

portals would need to register as brokers and the fees charged to funding portals would be the higher fees currently charged to broker-dealer members. FINRA's intent to establish a fee structure that minimizes the burden imposed on funding portal members by attempting to set the fees at the minimum necessary to recover FINRA's expected costs may encourage more entrants into crowdfunding activity. As such, the proposed rule change may promote competition in the market for crowdfunding services among funding portals and broker-dealers, increase the provision of capital to startups and small businesses, and lower the costs of capital-raising to these firms. In this way, the proposed rule change may enhance competition for the goods and services provided by those seeking funding from investors through funding portals.

*C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

Written comments were neither solicited nor received.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>34</sup> and paragraph (f)(2) of Rule 19b-4 thereunder.<sup>35</sup> At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings to determine whether the proposed rule should be approved or disapproved.

**IV. Solicitation of Comments**

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

*Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2015-041 on the subject line.

*Paper Comments*

- Send paper comments in triplicate to Robert W. Errett, Deputy Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2015-041. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-FINRA-2015-041 and should be submitted on or before November 18, 2015.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>36</sup>

**Brent J. Fields,**

*Secretary.*

[FR Doc. 2015-27371 Filed 10-27-15; 8:45 am]

**BILLING CODE 8011-01-P**

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-76239; File No. SR-FINRA-2015-040]

**Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of a Proposed Rule Change To Adopt the Funding Portal Rules and Related Forms and FINRA Rule 4518**

October 22, 2015.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on October 9, 2015, Financial Industry Regulatory Authority, Inc. ("FINRA") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by FINRA. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

**I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

FINRA is proposing to adopt Funding Portal Rules 100, 110, 200, 300, 800, 900 and 1200 (collectively, the "Funding Portal Rules") and related forms. In addition, as part of the proposed rule change, FINRA proposes to adopt new FINRA Rule 4518 (Notification to FINRA in Connection with the JOBS Act) in the FINRA rulebook.

The text of the proposed rule change is available on FINRA's Web site at <http://www.finra.org>, at the principal office of FINRA and at the Commission's Public Reference Room.

**II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

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

<sup>34</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>35</sup> 17 CFR 240.19b-4(f)(2).

<sup>36</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

*A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change*

1. Purpose

Title III of the Jumpstart Our Business Startups (“JOBS”) Act,<sup>3</sup> enacted in 2012 with the goal of increasing American job creation and economic growth, contains key provisions relating to securities offered or sold through “crowdfunding.”<sup>4</sup> Under Section 302 of the JOBS Act, a crowdfunding intermediary that engages in crowdfunding on behalf of issuers relying on the JOBS Act’s “crowdfunding exemption”<sup>5</sup> is required to register with the SEC as a “funding portal”<sup>6</sup> or broker and to register with an applicable self-regulatory organization.<sup>7</sup>

In October 2013, the SEC proposed Regulation Crowdfunding to require registration of funding portals and to implement the provisions of Title III of the JOBS Act.<sup>8</sup> Prospective funding portal operators have stated that they intend to register with the SEC pursuant to Regulation Crowdfunding if adopted

by the SEC and to apply for FINRA membership. Section 3(h)(2) of the Act,<sup>9</sup> as amended by the JOBS Act, requires that FINRA only examine for and enforce against registered funding portals rules that FINRA has written specifically for registered funding portals. Further, FINRA has stated that its rulemaking would be informed by the SEC’s rulemaking.<sup>10</sup> Accordingly, FINRA is proposing the Funding Portal Rules and related forms that would apply to SEC-registered funding portals that become FINRA members pursuant to the JOBS Act and the SEC’s Regulation Crowdfunding. The proposed Funding Portal Rules reflect Regulation Crowdfunding as proposed by the SEC and would implement, under FINRA rules, the provisions of Title III of the JOBS Act. FINRA has streamlined the proposed rules to reflect the limited scope of activity permitted by funding portals<sup>11</sup> while also maintaining investor protection. FINRA has written the proposed rules specifically for funding portals.<sup>12</sup>

