000 bank loan with \$300,000 raised from crowdfunding. This model could prove especially helpful to ventures backed by community development financial institutions (CDFIs), which frequently look for “gap-fillers” to help complete capital raises for ventures in underserved communities or those with high levels of unemployment. Securities crowdfunding could increase the participation rate among individuals who currently lack the opportunity to invest in these types of projects.

Moreover, coupling securities crowdfunding in a joint-investment structure with accredited investors like angels, VCs, banks, or CDFIs could benefit all involved parties. These partnerships would allow the crowdfunded businesses and crowdfunding investors to benefit from the due diligence and management expertise of sophisticated investors. Likewise, the crowd approval would provide these sophisticated investors with a strong indication of market demand for the business’s goods or services, which is invaluable information. Because of these compelling potential benefits, the roundtable participants agreed that the structuring of such partnerships merits further consideration.<sup>14</sup> As discussed in greater detail later, participants also agreed that policymakers may want to incentivize these structures/partnerships by offering exemptions from the most onerous regulatory requirements, such as financial statement reviews and audits or ongoing issuer disclosure requirements.

Based on the profiles of entrepreneurs who have sought or plan to seek crowdfunding and investors likely to be interested in the new securities, the

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13. Though estimates on the success rate of businesses seeking angel or venture capital investment vary, 2010 data suggest that only 2.8 percent of businesses successfully secured angel capital, while approximately 0.1 percent to 0.2 percent succeeded in securing venture capital. See Scott Shane, “Why Equity Financing Eludes Startups,” *Bloomberg Businessweek* (July 9, 2010), [http://www.businessweek.com/smallbiz/content/jul2010/sb2010079\\_119155.htm](http://www.businessweek.com/smallbiz/content/jul2010/sb2010079_119155.htm).

14. The average anticipated crowdfunding investment could present issues around concentration risk and an overbearing expense load, and participants suggested that creative thinking is needed to address these issues. One participant suggested that establishing crowdfunding mutual funds would allow for diversification of investments across a number of ventures and could help to absorb transaction costs. The specifics of these types of structures, however, were beyond the scope of the roundtable discussion.

participants cited a number of crowdfunding products and services, many already on the market, that could potentially benefit from the SEC exemption. The broad array of ventures included:

- Food and beverage (e.g. gluten-free baked goods, food trucks, pizzerias);
- Specialty-design apparel;
- Consumer electronics and products (e.g., the Glif, TapCap, Pebble Watch);
- Services (e.g., dog walking, aerial advertising);
- Real estate development and investment;
- Music, films, and books;
- Smartphone applications;
- Outdoor travel and adventure;
- Social impact investing;
- Peer-to-business lending;
- Minority- and women-owned businesses;
- Health and fitness (e.g., Medstartr);
- Community development (e.g., dentist offices, grocery stores, housing);
- Public goods (e.g., electric garbage trucks)

This diversity of potential uses of the crowdfunding exemption underscores the broad range of sectors and regions where securities crowdfunding could have an impact on the economy.

### ***B. Potential Limits and Criticisms of Securities Crowdfunding***

Roundtable participants also examined a number of risks and criticisms associated with securities crowdfunding, which could limit its potential use and application:

*Why would entrepreneurs opt to bear the added costs of regulatory compliance?*

Some questioned whether entrepreneurs would utilize the crowdfunding exemption when it is already possible to raise capital via existing crowdfunding models that do not offer the potential for financial return. Many have been able to raise thousands, if not millions, of dollars on such platforms as Indiegogo and Kickstarter without issuing debt or equity securities. With the current statutory cap on crowdfunding for a particular enterprise set at \$1 million, it remains an open question whether entrepreneurs will need to use securities crowdfunding to attract investment and raise sufficient capital.

Other participants responded, however, that though the stories are high-profile, few ventures have been able to raise even close to \$1 million through existing models of crowdfunding. They added that the new securities crowdfunding model should increase the pool of available capital for entrepreneurs by inducing greater public participation. Whether this plays out in the marketplace remains a key question surrounding the exemption.

*Will the exemption undermine existing models by offering an expectation of financial return?*

Participants expressed concern for entrepreneurs who plan to use the non-financial-return model of crowdfunding because of the possibility that the new exemption will undermine this existing model by creating an expectation of profit for those who crowdfund. It will thus be important to watch whether securities crowdfunding proves to be more attractive to funders and effectively “crowds out” current non-financial-return crowdfunding models.

*Will securities crowdfunding limit an entrepreneur’s ability to raise later-stage capital?*

A business with hundreds and possibly thousands of small investors might be less appealing to venture capitalists or later-stage investors/lenders. One suggested remedy could be to pool crowdfunding investors within a special purpose vehicle (SPV) that would have one voting right in the business via a proxy. It is unclear, however, whether the SPV would be subject to separate regulation as an investment company.

*How will the SEC enforce basic investor protections without creating an onerous regulatory process?*

The crowdfunding exemption does not yet specify what kinds of securities issuers can offer, what rights (including voting rights) investors and shareholders will have, what ongoing reporting and communication requirements will be placed on issuers, or how securities will be valued. Creating investor protections related to these issues will inevitably increase the burdens on portals and issuers and potentially reduce the attractiveness of the exemption.

