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November 18, 2015

Robert W. Errett
Deputy Secretary
Securities and Exchange Commission
100 F. Street., NE
Washington DC 205491090

Re: File No. SR-FINRA-2015-040 - FINRA Proposed Rule Change to Adopt the Funding Portal Rules and Related Forms and FINRA Rule 4518

Dear Mr. Errett:

I write on behalf of the Public Investors Arbitration Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules promulgated by regulatory and self-regulatory securities authorities to govern the conduct of securities firms and their representatives.

While PIABA understands why the JOBS Act was passed and signed into law by President Barack Obama on April 5, 2012, PIABA has always been troubled by the potential for investor fraud in the crowdfunding arena. The Securities and Exchange Commission (the "SEC" or "Commission") just released its final rules and forms under the Securities Act of 1933 and the Securities Exchange Act of 1934 to implement the requirements of Title III of the JOBS Act (referred to as "Regulation Crowdfunding") on November 6, 2015. PIABA is eager to review the new Regulation Crowdfunding rules and forms in conjunction with FINRA's proposed Funding Portal Rules, related forms and proposed Rule 4518 to identify any areas that may still leave investors vulnerable to bad actors in the crowdfunding arena.

Background

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, FINRA must file with the SEC a copy of any proposed rule change along with a statement of the basis and purpose of such proposed rule change. The SEC and FINRA have previously solicited comments relative to rulemaking required by the JOBS Act including, but not limited

to, Title III of the JOBS Act, which resulted in a new Section 4(a)(6) to the Securities Act of 1933.[1] Section 4(a)(6) provides an exemption from the registration requirements of Securities Act Section 5 for certain "crowdfunding transactions."

PIABA now offers comments regarding FINRA's proposed new Rules 100, 110, 200, 300, 800, 900 and 1200 (collectively, the "Funding Portal Rules" or "FP Rules") and related forms, as well as proposed new FINRA Rule 4518 ("Notification to FINRA in Connection with the JOBS Act").

Comments

As with many of PIABA's comment letters, in general PIABA supports the proposed rules because the Association knows that investors need protection against unscrupulous brokers, issuers and intermediaries in the crowdfunding space. However, as is sometimes the case, PIABA does not think that FINRA's proposed Funding Portal Rules go far enough in several instances. Despite not yet having sufficient time to fully evaluate the proposed Portal Rules and new Rule 4518 alongside the new Regulation Crowdfunding to determine how the new regulatory scheme may (or may not) work in its protection of investors,[2] PIABA submits this comment letter addressing certain obvious issues in the proposed Funding Portal Rules.

Proposed Funding Portal Rule 100 (General Standards)

According to FINRA, proposed Funding Portal Rule 100 is meant to make funding portal members/associated person subject to FINRA By-Laws and FINRA Regulation By-Laws. This is a good thing as far as PIABA is concerned, but PIABA is concerned that FINRA's latest proposal seems to include the potential for an unknown exception. Rather than simply stating that the funding portal members/associated persons will be subject to the referenced By-Laws, FP Rule 100 then includes the limiting language, "unless the context requires otherwise …"[3] Without a better understanding of what "context" could require an exception to the funding portal members/associated persons being subject to FINRA rules and regulations, PIABA believes that investors would be best served by omitting the limiting (*i.e.*, exception) language from FP Rule 100.

Proposed Removal of Funding Portal Rule 110(b) (Fidelity Bond)

[1] *See, e.g.*, FINRA Regulatory Notice 12-34 (request for comment on Proposed Regulation of Crowdfunding Activities [http://www.finra.org/industry/notices/12-34]) and FINRA Regulatory Notice 13-34 (request for comment on Proposed Funding Portal Rules and Related Forms [https://www.finra.org/industry/notices/13-34]). PIABA filed a comment letter in response to RN 12-34 on August 30, 2012 [http://www.finra.org/sites/default/files/NoticeComment/p163714.pdf], in which it cautioned against creating special crowdfunding-related exceptions to the existing rules and regulations, instead emphasizing the importance of having a uniform set of all rules for all business activities (including crowdfunding activities).

[2] FINRA has already acknowledged in its filing related to its proposed Funding Portal Rules that its rulemaking would be "informed by the SEC's rulemaking," but until November 6, 2015, FINRA only had the SEC's proposed Regulation Crowdfunding from which to work. Now that the SEC has finalized Regulation Crowdfunding, FINRA and the public should review and evaluate FINRA's proposed Funding Portal Rules, related forms and new Rule 4518 in light of the new crowdfunding regulations.

[3] That same, or similar, limiting language that references "context" is included in several of the proposed Funding Portal Rules and PIABA does not know to what context the proposed rules are referring or why it means that some part of the proposed rules should not apply.