In developing the proposed Funding Portal Rules, FINRA has considered comments that were received in response to *Regulatory Notice* 13–34 (October 2013) (FINRA Requests Comment on Proposed Funding Portal Rules and Related Forms) (the “*Notice*”).<sup>13</sup> The proposed Funding Portal Rules and forms as set forth in this filing are largely as published in the *Notice*. FINRA has made clarifying revisions and a number of additions to the proposal for administrative purposes. Further, as discussed below, FINRA has revised the proposal vis-à-vis the version published in the *Notice* to better align the provisions governing the right to appeal and hearing under the proposed membership application and eligibility rules with existing provisions for broker-dealer members. In addition, FINRA is not proposing at this time the proposed rule that would have required funding portal members to maintain fidelity bond coverage.<sup>14</sup>

Further, FINRA is not proposing at this time the rule that would have required funding portal members to develop and implement a written anti-money laundering program.<sup>15</sup>

As set forth in this filing, the proposed Funding Portal Rules consist of a set of seven rules (Funding Portal Rules 100, 110, 200, 300, 800, 900 and 1200) and related forms (Form FP–NMA, Form FP–CMA, Funding Portal Rule 300(c) Form, and Form FP–Statement of Revenue). In addition, as part of the proposed rule change, FINRA is proposing to adopt new FINRA Rule 4518 (Notification to FINRA in Connection with the JOBS Act) in the FINRA rulebook. New FINRA Rule 4518 would apply to registered broker members. The proposed requirements of the Funding Portal Rules and related forms and FINRA Rule 4518 are set forth below.

*A. Proposed Funding Portal Rule 100 (General Standards)*

Proposed Funding Portal Rule 100 (General Standards), similar to the FINRA Rule 0100 Series, sets forth basic standards and definitions for purposes of the Funding Portal Rules. Paragraph (a) under the rule provides that all funding portal members and persons associated with funding portal members shall be subject to the FINRA By-Laws and FINRA Regulation By-Laws,<sup>16</sup> unless the context requires otherwise, and the Funding Portal Rules. The rule provides that persons associated with a funding portal member shall have the same duties and obligations as a funding portal member under the Funding Portal Rules. For purposes of Section 1(a) of Article III of the FINRA By-Laws, the proposed rule provides that a registered broker or dealer shall include a registered funding portal.

The proposed rule provides that the terms used in the Funding Portal Rules, if defined in the FINRA By-Laws, shall have the meaning as defined in the FINRA By-Laws, unless a term is

later time whether a rulemaking with respect to fidelity bonds or other financial responsibility requirements is merited. *See also* Item I.I.C.1 of this filing.

<sup>15</sup> Pursuant to the Bank Secrecy Act (“BSA”) (31 U.S.C. 5311, *et seq.*) and implementing regulations thereunder (31 CFR Chapter X), brokers and dealers in securities that are registered or required to be registered with the Commission must among other things establish and maintain an effective anti-money laundering program. The BSA and implementing regulations thereunder do not apply to funding portals at this time. *See also* Item I.I.C.2 of this filing.

<sup>16</sup> FINRA has revised the proposed rule vis-à-vis the version published in the *Notice* to add “and FINRA Regulation By-Laws” to clarify that funding portal members will also be subject to the FINRA Regulation By-Laws.

<sup>3</sup> Pub. L. 112–106, 126 Stat. 306 (2012).

<sup>4</sup> Crowdfunding generally refers to the use of the Internet by small businesses to raise capital through limited investments from a large number of investors.

<sup>5</sup> *See* new Section 4(a)(6) of the Securities Act of 1933 (the “Securities Act”) (15 U.S.C. 77d(a)(6)), as amended by the JOBS Act. The crowdfunding exemption creates an exemption from registration under the Securities Act for securities offered by issuers pursuant to Title III of the JOBS Act.

<sup>6</sup> Section 3(a)(80) of the Act (15 U.S.C. 78c(a)(80)), as amended by Title III of the JOBS Act, provides that 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 Securities Act Section 4(a)(6) (15 U.S.C. 77d(a)(6)), that does not: (1) offer investment advice or recommendations; (2) solicit purchases, sales, or offers to buy the securities offered or displayed on its Web site or portal; (3) compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its Web site or portal; (4) hold, manage, possess, or otherwise handle investor funds or securities; or (5) engage in such other activities as the Commission, by rule, determines appropriate. (The JOBS Act inadvertently created two Sections 3(a)(80) in the Act, the other being the definition of “emerging growth company,” added by Section 101(b) of Title I of the JOBS Act. All references in this filing to Section 3(a)(80) of the Act are to the definition of “funding portal” under Title III of the JOBS Act.)