With respect to valuation, some participants expressed concern that share values might be diluted through future issuances without crowdfunding investors being aware of this risk. Participants also questioned how the SEC would regulate a potential secondary market for crowdfunded shares; under the exemption, a secondary market could develop for shares that have been held for more than 12 months.

*What is the risk of fraud and abuse?*

There is significant concern that fraud will become a widespread problem, with little incentive for regulatory enforcement, given the small sums of money that are by definition involved with crowdfunding. Lawyers may also not be motivated to take on lawsuits alleging fraud because it is unlikely that they will obtain large payouts and because fraud can be difficult to prove (one must demonstrate intent) in the context of startups and small businesses, which are known to have high failure rates.

Some roundtable members suggested that the crowd itself was capable of ferreting out fraud, with one participant noting that crowds bombard an entrepreneur through social media if the entrepreneur “goes dark” for even short periods of time (i.e., if the entrepreneur fails to communicate project updates). Another member added that crowdfunding portals have devised algorithms and other metrics to detect and block attempts at fraud. Indiegogo, one of the largest crowdfunding portals, claims to detect and prevent fraud in the vast majority of all attempts.<sup>15</sup> The ability to detect and prevent fraud is crucial to a crowdfunding platform’s credibility and reputation.

*Would fewer disclosure requirements and less transparency decrease the quality of capital formation overall and reduce investor trust in markets?*

The roundtable members discussed the need for appropriate levels of due diligence to provide sufficient information to investors without creating excessive burdens or costs for the crowdfunded enterprise. Some questioned, however, whether this due diligence would simply take the place of what detailed regulatory disclosure requirements typically accomplish. Moreover, it remains an open question whether investors might begin to lose faith in markets if high-profile securities scams proliferate.

*Will businesses crowdfunded through the sale of securities be able to deliver competitive returns?*

Many of these businesses have high-risk profiles and take on “pursuit of passion” projects rather than ventures motivated solely by the bottom line. They may lack significant growth prospects and may not deliver returns, including dividends, until years down the road. With the combination of high failure risk, potential low growth, and likely delay in yielding investor returns, it remains to be seen if businesses supported through securities crowdfunding can generate sufficient returns to attract investors.<sup>16</sup> And to the extent that they do, investors may be channeling capital not necessarily to its most productive and efficient use.<sup>17</sup>

*How will regulators ensure that investors do not exceed the statutory individual investment cap?*

Participants agreed that the statutory investment cap is critical to limiting potential investor losses. To this end, one participant suggested the creation of a central

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15. See Margaret Collins, “Will Crowdfunding Beget Crowdfunding?,” *Bloomberg Businessweek* (April 26, 2012), <http://www.businessweek.com/articles/2012-04-26/will-crowdfunding-beget-crowdfunding>.

16. One participant noted that delay in providing financial returns and high-failure risks are especially present with some bioscience initiatives, including drug research. For this reason, the participant suggested that funders would be better off giving charitable contributions to these types of projects, thus receiving guaranteed income tax deductions.

17. See also Matthew Iglesias, “The Kickstarter Recession,” *Slate* (June 17, 2012), <http://hive.slate.com/hive/10-rules-starting-small-business/article/the-kickstarter-recession>.

repository of crowdfunding investor data that would help to ensure that caps are not circumvented.

### ***C. Regulatory Models and Approaches***

In light of the potential creative uses and applications of securities crowdfunding, as well as the potential downside risks, the roundtable participants discussed at length different regulatory approaches and the costs and benefits associated with each. On one end of the spectrum would be allowing the market to effectively regulate itself similar to the approach taken with eBay, whereby the platform is left to self-police in order to ensure its own credibility and attract buyers and sellers. This approach was coined Indiegogo-plus by one of the participants. On the other end would be a more aggressive regulatory approach where the SEC imposes stringent requirements on the crowdfunding portals, the issuers, the investors, or even potentially all of the above. This approach was termed Merrill Lynch-minus. The more numerous the requirements, of course, the greater the costs.

A few participants highlighted a questionable distinction in the law in that securities crowdfunding for a particular business is capped at \$1 million a year, but capital raised under Regulation 506 is uncapped, even though accredited investors can be joined by so-called “sophisticated” non-accredited investors. Moreover, it is an odd result that current crowdfunding (not based in securities) that promises rewards and gifts to funders and can raise far more than \$1 million is wholly unregulated, while securities crowdfunding will now be subject to federal oversight. One participant argued that fraud and improper disclosures are just as likely under the existing crowdfunding model. He added that the fact that crowdfunding platforms have apparently been able to avoid a significant number of scams through self-policing would seem to lend support to the argument that less government regulation is necessary.<sup>18</sup>

Another roundtable participant suggested that this distinction between forms of crowdfunding demonstrates that federal securities laws are outdated and do not adequately contemplate today’s marketplace. Rather than trying to force securities crowdfunding into an antiquated regulatory framework, the participant suggested that it would be better to rework the regulations to recognize that money flows and investor behavior operate differently today than they did when the securities laws were drafted after the Great Depression. With significant changes in technology and access to seemingly countless investment opportunities, today’s investors seek out information through numerous sources rather than passively receive traditional financial disclosures (e.g., 10-Ks and 10-Qs) from the issuer. It was acknowledged, however, that the SEC must work within the confines of the JOBS Act.