FINRA is now proposing FP Rule 110 without any requirement that the funding portals obtain a fidelity bond (prior proposed FP Rule 110(b)). FINRA's removal of a fidelity bond requirement is inexplicable as it serves principally to add to the risk for unsuspecting crowdfunding investors. FINRA attempts to justify the removal of the requirement of a fidelity bond on:

the interest of reducing potential burdens on prospective funding portal members given the limited nature of the funding portal business and given that regulatory experience with funding portals is developing.

See Item 5A of the SR-FINRA-2015-040. In other words, the interests of those trying to raise money via crowdfunding trump the interests of investors in need of FINRA's protection. The fact that the funding portal business is developing, and therefore may contain unseen pitfalls, is the exact reason why additional protections for retail investors should be implemented. To argue such protection is not needed, FINRA must ignore the fact that one of the duties of the funding portals is to take measures to reduce the risk of fraud with respect to crowdfunding transactions, including obtaining a background and securities enforcement regulatory history check on each office, director, and person holding more than 20 percent of the outstanding equity of every issuer whose securities are offered by such person.

See SEC Release Nos. 33-9974; 34-76324, p.168.

Although the SEC did not go so far as requiring that funding portals conduct any type due diligence (as it is understood in the securities industry) regarding issuers, funding portals still have significant responsibilities and potential liability.[4] Thus, it would be prudent for funding portal members to be required to have some kind of insurance – be it a fidelity bond or something else – available to help defray avoidable losses suffered by investors while the SEC and FINRA experiment with crowdfunding.

Accordingly, PIABA advocates a new proposed funding portal rule that closely approximates FINRA Rule 4360 in terms of requiring funding portals to obtain a bond covering 'securities' since they will be selling unregistered securities to the general public. Additionally, funding portals should not be permitted to maintain fidelity bonds with deductibles because many of the funding portals will likely be thinly capitalized.[5] Further, the amount of the required minimum fidelity bond required by portals should be increased from $100,000 to up to $1 million to match the amount of investor funds that will be used to purchase these unregistered securities. Finally, the funding portals should be required to clearly disclose to investors what the "blanket fidelity bond coverage"

[4] Indeed, given the funding portals' responsibilities, their employees in charge of compliance should be required to pass a rigorous licensing test based on minimum requirements that are necessary to protect investors.

[5] PIABA is actually of the opinion that the SEC should also require *issuers* to obtain at least minimal fidelity bond coverage—with no deductibles—to protect investors from issuers' potential fraud. The money needed to pay for this insurance can be included in the offering. If, after diligent effort, the issuer is unable to obtain any type of insurance or fidelity bond, that fact should be disclosed to investors. In such cases, the funding portals should be tasked with obtaining a certification from the issuer documenting what efforts the issuer made to obtain the coverage and making those certifications available to potential investors. Another alternative is for FINRA and the SEC to mandate that funding portals and/or issuers contribute to some type of managed group insurance fund akin to FDIC or SIPC insurance. Such a fund would help protect investors from outright theft by portals or issuers. Additionally, funding portals should be subject to net capital requirements.

covers and what it does not (*e.g.*, if a funding portal's fidelity bond coverage merely covers fraud by the funding portal, and not the issuers, the funding portal should disclose that in plain English).

Proposed Funding Portal Rule 200 (Funding Portal Conduct)

According to FINRA, it "further streamlined the rule vis-à-vis the version published in [Regulatory …] Notice [13-34] to reflect the limited scope of activity permitted by funding portals." However, when the original proposed FP Rule 200 is compared with the new proposed FP Rule 200, the only noticeable change is contained in FP Rule 200(c)(2)(B), which sets forth the content required in funding portal member communications. The change made by FINRA, without any substantive explanation, was to delete the requirement that funding portal member communications "provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service."

Thus, even though intermediaries like funding portals are required by Securities Act Section 4A(a)(5) to take measures necessary to reduce the risk of fraud related to crowdfunding transactions, they are not required to provide a sound basis for the evaluating the relevant facts. There is no logical reason that the requirement to provide a sound basis for evaluating facts should only apply to broker-dealers and not also to funding portals.

Proposed Funding Portal Rule 300 (Reporting Requirements)

According to FINRA, proposed FP Rule 300(c) is "largely based on current FINRA Rule 4530 (Reporting Requirements)." In reality, there is at least one portion of FP Rule 300(c) that is identical to FINRA Rule 4530, but needs to be modified for funding portal members/associated persons so that it is consistent with other modifications made to the FINRA Rules by the proposed Funding Portal Rules.