<sup>7</sup> *See* Sections 4A(a)(1) and (2) of the Securities Act (15 U.S.C. 77d-1(a)(1) and (2)).

<sup>8</sup> *See* Securities Exchange Act Release No. 70741 (October 23, 2013), 78 FR 66428 (November 5, 2013) (Crowdfunding; Proposed Rules) (the “Regulation Crowdfunding Proposal”). The SEC’s proposed Rule 400(a) under Regulation Crowdfunding requires in part that a funding portal must register with the Commission and become a member of FINRA or any other applicable national securities association registered under SEA Section 15A. FINRA is the only registered national securities association.

<sup>9</sup> 15 U.S.C. 78c(h)(2).

<sup>10</sup> *See* Securities Exchange Act Release No. 68633 (January 11, 2013), 78 FR 4186 (January 18, 2013) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Adopt Interim Form for Funding Portals Under the Jumpstart Our Business Startups Act; File No. SR–FINRA–2013–005).

<sup>11</sup> *See* note 6 *supra*. Proposed Rule 300(c)(2) under Regulation Crowdfunding reflects the definition of funding portal as set forth in Section 3(a)(80) of the Act (15 U.S.C. 78c(a)(80)).

<sup>12</sup> FINRA also has submitted a companion filing to adopt Section 15 of Schedule A to the FINRA By-Laws governing the fees for funding portals that are FINRA members. *See* SR–FINRA–2015–041.

<sup>13</sup> Comments are discussed in Item I.I.C of this filing.

<sup>14</sup> FINRA is monitoring the development of funding portal business and will determine at a

defined differently in a Funding Portal Rule, or unless the context of the term within a Funding Portal Rule requires a different meaning.

The proposed definitions contained in the rule are set forth under paragraph (b). The proposed definitions are largely based on definitions under current FINRA rules, modified as appropriate to apply to funding portal members. The proposed rule provides that, when used in the Funding Portal Rules, unless the context otherwise requires, the terms below have the following meanings:

- *Associated person of a funding portal member or person associated with a funding portal member:* The term “associated person of a funding portal member” or “person associated with a funding portal member” means any sole proprietor, partner, officer, director or manager of a funding portal, or other natural person occupying a similar status or performing similar functions, or any natural person directly or indirectly controlling or controlled by a funding portal member, or any employee of a funding portal member.

- *By-Laws:* The term “By-Laws” means the By-Laws of the Corporation or the FINRA By-Laws.

- *Exchange Act or SEA:* The term “Exchange Act” or “SEA” means the Securities Exchange Act of 1934, as amended.

- *FINRA:* The term “FINRA” means, collectively, FINRA, Inc., FINRA Regulation, Inc. and FINRA Dispute Resolution, Inc.

- *Funding Portal:* The term “funding portal” is as defined pursuant to proposed Rule 300(c)(2) of SEC Regulation Crowdfunding.

- *Funding Portal Member:* The term “funding portal member” means any funding portal admitted to membership in FINRA.

- *Funding Portal Rules:* The term “Funding Portal Rules” means Funding Portal Rules 100 through 1200.

- *Investor:* The term “investor” does not include a broker, dealer or funding portal.

- *Person:* The term “person” includes any natural person, partnership, corporation, association, or other legal entity (provided, however, that for purposes of the definition of associated person of a funding portal member as set forth under the rule, the term “person” shall solely include a natural person).

- *SEC:* The term “SEC” means the Securities and Exchange Commission.

- *Securities Act:* The term “Securities Act” means the Securities Act of 1933, as amended.

### *B. Proposed Funding Portal Rule 110 (Funding Portal Application)*

#### 1. Proposed Funding Portal Rule 110(a) (Member Application Process)

Proposed Funding Portal Rule 110(a) addresses the membership application process (“MAP”) for funding portals (referred to in the rule as “FP Applicants”). The MAP will enable FINRA to assess whether funding portals are capable of complying with applicable federal securities laws, the rules and regulations thereunder, and the Funding Portal Rules. The proposed rule is based on the current NASD Rule 1010 Series membership rules that apply to broker-dealers. However, as discussed below, FINRA has simplified the MAP for funding portals to reflect the limited nature of their business. The proposed rule requirements are set forth below.