Regulators will have to determine whether there should be safe harbors and/or other exemptions for particular types of ventures, including those focused on

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18. But see Matt Krantz, “Crowd-Funding Dark Side: Sometimes Investments Go Down Drain,” *USA Today* (Aug. 15, 2012), <http://www.usatoday.com/money/markets/story/2012-08-14/crowd-funding-raising-money/57058678/1>.

community development or social philanthropy. And one participant explained that the SEC could use its broad exemptive rulemaking power to exclude certain crowdfunding transactions from the more onerous requirements of Title III, including providing audited financial statements and lengthy issuer disclosures, if the SEC determines that the nature and structure of the exempted transaction adequately protects investors.

The SEC will be issuing rules and regulations in a number of important areas, including: various CPA review requirements according to the capital-raise threshold; crowdfunding portal investor education requirements; crowdfunding portal SEC and self-regulatory organization (e.g., FINRA) registration requirements; ongoing issuer compliance requirements; and rules regarding solicitation and the definition of “investment advice” as they relate to the platforms.

Participants were most concerned with how CPA and legal due diligence could be performed while keeping costs manageable. Some expressed concern that the costs for legal reviews and auditing could run into the tens of thousands of dollars, prohibitive sums for startups seeking seed capital. The idea of a pilot program was well received; the SEC could create such a program for relatively small securities crowdfunding to study risks and pitfalls. If results were positive, the SEC could expand investment limits and ease regulations.

On the downside, excessive CPA and legal due diligence could deter participation by entrepreneurs seeking crowdfunding who may prefer to use existing models that do not require selling securities. To the extent that review and due diligence are required, however, the participants agreed that technology and standardization could help to lower costs.

Also discussed was the possible creation of a portal certification or licensing process that would establish a baseline of competent crowdfunding platforms. This approach could mirror what is occurring in the United Kingdom, where portals offering securities crowdfunding apply for regulatory approval on a case-by-case basis from the Financial Securities Authority.<sup>19</sup> Similarly, the SEC could certify portals or crowdfunding advisors who would also be responsible for some of the platform education and/or due diligence requirements. For example, CrowdCheck is a new business that plans to provide due diligence services to investors, startups, and crowdfunding platforms.

The SEC will also have to ensure that investors do not circumvent the statutory investment caps. The crowdfunding exemption puts this responsibility on the platforms, though some roundtable members suggested that it may be inadequate simply to require an investor to check a box certifying that he or she has not exceeded the annual investment limit. A central repository of investor data might be

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19. Notably, many securities crowdfunding platforms in the UK are operating in a gray area of the law since they have not applied for and received approval from the FSA. Seedrs was the first platform to seek and receive FSA regulatory approval, and may serve as a model for other aspiring platforms. See jeffseedrs (May 21, 2012), “FSA Authorization,” <http://blog.seedrs.com/2012/05/21/fsa-authorisation/>.

a solution, though this could prove costly and result in delays while the repository is developed.

On the topic of investor education, especially about the risks involved in securities crowdfunding, a simple warning label might suffice, similar to the surgeon general's warning appearing on cigarette packages. Another noted that crowdfunding could become a means for educating less-experienced investors about the basics of investment and securities regulation. However, user experience plays a large role in the success of crowdfunding platforms, and some participants felt that it was important to allow crowdfunding platforms to determine how their users interact with the provided information. The roundtable agreed about the need for a standardized and searchable process for disclosure information, and while there was some debate about the amount of detail necessary, all agreed that transparency was essential.

It was also suggested that standardized disclosures could mirror the model provided by new standardized requirements for mortgage disclosures. Investors here would have easy access to information about the entrepreneurs seeking capital, the business idea and financial projections, details of the securities being issued, and associated risks.

Notably, participants found broad agreement on the benefits of coupling securities crowdfunding (whether through debt or equity) with other angel, venture capital, bank, or CDFI financing. The crowdfunding investors would benefit from the expertise of sophisticated investors. And, as noted earlier, a venture's crowdfunding success would give a strong indication of market demand and product validation, inducements for sophisticated investors. This partnership could offer valuable modeling information for how best to integrate securities crowdfunding into the capital markets; securities crowdfunding could further democratize finance by giving retail investors the ability to participate where previously only accredited investors had the opportunity. In order for such coupling to work, however, the SEC must clarify that the investor caps do not apply to accredited investors, meaning venture capitalists, angel investors, banks, institutional investors, and sophisticated wealthy investors.