For example, proposed FP Rule 300(c)(1), provides 30 calendar days for a funding portal member/associated person to report to FINRA certain conduct of funding portal members associated persons. This is generally consistent with FINRA Rule 4350. However, while FP Rule 300(c)(1) provides broker-dealers with 30 calendar days to report, there are several other instances in which the time frames applicable to broker-dealers are shortened by the proposed Funding Portal Rules. As with broker-dealers, if not more so, disclosure and transparency related to funding portal members/associated persons and their conduct is critical as everyone embarks on the crowdfunding experiment. That fact, along with the fact that proposed FP Rule 110(a)(3) (Application to be a Funding Portal Member) requires a funding portal applicant to report any changes to information on its application "not later than 10 days following any change in such information," supports shortening the time period in which funding portals must report misconduct from 30 days to 10 days.[6]

On the other hand, there is least one portion of proposed FP Rule 300(c) that has been modified to omit certain misconduct that is included in the equivalent FINRA Rule (4530). For example, FINRA Rule 4530(a)(1)(B) requires reporting to FINRA if a member/associated person "is the subject of any written complaint involving allegations of theft or misappropriation of funds or securities or of forgery." For some reason, proposed FP Rule 300(c)(1)(A)(ii) has changed the reporting requirement for funding portal members/associated persons such that they only need to report to FINRA when a written complaint involves "allegations of fraudulent conduct or misuse or misappropriation of funds or assets." PIABA questions why the reporting standard for one type of member is

[6] The same change from 30 days to 10 days should also be made in proposed FP Rule 300(c)(2).

different than the reporting standard for another. If FINRA does not consider the reporting standards to be different, then PIABA questions why the wording was changed.

FINRA's disparate treatment of the reporting of written complaints is especially perplexing given that the remainder of proposed FP Rule 300(c)(1)(A) retains some of the very language that has been removed from FP Rule 300(c)(1)(A)(ii). For example, 300(c)(1)(A)(iv) still requires reporting to FINRA if a funding portal member/associated person is indicted, convicted of, or pleads guilty to, or pleads no contest to a list of different infractions including theft, forgery and misappropriation of funds or securities. PIABA questions why those same infractions are not included in the items that must be reported if they are the subject of a written complaint.

Moreover, proposed FP Rule 300 inexplicably omits the requirement found in FINRA Rule 4530(d) that mandates broker-dealers report to FINRA statistical and summary information related to written customer complaints. Presumably, the rationale in not requiring similar reporting for funding portal members is cost-related, but PIABA was under the impression that the SEC and FINRA wanted to evaluate how crowdfunding works in practice and such statistical and summary reports would help in that regard. The requirement in FINRA Rule 4530(d) is only quarterly and, frankly, if there are so many customer complaints against funding portal members/associated persons that this requirement would be too costly, then there is a larger and more fundamental problem with the crowdfunding experiment.

Similarly, FINRA provides no reasonable explanation why funding portal members/associated persons should not be subject to the same mandates as those found in FINRA Rule 4530(f), which simply require members to provide FINRA with copies of the source documents from which reportable information comes. Again, the costs cannot possibly outweigh the benefits of having as much information as possible related to the conduct of funding portal members/associated persons in the hands of FINRA. Interestingly, additional evidence of FINRA treating funding portal members differently when it comes to reporting requirements can be seen in the fact that nearly all of the Supplementary Material to FINRA Rule 4530 is specifically applied to different sections of proposed FP Rule 300, except Supplementary Material .08 concerning customer complaints.

Otherwise, with respect to FP Rule 300, PIABA is generally supportive of the additions contained in proposed FP Rule 300(e) and proposed FP Rule 300(f) since they tend to increase the disclosure and transparency of financial information about the funding portal members/associated persons.

Proposed Funding Portal Rule 800 (Investigations and Sanctions)

According to FINRA, proposed Funding Portal Rule 800 is meant to apply portions of FINRA Rule 8000 Series (Investigations and Sanctions) to funding portals. Unfortunately, there are notable exceptions to the application of the equivalent FINRA Rules to funding portal members/associated persons.

First, FINRA Rule 8110 (Availability of Manual to Customers) is specifically excluded. FINRA Rule 8110 states that "[m]embers shall make available a current copy of the FINRA Manual for examination by customers upon request…" FINRA Rule 8110 also states that members can comply by providing customers with access to the FINRA Manual electronically. In its discussion of proposed FP Rule 800, FINRA summarily states that it does not propose to apply FINRA Rule 8110 as "the rule addresses availability of the complete FINRA Manual and FINRA is not proposing to apply the complete Manual to funding portal members." That may be, but PIABA questions why FINRA would not require that funding portal members provide investors with access to whatever FINRA rules are applicable

to funding portal members. Consumers investing through funding portals have at least as much reason as customers of broker-dealers to know the rules by which FINRA members must abide.