- *Definitions (Proposed Funding Portal Rule 110(a)(1))*

Paragraph (a)(1) of the proposed rule sets forth a set of definitions that apply solely for purposes of MAP. Specifically:

- *Associated Person:* The rule provides that, solely for purposes of paragraph (a) of Funding Portal Rule 110, the term “associated person” means any: (1) Sole proprietor, partner, officer, director or manager of a funding portal, or other natural person occupying a similar status or performing similar functions; (2) natural person directly or indirectly controlling or controlled by such funding portal, or any employee of a funding portal, except that any person associated with a funding portal whose functions are solely clerical or ministerial shall not be included in the meaning of such term; or (3) partnership, corporation, association, or other legal entity controlled by or controlling the FP Applicant.

- *FP Applicant:* The term “FP Applicant” means a person that applies for admission to FINRA as a funding portal member under paragraph (a)(3) of Funding Portal Rule 110 or a funding portal member that files an application for approval of a change in ownership or control under paragraph (a)(4) of the rule.<sup>17</sup>

- *Day:* The term “day” means calendar day. The rule provides that, solely for purposes of paragraph (a) of Funding Portal Rule 110, in calculating a period of time, the day of the act (e.g., filing of application, service of notice) from which the period of time designated begins to run shall not be

<sup>17</sup> Proposed Funding Portal Rule 110(a)(3) and Rule 110(a)(4) are discussed below.

included, provided, however, that where the last day of a period so calculated is a Saturday, Sunday or day on which FINRA is otherwise closed, the period shall run until the end of the next business day.<sup>18</sup>

- *Department:* The term “Department” means the Department of Member Regulation of FINRA.

- *District:* The term “district” means a district established by the FINRA Regulation Board.

- *Service or Filing Date (Proposed Funding Portal Rule 110(a)(2))*

Proposed Funding Portal Rule 110(a)(2)(A) provides that FINRA shall serve a notice or decision issued under paragraph (a) of the rule by electronic delivery. Paragraph (a)(2)(B) of the rule provides that, for purposes of Funding Portal Rule 110(a), service by FINRA or filing by an FP Applicant shall be deemed complete on the date recorded by FINRA’s electronic systems for electronic communications or by other means of verification prescribed by FINRA.

- *Application To Be a Funding Portal Member (Proposed Funding Portal Rule 110(a)(3))*

Proposed Funding Portal Rule 110(a)(3)(A) provides that an FP Applicant for FINRA membership must submit its application to the Department by filing a Form FP-NMA<sup>19</sup> in the manner prescribed by FINRA and an application fee. Proposed Funding Portal Rule 110(a)(3)(B) provides that, at the time an FP Applicant for FINRA membership submits its application pursuant to paragraph (a)(3)(A) of the rule, the FP Applicant must submit information, in a format to be prescribed by FINRA, indicating whether the FP Applicant or any associated person (as defined in Funding Portal Rule 100(b)(1)) of the FP Applicant is subject to an event described in Section 3(a)(39) of the Act.<sup>20</sup> The FP Applicant must keep this information current and must update such information promptly, but

<sup>18</sup> As proposed in the *Notice*, the proposed definition of “day” for purposes of the MAP for funding portals did not address situations where the last day of a period calculated is a Saturday, Sunday or day on which FINRA is closed. FINRA has added this language in the interest of clarity.

<sup>19</sup> Proposed Form FP-NMA is set forth in Exhibit 3a. FINRA has modified the proposed form vis-à-vis the version published in the *Notice* to reflect the removal of the proposed anti-money laundering and fidelity bond requirements as had been set forth in the *Notice* and to make other clarifications. Consistent with the limited scope of business to be conducted by funding portals, the proposed form requires significantly less information than the Form NMA for broker-dealer applicants.

<sup>20</sup> 15 U.S.C. 78c(a)(39). Section 3(a)(39) of the Act sets forth the definition of “statutory disqualification.”

in any event not later than 10 days following any change in such information.