## **Takeaways and Recommendations**

The crowdfunding exemption offers intriguing possibilities, though only time will tell if it has a significant impact on the economy or whether its risks outweigh the benefits. One thing is predictable, the roundtable participants agreed: while it remains crucial to address concerns over fraud and abuse, if the SEC creates overly burdensome requirements, then securities crowdfunding will suffer a premature death, and with it any promise it might have for spurring economic growth and job creation. The SEC must be mindful that enterprises raising less than \$1 million will likely not be able to afford significant expenditures on due diligence, legal and accounting reviews, and ongoing compliance requirements.

Within this context, four specific takeaways or recommendations could be gleaned from the roundtable discussion:

- *Consider pilot programs to test the crowdfunding exemption.*  
Because it is difficult to predict precisely how certain risks will manifest, regulators should proceed carefully and consider testing the functionality of the exemption with various pilot programs. Regulators could, for example, initially limit investment to levels below the statutory cap. With positive findings, the SEC could expand the limits, perhaps relax requirements and allow for greater industry self-policing, and consider permitting the development of secondary markets.
- *Consider a “green-light model” for securities crowdfunding.*  
Many of the participants were optimistic that coupling securities crowdfunding with investments/loans from accredited investors (e.g. angel investors, venture capitalists, banks, and CDFIs) could benefit all involved parties and mitigate some of the risks associated with the exemption. More specifically, the crowdfunding investors in such a joint investment structure and the business could enjoy the financial and management expertise of the sophisticated investors, while the sophisticated investors would have a new method of gauging the promise of a business by gaining feedback from the crowd. In order to promote this structure, the SEC could create a “green-light model,” whereby a venture securing a joint investment from accredited and crowdfunding investors would be exempt from certain regulatory requirements. The need for audited financial statements, for example, may be reduced if the crowd knows that the sophisticated party has already reviewed and “approved” these statements. This approach could reduce the risks of securities crowdfunding, while democratizing retail investor access to new investment opportunities.
- *Balance the need for standard disclosures with platform control of user experience.*  
While the roundtable agreed on the need for minimum disclosure and due diligence requirements, there was an apparent split between how disclosures should be presented to investors. On one side were those who would like the SEC to mandate how that information is communicated through the crowdfunding platforms. Others argued that crowdfunding platforms should maintain sufficient autonomy over the presentation of information in order to differentiate their portals and control the user experience. It is conceivable that a strict SEC mandate over how information is presented could limit the space for multiple, competing crowdfunding platforms.
- *Pursue a common-sense approach to regulation that balances the risks of securities crowdfunding with concerns over excessive compliance costs by:*
  - *Promoting basic investor education on crowdfunding platforms so risks are clear.*

This could take the form of a warning label cautioning investors of the high risk of failure for a startup company, something akin to the surgeon general's warning on cigarette packaging. Regulators could also use the investor education requirement as an opportunity to inform retail investors about capital markets (e.g., types of securities, investor rights).

- *Requiring standardization of financial and reporting disclosures.*  
While there was debate as to the necessary amount of detail, the general consensus was that transparency and searchability should be the paramount goals of disclosure requirements. They might mirror new mortgage disclosure requirements mandating simplicity and transparency. As noted above, some participants suggested that crowdfunding portals should be able to control how they present this information to investors as a way to differentiate themselves and control the user experience.
- *Encouraging efficient due diligence and review.*  
It is important to minimize the costs of due diligence or legal and accounting reviews because of the small sums of money involved in these securities issuances. Technology and standardization are the primary ways to keep these costs down.
- *Ensuring that statutory individual investor caps are not circumvented.*  
The creation of a central repository of investor data could help ensure that statutory investment limits are not exceeded. Some noted, however, that such an approach would be costly and result in delay. Nevertheless, all participants agreed that investor limits are crucial for reducing the magnitude of the downside risk from securities crowdfunding.
- *Clarifying that securities crowdfunding can work alongside other forms of capital-raising.*  
Coupling securities crowdfunding with angel, venture capital, bank, or CDFI investment/financing could benefit all involved parties. In order for this coupling to occur, the SEC must clarify that securities crowdfunding investor caps do not apply to accredited investors, and that nothing in the legislation precludes a joint-investment structure.

## Appendix A: Full Text of Title III of the JOBS Act

### TITLE III—CROWDFUNDING

#### SEC. 301. SHORT TITLE.

This title may be cited as the “Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012” or the “CROWDFUND Act.”

#### SEC. 302. CROWDFUNDING EXEMPTION.

(a) SECURITIES ACT OF 1933.—Section 4 of the Securities Act of 1933 (15 U.S.C. 77d) is amended by adding at the end the following:

“(6) transactions involving the offer or sale of securities by an issuer (including all entities controlled by or under common control with the issuer), provided that—

“(A) the aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction, is not more than \$1,000,000;

“(B) the aggregate amount sold to any investor by an issuer, including any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction, does not 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;

“(C) the transaction is conducted through a broker or funding portal that complies with the requirements of section 4A(a); and

“(D) the issuer complies with the requirements of section 4A(b).”