Second, FINRA Rule 8312 (FINRA BrokerCheck Disclosure) is not proposed by FINRA to be applied wholesale to funding portal members/associated persons. Proposed FP Rule 800(b) (Public Disclosure of Information on Funding Portals) is meant to accomplish for funding portals what FINRA Rule 8312 accomplishes for broker-dealers. PIABA is not certain what it is that proposed FP Rule 800(b) actually requires to be given to the public because the language in proposed FP Rule 800(b)(1) is merely permissive. This is particularly troubling as the previous version of the proposed rule mandated disclosures that are only voluntary in the current iteration of the proposed rule. The proposed rule sets forth what FINRA *may* provide access to – not what FINRA *shall* provide access to. The only disclosure mandated by proposed FP Rule 800(b) is found in Subsection 2, and it limited to a disclosure of whether a funding portal member/associated person is "subject to an event described in Section 3(a)(39) of the Securities Exchange Act."

The problem is that Section 3(a)(39) of the Securities Exchange Act only addresses someone subject to a "'statutory disqualification' with respect to membership or participation in, or association with a member of, a self-regulatory organization …" in certain specified circumstances. As far as PIABA is aware, events described in Section 3(a)(39) do not include all of the conduct that a funding portal member/associated person is required to report to FINRA and, thus, FINRA is proposing to disclose less than is required to be disclosed by broker-dealers. If reference to events addressed by Section 3(a)(39) alone is not enough of a public disclosure for a broker-dealer, then why does FINRA think that is sufficient for a funding portal?

It makes no sense, given the SEC's and FINRA's purported commitment to disclosure and transparency regarding crowdfunding activities, that so much pertinent information is proposed to be kept from investors. PIABA questions why investors using funding portals would not be entitled to obtain most (if not all) of the information funding portal members/associated persons will be required to report to FINRA pursuant to proposed FP Rule 300. This is particularly troublesome with respect to information such as historic written complaints, current approved registrations, summary information about certain arbitration awards with public customers or investors and the like (all of which are required to be disclosed by broker-dealers under FINRA Rule 8312). To the extent that FINRA is concerned about the costs of disclosure, such concern is unfounded. In reality, there should not be any significant additional cost since the funding portals are supposed to collect and disclose most (if not all) of the same information in any event, pursuant to other proposed Funding Portal Rules.

Proposed Funding Portal Rule 1200 (Arbitration and Mediation)

According to FINRA, proposed FP Rule 1200 is designed to provide that funding portal members/associated persons will be subject to various other series of rules, including FINRA Rule 12000 Series (Code of Arbitration). PIABA's objections/comments to certain portions of proposed FP Rule 1200 are the same general objections/comments that PIABA has articulated many times in relation to customer claims against broker-dealers.

Arbitration of crowdfunding disputes should be at the investor's election. Aggrieved crowdfunding investors must be given the right to opt out of arbitration agreements and pursue their claims in court (either individually or as part of a class action). The choice of forum and claims is especially important because, presuming issuers adhere to the investment limits set out in the Regulation Crowdfunding rules, many of the claims for monetary losses will be modest if not outright small. Any rule language that would serve to restrain aggrieved investors from filing class

actions against funding portal members would essentially insulate those funding portal members from prosecution. The costs of pursuing an individual case (in arbitration or otherwise) could quickly usurp the benefits even if the case were to result in a favorable one for the aggrieved investor. Accordingly, the only opportunity aggrieved crowdfunding investors may have to pursue justice could be in the class action context. If FINRA is not willing to include the right to choose forums (and claims) in the proposed Funding Portal Rules then, at a bare minimum, FINRA should explicitly bar any arbitration agreement that would preclude an investor from participating in a class action against a funding portal member. Moreover, if aggrieved investors are forced to bring their crowdfunding claims in FINRA arbitration (as opposed to being able to alternatively file a court case) then they should be permitted to include their claims against the issuers in the same FINRA arbitration. If an issuer participates in crowdfunding through FINRA's funding portal members then that issuer should be subject to FINRA arbitration so that aggrieved investors are not forced to fight their battles in multiple forums.

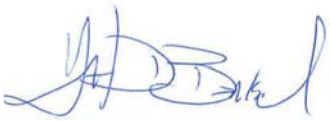
Conclusion

PIABA believes that Congress has greatly increased risks to the investing public by implementing the JOBS Act and suspending laws that were created to protect investors from financial industry predators. In PIABA's opinion, that makes FINRA's rulemaking in the crowdfunding arena that much more important.

For the foregoing reasons, PIABA respectfully requests that: (1) the SEC reject FINRA's rule proposal at this time; (2) require FINRA to resubmit the rule proposal after it has reviewed and analyzed the newly issued Regulation Crowdfunding and decided whether further rulemaking is necessary; and, (3) extend the comment period to allow the public additional time to consider the impact, any of, the newly issued Regulation Crowdfunding. Thank you for the opportunity to comment on such important issues.

Thank you for your consideration herein.

Sincerely yours,



Hugh D. Berkson
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