• *Application for Approval of a Change in Ownership or Control (Proposed Funding Portal Rule 110(a)(4))*

Proposed Funding Portal Rule 110(a)(4)(A) provides that a funding portal member must file an application for prior approval of any change:

- in the equity ownership or partnership capital, LLC membership interest, or other ownership interest of the funding portal member that results in one person or entity directly or indirectly owning or controlling 25 percent or more of the equity or partnership capital, LLC membership interest, or other ownership interest; or
- of control persons of the funding portal member, other than the appointment or election of a natural person as an officer or director of the funding portal member in the normal course of business, regardless of whether such change occurred as a result of a direct or indirect change in the equity ownership, partnership capital, LLC membership interest, or other ownership interest in the funding portal member.

Paragraph (a)(4)(B) of the rule provides that a funding portal member must submit its application for prior approval of any of the changes described in Funding Portal Rule 110(a)(4)(A) to the Department by filing a Form FP-CMA<sup>21</sup> in the manner prescribed by FINRA and an application fee.

• *Rejection of Application That Is Not Complete (Proposed Funding Portal Rule 110(a)(5))*

Proposed Funding Portal Rule 110(a)(6) provides that, within 14 days after the filing of an application filed pursuant to paragraphs (a)(3) or (a)(4) of the rule, the Department shall serve an initial request for any additional information or documents necessary to render a decision on the application, and the FP Applicant must file any additional information and documents with the Department within 14 days after service of the Department's initial request. The rule provides that the Department may serve subsequent requests for additional information or documents at any time during the membership application process. Unless otherwise agreed by the Department and

the FP Applicant, the FP Applicant must file any additional information and documents with the Department within seven days after service of any subsequent request.

• *Withdrawal of Application (Proposed Funding Portal Rule 110(a)(7))*

Proposed Funding Portal Rule 110(a)(7) provides that, if an FP Applicant withdraws an application filed pursuant to paragraphs (a)(3) or (a)(4) of the rule within 14 days after filing the application, FINRA shall refund the application fee, less a processing fee which shall be retained by FINRA. The rule provides that if the FP Applicant determines to again seek funding portal membership or approval of a change in ownership or control, the FP Applicant must submit a new application and fee pursuant to paragraphs (a)(3) or (a)(4) of the rule.

• *Lapse of Application (Proposed Funding Portal Rule 110(a)(8))*

Proposed Funding Portal Rule 110(a)(8) is an addition to the proposal vis-à-vis the proposed rules as published in the *Notice*. The provision, based largely on NASD Rule 1012(b), is designed to ensure that the provisions governing lapse of an application filed pursuant to paragraphs (a)(3) or (a)(4) of the rule better align with existing provisions for broker-dealer members, while also reflecting the more streamlined application process provided for funding portal members in light of their limited permissible activities and the related shorter time frames in which the Department must act on an application. Proposed Funding Portal Rule 110(a)(8)(A) provides that, absent a showing of good cause, an application filed under paragraphs (a)(3) or (a)(4) of the rule shall lapse if an FP Applicant fails to:

- Respond fully within 14 days after service of an initial written request, or within seven days after service of a subsequent written request, for information or documents under paragraph (a)(6) of the rule, or within such other time period as agreed to by the Department and the FP Applicant;
- appear at or otherwise participate in a scheduled membership interview pursuant to paragraph (a)(9) of the rule, as discussed below; or
- file an executed membership agreement under paragraph (a)(11) of the rule, as discussed below, within seven days after service of the agreement, or within such other period as agreed to by the Department and the FP Applicant.

Proposed Funding Portal Rule 110(a)(8)(B) provides that if an FP Applicant wishes to again seek

membership or approval of a change in ownership or control subsequent to the lapse of an application pursuant to paragraph (a)(8)(A) of this Rule, then the FP Applicant shall be required to submit a new application in the manner prescribed in paragraph (a)(3) or (a)(4) of the rule, respectively, including the timely submission of an application fee pursuant to Schedule A to the FINRA By-Laws. The rule provides that FINRA shall not refund any fee for a lapsed application.

• *Membership Interview (Proposed Funding Portal Rule 110(a)(9))*

Proposed Funding Portal Rule 110(a)(9)(A) provides that, before the Department serves its decision on an application for new membership in FINRA, the Department shall conduct one or more membership interviews with a representative or representatives of the FP Applicant. The membership interview(s) may be conducted by video conference or such other means as FINRA may specify. Paragraph 110(a)(9)(B) of the rule provides that, at least five days before a membership interview, the Department shall serve on the FP Applicant a written notice that specifies the date and time of the interview and the representative or representatives of the FP Applicant who are required to participate in the interview. The rule provides that the Department shall serve the notice in a manner consistent with proposed Funding Portal Rule 110(a)(2). The rule further provides that the FP Applicant and the Department may agree to a shorter or longer period for notice or a different method of service. Paragraph 110(a)(9)(C) of the rule provides that, unless the Department directs otherwise for good cause shown, a membership interview shall be scheduled to occur within 30 days after the filing of an application or within 14 days after the filing of all additional information or documents requested, whichever is later.