(b) REQUIREMENTS TO QUALIFY FOR CROWDFUNDING EXEMPTION.— The Securities Act of 1933 (15 U.S.C. 77a et seq.) is amended by inserting after section 4 the following:

**“SEC. 4A. REQUIREMENTS WITH RESPECT TO CERTAIN SMALL TRANSACTIONS.**

“(a) REQUIREMENTS ON INTERMEDIARIES.—A person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others pursuant to section 4(6) shall—

“(1) register with the Commission as—

“(A) a broker; or

“(B) a funding portal (as defined in section 3(a)(80) of the Securities Exchange Act of 1934);

“(2) register with any applicable self-regulatory organization (as defined in section 3(a)(26) of the Securities Exchange Act of 1934);

“(3) provide such disclosures, including disclosures related to risks and other investor education materials, as the Commission shall, by rule, determine appropriate;

“(4) ensure that each investor—

“(A) reviews investor-education information, in accordance with standards established by the Commission, by rule;

“(B) positively affirms that the investor understands that the investor is risking the loss of the entire investment, and that the investor could bear such a loss; and

“(C) answers questions demonstrating—

“(i) an understanding of the level of risk generally applicable to investments in startups, emerging businesses, and small issuers;

“(ii) an understanding of the risk of illiquidity;

and

“(iii) an understanding of such other matters as the Commission determines appropriate, by rule;

“(5) take such measures to reduce the risk of fraud with respect to such transactions, 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;

“(6) 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), make available to the Commission and to potential investors any information provided by the issuer pursuant to subsection (b);

“(7) 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 allow all investors to cancel their commitments to invest, as the Commission shall, by rule, determine appropriate;

“(8) make such efforts as the Commission determines appropriate, by rule, to ensure that no investor in a 12-month period has purchased securities offered pursuant to section 4(6) that, in the aggregate, from all issuers, exceed the investment limits set forth in section 4(6)(B);

“(9) take such steps to protect the privacy of information collected from investors as the Commission shall, by rule, determine appropriate;

“(10) not compensate promoters, finders, or lead generators for providing the broker or funding portal with the personal identifying information of any potential investor;

“(11) 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; and

“(12) meet such other requirements as the Commission may, by rule, prescribe, for the protection of investors and in the public interest.

“(b) REQUIREMENTS FOR ISSUERS.—For purposes of section 4(6), an issuer who offers or sells securities shall—

“(1) file with the Commission and provide to investors and the relevant broker or funding portal, and make available to potential investors—

“(A) the name, legal status, physical address, and website address of the issuer;

“(B) 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;

“(C) a description of the business of the issuer and the anticipated business plan of the issuer;

“(D) a description of the financial condition of the issuer, including, for offerings that, together with all other offerings of the issuer under section 4(6) within the preceding 12-month period, have, in the aggregate, target offering amounts of—

“(i) \$100,000 or less—

“(I) the income tax returns filed by the issuer for the most recently completed year (if any); and

“(II) 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;

“(ii) more than \$100,000, but not more than

\$500,000, financial statements reviewed by a public accountant who is independent of the issuer, using professional standards and procedures for such review or standards and procedures established by the Commission, by rule, for such purpose; and

“(iii) more than \$500,000 (or such other amount as the Commission may establish, by rule), audited financial statements;

“(E) 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;

“(F) the target offering amount, the deadline to reach the target offering amount, and regular updates regarding the progress of the issuer in meeting the target offering amount;

“(G) the price to the public of the securities or the method for determining the price, provided that, prior to sale, each investor shall be provided in writing the final price and all required disclosures, with a reasonable opportunity to rescind the commitment to purchase the securities;

“(H) a description of the ownership and capital structure of the issuer, including—

“(i) terms of the securities of the issuer being offered and each other class of security of the issuer, including how such terms may be modified, and a summary of the differences between such securities, including 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;

“(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 examples of methods for how such securities may be valued by the issuer in the future, including during subsequent corporate actions; 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; and

“(I) such other information as the Commission may,

by rule, prescribe, for the protection of investors and in the public interest;

“(2) not advertise the terms of the offering, except for notices which direct investors to the funding portal or broker;

“(3) not compensate or commit to compensate, directly or indirectly, any person to promote its offerings through communication 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;

“(4) not less than annually, 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; and

“(5) comply with such other requirements as the Commission may, by rule, prescribe, for the protection of investors and in the public interest.

“(c) LIABILITY FOR MATERIAL MISSTATEMENTS AND OMISSIONS.—

“(1) ACTIONS AUTHORIZED.—

“(A) IN GENERAL.—Subject to paragraph (2), a person who purchases a security in a transaction exempted by the provisions of section 4(6) may bring an action against an issuer described in paragraph (2), either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if such person no longer owns the security.

“(B) LIABILITY.—An action brought under this paragraph shall be subject to the provisions of section 12(b) and section 13, as if the liability were created under section 12(a)(2).

“(2) APPLICABILITY.—An issuer shall be liable in an action under paragraph (1), if the issuer—

“(A) by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by any means of any written or oral communication, in the offering or sale of a security in a transaction exempted by the provisions of section 4(6), 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 the light of the circumstances under which they were made, not misleading,

provided that the purchaser did not know of such untruth or omission; and

“(B) 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 such untruth or omission.