• *Standards for Granting or Denying Application (Proposed Funding Portal Rule 110(a)(10))*

Proposed Funding Portal Rule 110(a)(10) provides that, after considering an application filed pursuant to paragraphs (a)(3) or (a)(4) of the rule, other information and documents provided by the FP Applicant during the application process, other information and documents obtained by the Department, and the public interest and the protection of investors, the Department shall determine whether the FP

<sup>21</sup> Proposed Form FP-CMA is set forth in Exhibit 3b. FINRA has made clarifying revisions to the form vis-à-vis the version published in the *Notice*. Consistent with the limited scope of business to be conducted by funding portals, the proposed form requires significantly less information than is required for broker-dealer applicants.

Applicant meets each of the following five standards, as applicable:<sup>22</sup>

- The FP Applicant and its associated persons are capable of complying with applicable federal securities laws, the rules and regulations thereunder, and the Funding Portal Rules, including observing high standards of commercial honor and just and equitable principles of trade. In determining whether this standard is met, the Department shall take into consideration all information in its possession, including information regarding whether an FP Applicant or its associated persons:<sup>23</sup>

- is subject to an event described in Section 3(a)(39) of the Exchange Act; and

- is the subject of a pending, adjudicated, or settled regulatory action or investigation by the SEC, the Commodity Futures Trading Commission, a federal, state, or foreign regulatory agency, or a self-regulatory organization; an adjudicated or settled investment-related private civil action for damages or an injunction; or a criminal action (other than a minor traffic violation) that is pending, adjudicated, or that has resulted in a guilty or no contest plea of an FP Applicant or its associated persons.

- The FP Applicant has established all contractual or other arrangements and business relationships with banks, broker-dealers, clearing corporations, service bureaus, escrow agents, transfer agents, technology service providers, or others necessary to initiate the operations described in the FP Applicant's Form FP-NMA.<sup>24</sup>

- The FP Applicant has a supervisory system that is reasonably designed to achieve compliance with applicable federal securities laws, the rules and regulations thereunder, and the Funding Portal Rules.<sup>25</sup>

- The FP Applicant has fully disclosed and established through documentation all direct and indirect sources of funding.<sup>26</sup>

- The FP Applicant has a recordkeeping system that enables the FP Applicant to comply with federal,

state, and self-regulatory organization recordkeeping requirements.<sup>27</sup>

- *Granting or Denying Application (Proposed Funding Portal Rule 110(a)(11))*

Proposed Funding Portal Rule 110(a)(11)(A) provides that, if the Department determines that the FP Applicant meets each of the applicable standards in paragraph (a)(10) of the rule, the Department shall grant the application filed pursuant to proposed Funding Portal Rule 110(a)(3) or (a)(4). The rule provides that the FP Applicant's approval for membership shall be contingent upon the FP Applicant's filing of an executed written membership agreement. Paragraph (a)(11)(B) of the rule provides that, if the Department determines that the FP Applicant does not meet one or more of the applicable standards in proposed Funding Portal Rule 110(a)(10), the Department shall deny the application.

- *Decision (Proposed Funding Portal Rule 110(a)(12))*

Proposed Funding Portal Rule 110(a)(12) provides that the Department shall serve a written decision on the application filed pursuant to paragraphs (a)(3) or (a)(4) of the rule within 60 days after the filing of the application or such later date as the Department and the FP Applicant have agreed in writing.<sup>28</sup> The rule provides that if the Department denies the application, the decision shall explain in detail the reason for denial, referencing the applicable standard or standards in paragraph (a)(10) of the rule. The rule provides that a decision that denies the application shall become effective upon service. The Department shall serve its decision and, as applicable, the membership agreement on the FP Applicant in accordance with paragraph (a)(2) of the rule.

- *Appeal of Department's Decision (Proposed Funding Portal Rule 110(a)(13))*

Proposed Funding Portal Rule 110(a)(13) addresses an appeal of the Department's decision. FINRA has

revised the proposed rule vis-à-vis the proposal as published in the *Notice* so that the appeal process, based in large part on NASD Rules 1015 and 1016, better aligns with existing provisions for broker-dealer applicants. As revised, the proposed rule among other things: (1) Permits the FP Applicant to file a written request for review of the Department's decision with the full National Adjudicatory Council; (2) provides for the National Adjudicatory Council or the Review Subcommittee as defined in FINRA Rule 9120 to appoint a Subcommittee to participate in the review; (3) allows either the FP Applicant to request or the Subcommittee to direct a hearing; and (4) sets forth hearing procedures. In addition, FINRA has made other conforming revisions. The specific requirements of the proposed rule as revised are set forth below.

- Request for Review; Final Action

Paragraph (a)(13)(A)(i) of the rule provides that, within 14 days after service of a decision under paragraph (a)(12) of the rule, an FP Applicant may file a written request for review with the National Adjudicatory Council. A request for review must state with specificity why the FP Applicant believes that the Department's decision is inconsistent with the applicable standards set forth in paragraph (a)(10) of the rule or otherwise should be set aside, and state whether a hearing is requested. An FP Applicant may withdraw its notice of appeal at any time by filing a written notice of withdrawal of appeal with the National Adjudicatory Council. Paragraph (a)(13)(A)(ii) of the rule provides that, if the FP Applicant does not file a request for a review, abandons its appeal or withdraws its notice of appeal, the Department's decision shall constitute final action by FINRA.

- Transmission of Documents

Paragraph (a)(13)(B) of the rule provides that, within 14 days after the filing of a request for review, the Department shall: Transmit to the National Adjudicatory Council copies of all documents that were considered in connection with the Department's decision and an index to the documents; and serve on the FP Applicant a copy of such documents (other than those documents originally submitted by the FP Applicant) and a copy of the index.

- Appointment of Subcommittee

Paragraph (a)(13)(C) of the rule provides that the National Adjudicatory Council or the Review Subcommittee as defined in FINRA Rule 9120 shall appoint a Subcommittee to participate

<sup>22</sup> The five standards that FINRA is proposing are streamlined and consolidated vis-à-vis the 14 standards that apply to broker-dealer applications under NASD Rule 1014(a). FINRA believes that the streamlined, consolidated approach is appropriate to reflect the limited nature of funding portal business.

<sup>23</sup> See proposed Funding Portal Rule 110(a)(10)(A) in Exhibit 5.

<sup>24</sup> See proposed Funding Portal Rule 110(a)(10)(B) in Exhibit 5.

<sup>25</sup> See proposed Funding Portal Rule 110(a)(10)(C) in Exhibit 5.

<sup>26</sup> See proposed Funding Portal Rule 110(a)(10)(D) in Exhibit 5.

<sup>27</sup> See proposed Funding Portal Rule 110(a)(10)(E) in Exhibit 5.

<sup>28</sup> The proposed 60 day time frame is shorter than the 180 day time frame that applies to broker-dealer applicants under NASD Rule 1014(c). FINRA believes that the 60 day time frame for funding portals is appropriate to reflect the limited nature of funding portal business. The provision "or such later date as the Department and the FP Applicant have agreed in writing" is an addition to the proposal vis-à-vis the proposed rules as published in the *Notice* and is intended, based in large part on NASD Rule 1014(c), to better align the rule with existing provisions for broker-dealer members. In addition, FINRA has made other conforming revisions.

in the review.<sup>29</sup> Paragraph (a)(13)(C) further provides that the Subcommittee shall be composed of two or more persons who shall be current or past members of the National Adjudicatory Council or former Directors or Governors.

○ Powers of Subcommittee

Paragraph (a)(13)(D) of the proposed rule provides that, if a hearing is requested, the Subcommittee shall conduct the hearing. If a hearing is not requested, the Subcommittee may serve a notice directing that a hearing be held. The rule provides that if a hearing is not requested or directed, the Subcommittee shall conduct its review on the basis of the record developed before the Department and any written submissions made by the FP Applicant or the Department in connection with the request for review.