“(3) DEFINITION.—As used in this subsection, the term ‘issuer’ includes any person who is a director or partner of the issuer, and the principal executive officer or officers, principal financial officer, and controller or principal accounting officer of the issuer (and any person occupying a similar status or performing a similar function) that offers or sells a security in a transaction exempted by the provisions of section 4(6), and any person who offers or sells the security in such offering.

“(d) INFORMATION AVAILABLE TO STATES.—The Commission shall make, or shall cause to be made by the relevant broker or funding portal, the information described in subsection (b) and such other information as the Commission, by rule, determines appropriate, available 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.

“(e) RESTRICTIONS ON SALES.—Securities issued pursuant to a transaction described in section 4(6)—

“(1) may not be transferred by the purchaser of such securities during the 1-year period beginning on the date of purchase, unless such securities are transferred—

“(A) to the issuer of the securities;

“(B) to an accredited investor;

“(C) as part of an offering registered with the Commission;

or

“(D) to 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, in the discretion of the Commission; and

“(2) shall be subject to such other limitations as the Commission shall, by rule, establish.

“(f) APPLICABILITY.—Section 4(6) 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;

“(3) is an investment company, as defined in section 3 of the Investment Company Act of 1940, or is excluded from the definition of investment company by section 3(b) or section

3(c) of that Act; or

“(4) the Commission, by rule or regulation, determines appropriate.

“(g) RULE OF CONSTRUCTION.—Nothing in this section or section 4(6) shall be construed as preventing an issuer from raising capital through methods not described under section 4(6).

“(h) CERTAIN CALCULATIONS.—

“(1) DOLLAR AMOUNTS.—Dollar amounts in section 4(6) and subsection (b) of this section shall be adjusted by the Commission not less frequently than once every 5 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.

“(2) INCOME AND NET WORTH.—The income and net worth of a natural person under section 4(6)(B) shall be calculated in accordance with any rules of the Commission under this title regarding the calculation of the income and net worth, respectively, of an accredited investor.”.

(c) RULEMAKING.—Not later than 270 days after the date of enactment of this Act, the Securities and Exchange Commission (in this title referred to as the “Commission”) shall issue such rules as the Commission determines may be necessary or appropriate for the protection of investors to carry out sections 4(6) and section 4A of the Securities Act of 1933, as added by this title. In carrying out this section, the Commission shall consult with any securities commission (or any agency or office performing like functions) of the States, any territory of the United States, and the District of Columbia, which seeks to consult with the Commission, and with any applicable national securities association.

(d) DISQUALIFICATION.—

(1) IN GENERAL.—Not later than 270 days after the date of enactment of this Act, the Commission shall, by rule, establish disqualification provisions under which—

(A) an issuer shall not be eligible to offer securities pursuant to section 4(6) of the Securities Act of 1933, as added by this title; and

(B) a broker or funding portal shall not be eligible to effect or participate in transactions pursuant to that section 4(6).

(2) INCLUSIONS.—Disqualification provisions required by this subsection shall—

(A) be substantially similar to the provisions of section 230.262 of title 17, Code of Federal Regulations (or any successor thereto); and

(B) disqualify any offering or sale of securities by a person that—

- (i) 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, or the National Credit Union Administration, that—
  - (I) bars the person from—
    - (aa) association with an entity regulated by such commission, authority, agency, or officer;
    - (bb) engaging in the business of securities, insurance, or banking; or
    - (cc) 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 within the 10-year period ending on the date of the filing of the offer or sale; or
- (ii) has been convicted of any felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the Commission.

### **SEC. 303. EXCLUSION OF CROWDFUNDING INVESTORS FROM SHAREHOLDER CAP.**

(a) EXEMPTION.—Section 12(g) of the Securities Exchange Act of 1934 (15 U.S.C. 78l(g)) is amended by adding at the end the following:

“(6) EXCLUSION FOR PERSONS HOLDING CERTAIN SECURITIES.—The Commission shall, by rule, exempt, conditionally or unconditionally, securities acquired pursuant to an offering made under section 4(6) of the Securities Act of 1933 from the provisions of this subsection.”.

(b) RULEMAKING.—The Commission shall issue a rule to carry out section 12(g)(6) of the Securities Exchange Act of 1934 (15 U.S.C. 78c), as added by this section, not later than 270 days after the date of enactment of this Act.

### **SEC. 304. FUNDING PORTAL REGULATION.**

(a) EXEMPTION.—

(1) IN GENERAL.—Section 3 of the Securities Exchange Act

of 1934 (15 U.S.C. 78c) is amended by adding at the end the following:

“(h) LIMITED EXEMPTION FOR FUNDING PORTALS.—

“(1) IN GENERAL.—The Commission shall, by rule, exempt, conditionally or unconditionally, a registered funding portal from the requirement to register as a broker or dealer under section 15(a)(1), provided that such funding portal—

“(A) remains subject to the examination, enforcement, and other rulemaking authority of the Commission;

“(B) is a member of a national securities association registered under section 15A; and

“(C) is subject to such other requirements under this title as the Commission determines appropriate under such rule.

“(2) NATIONAL SECURITIES ASSOCIATION MEMBERSHIP.—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, except to the extent that the Commission, by rule, determines otherwise, provided that a national securities association shall only examine for and enforce against a registered funding portal rules of such national securities association written specifically for registered funding portals.”.

(2) RULEMAKING.—The Commission shall issue a rule to carry out section 3(h) of the Securities Exchange Act of 1934 (15 U.S.C. 78c), as added by this subsection, not later than 270 days after the date of enactment of this Act.

(b) DEFINITION.—Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)) is amended by adding at the end the following:

“(80) FUNDING PORTAL.—The term ‘funding portal’ means any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to section 4(6) of the Securities Act of 1933 (15 U.S.C. 77d(6)), that does not—

“(A) offer investment advice or recommendations;

“(B) solicit purchases, sales, or offers to buy the securities offered or displayed on its website or portal;

“(C) compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal;

“(D) hold, manage, possess, or otherwise handle investor funds or securities; or

“(E) engage in such other activities as the Commission, by rule, determines appropriate.”.

**SEC. 305. RELATIONSHIP WITH STATE LAW.**

(a) IN GENERAL.—Section 18(b)(4) of the Securities Act of 1933 (15 U.S.C. 77r(b)(4)) is amended—

(1) by redesignating subparagraphs (C) and (D) as subparagraphs (D) and (E), respectively; and

(2) by inserting after subparagraph (B) the following:

“(C) section 4(6);”.

(b) CLARIFICATION OF THE PRESERVATION OF STATE ENFORCEMENT AUTHORITY.—

(1) IN GENERAL.—The amendments made by subsection (a) relate solely to State registration, documentation, and offering requirements, as described under section 18(a) of Securities Act of 1933 (15 U.S.C. 77r(a)), and shall have no impact or limitation on other State authority to take enforcement action with regard to an issuer, funding portal, or any other person or entity using the exemption from registration provided by section 4(6) of that Act.

(2) CLARIFICATION OF STATE JURISDICTION OVER UNLAWFUL CONDUCT OF FUNDING PORTALS AND ISSUERS.—Section 18(c)(1) of the Securities Act of 1933 (15 U.S.C. 77r(c)(1)) is amended by striking “with respect to fraud or deceit, or unlawful conduct by a broker or dealer, in connection with securities or securities transactions.” and inserting the following: “, in connection with securities or securities transactions

“(A) with respect to—

“(i) fraud or deceit; or

“(ii) unlawful conduct by a broker or dealer; and

“(B) in connection to a transaction described under section 4(6), with respect to—

“(i) fraud or deceit; or

“(ii) unlawful conduct by a broker, dealer, funding portal, or issuer.”.

(c) NOTICE FILINGS PERMITTED.—Section 18(c)(2) of the Securities Act of 1933 (15 U.S.C. 77r(c)(2)) is amended by adding at the end the following:

“(F) FEES NOT PERMITTED ON CROWDFUNDED SECURITIES.—Notwithstanding subparagraphs (A), (B), and (C), no filing or fee may be required with respect to any security that is a covered security pursuant to subsection (b)(4)(B), or will be such a covered security upon completion of the transaction, except for the securities commission (or any agency or office performing like functions) of the State of the principal place of business of the issuer, or any State in which purchasers of 50 percent or greater of the

aggregate amount of the issue are residents, provided that for purposes of this subparagraph, the term ‘State’ includes the District of Columbia and the territories of the United States.”.

(d) FUNDING PORTALS.—

(1) STATE EXEMPTIONS AND OVERSIGHT.—Section 15(i) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(i)) is amended—

(A) by redesignating paragraphs (2) and (3) as paragraphs (3) and (4), respectively; and

(B) by inserting after paragraph (1) the following:

“(2) FUNDING PORTALS.—

“(A) LIMITATION ON STATE LAWS.—Except as provided in subparagraph (B), no State or political subdivision thereof may enforce any law, rule, regulation, or other administrative action against a registered funding portal with respect to its business as such.

“(B) EXAMINATION AND ENFORCEMENT AUTHORITY.—Subparagraph (A) does not apply with respect to the examination and enforcement of any law, rule, regulation, or administrative action of a State or political subdivision thereof in which the principal place of business of a registered funding portal is located, provided that such law, rule, regulation, or administrative action is not in addition to or different from the requirements for registered funding portals established by the Commission.

“(C) DEFINITION.—For purposes of this paragraph, the term ‘State’ includes the District of Columbia and the territories of the United States.”.

(2) STATE FRAUD AUTHORITY.—Section 18(c)(1) of the Securities Act of 1933 (15 U.S.C. 77r(c)(1)) is amended by striking “or dealer” and inserting “, dealer, or funding portal”.

## Appendix B : Discussion Participants

### **James Angel**

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Georgetown University  
McDonough School of Business*

### **Bradley Belt**

*Senior Managing Director  
Milken Institute*

### **Timothy Bowler**

*Deputy Assistant Secretary  
Office of Capital Markets  
U.S. Department of the Treasury*

### **Chris Brummer**

*Senior Fellow  
Milken Institute  
Professor of Law  
Georgetown University Law Center*

### **Reggie Chambers**

*White House Fellow  
National Economic Council  
The White House*

### **Trey Clark**

*Founder  
RealtyShares*

### **Brian Deese**

*Deputy Director  
National Economic Council  
The White House*

### **Richard Ditzio**

*Executive Director  
Program Development  
Milken Institute*

### **Daniel Gorfine**

*Director of Special Projects  
and Legal Counsel  
Milken Institute*

### **Andrew Green**

*Legislative Counsel  
The Honorable Jeff Merkley  
United States Senate*

### **Sean Greene**

*Associate Administrator for Investment  
and Special Advisor for Innovation  
U.S. Small Business Administration*

### **Sara Hanks**

*Co-Founder and CEO  
CrowdCheck*

### **Antone Johnson**

*Founder  
Bottom Line Law Group*

### **Donald Langevoort**

*Professor  
Georgetown University Law Center*

### **Lisa Lindsley**

*Director of Capital Strategies  
AFSCME*

### **Maurice Lopes**

*Founder and CEO  
Early Shares*

### **David Marlett**

*Founder and Executive Director  
National Crowdfunding Association*

### **The Honorable Patrick McHenry**

*U.S. House of Representatives  
Member  
House Committee on Financial Services*

### **Ryan Minto**

*Press Secretary  
The Honorable Patrick McHenry  
U.S. House of Representatives*

**Vincent Molinari**

*Co-Chair  
Crowdfunded Intermediary Regulatory  
Advocates*

**Lucas Moskowitz**

*Counsel to Commissioner Gallagher  
U.S. Securities and Exchange  
Commission*

**Alice Ning**

*Founder  
TapCaps*

**Kunal Pahwa**

*Senior Legislative Assistant  
The Honorable Patrick McHenry  
U.S. House of Representatives*

**Joseph Price**

*Senior Vice President  
Financial Industry Regulatory Authority*

**Monique Rollins**

*Senior Policy Adviser  
Office of Capital Markets  
U.S. Department of the Treasury*

**Jeffrey Rubin**

*Federal Regulation of Securities Chairman  
American Bar Association  
Partner  
Hogan Lovells*

**Slava Rubin**

*Founder and CEO  
Indiegogo*

**Melissa Stevens**

*Deputy Executive Director  
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**Andrew Verstein**

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Center for the Study of Corporate Law  
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**Peggy Wallace**

*Managing Director  
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**David Wilkinson**

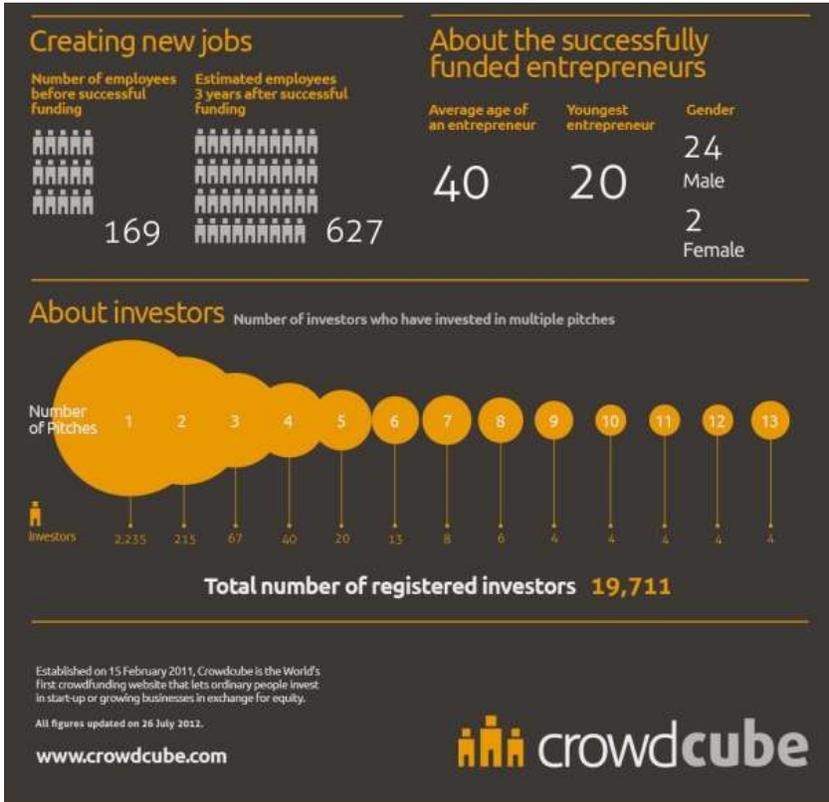
*Executive Director  
City First Enterprises*

**Herbie Ziskend**

*Director of Strategic Projects  
Revolution LLC*

# Appendix C: Crowdcube Growth (February 2011–July 2012)





Source for info graphics: [www.crowdcube.com](http://www.crowdcube.com).



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