○ Hearing

Paragraph (a)(13)(E) of the rule addresses the hearing:

➤ Notice: Paragraph (a)(13)(E)(i) provides that, if a hearing is requested or directed, the hearing shall be held within 45 days after the filing of the request with the National Adjudicatory Council or service of the notice by the Subcommittee. The rule provides that the National Adjudicatory Council shall serve written notice of the date and time of the hearing to the FP Applicant by email, facsimile or overnight courier not later than 14 days before the hearing;

➤ Counsel: Paragraph (a)(13)(E)(ii) provides that the FP Applicant and the Department may be represented by counsel at a hearing conducted pursuant to the rule;

➤ Evidence: Paragraph (a)(13)(E)(iii) provides that formal rules of evidence shall not apply to a hearing under the rule. Not later than five days before the hearing, the FP Applicant and the Department shall exchange copies of their proposed hearing exhibits and witness lists and provide copies of the same to the National Adjudicatory Council. The rule provides that if the FP Applicant or the Department fails to provide copies of its proposed hearing exhibits or witness list within such time, the Subcommittee shall exclude the evidence or witnesses from the proceeding, unless the Subcommittee determines that good cause is shown for failure to comply with the production date set forth in this subparagraph;

➤ Transcript: Paragraph (a)(13)(E)(iv) of the proposed rule provides that the hearing shall be recorded and a

transcript prepared by a court reporter. The rule provides that a transcript of the hearing shall be available for purchase from the court reporter at prescribed rates. The FP Applicant, the Department, or a witness may seek to correct the transcript. The rule further provides that, upon notice to the FP Applicant and the Department, the Subcommittee may direct the correction to the transcript as requested or sua sponte.

○ Additional Information, Briefs

Paragraph (a)(13)(F) of the rule provides that, at any time during its consideration, the Subcommittee or the National Adjudicatory Council may direct the FP Applicant or the Department to file additional information or briefs. The rule provides that any additional information or brief filed shall be provided to all parties before the National Adjudicatory Council renders its decision.

○ Subcommittee Recommendation

Paragraph (a)(13)(G) of the rule provides that the Subcommittee shall present a recommended decision in writing to the National Adjudicatory Council within 60 days after the date of the hearing held pursuant to paragraph (a)(13)(E) of the rule.

○ Decision

Paragraph (a)(13)(H) of the rule provides that, after considering all matters presented in the review and the Subcommittee's recommended written decision, the National Adjudicatory Council may affirm, modify, or reverse the Department's decision or remand the membership proceeding with instructions.

○ Discretionary Review by the FINRA Board

Paragraph (a)(13)(I)(i) of the rule provides that the National Adjudicatory Council shall provide a copy of its decision to the Board. Alternatively, the National Adjudicatory Council may remand the membership proceeding with instructions. If the Board does not call the decision for review under paragraph (a)(13)(I)(ii) of the rule, as discussed below, the National Adjudicatory Council shall issue the written decision after the expiration of the Board call for review period, and the decision shall constitute final FINRA action.

Paragraph (a)(13)(I)(ii) of the rule provides that a Governor may call a membership proceeding for review by the Board at the next meeting of the Board that is at least 15 days after the date on which the Board received the decision. If a call for review is made, the Board shall review the membership

proceeding not later than the next meeting of the Board. The rule provides that the Board shall issue a written decision affirming, modifying or reversing the National Adjudicatory Council's decision and setting forth its findings and conclusions. Alternatively, the Board may remand the membership proceeding with instructions. The rule provides that the decision shall constitute final FINRA action, unless the Board remands the membership proceeding.

• *Application to the SEC for Review (Proposed Funding Portal Rule 110(a)(14))*

Proposed Funding Portal Rule 110(a)(14) provides that a person aggrieved by final action of FINRA under paragraph (a) of the rule may apply for review by the SEC pursuant to Section 19(d)(2) of the Act.<sup>30</sup> The filing of an application for review shall not stay the effectiveness of a decision constituting final action of FINRA, unless the SEC otherwise orders.

• *Filing of Misleading Information as to Membership or Registration (Proposed Funding Portal Rule 110(a)(15))*

Proposed Funding Portal Rule 110(a)(15) provides that no funding portal member or person associated with a funding portal member shall file with FINRA information with respect to membership or registration that is incomplete or inaccurate so as to be misleading, or that could in any way tend to mislead, or shall fail to correct such filing after notice thereof.

*C. Proposed Funding Portal Rule 200 (Funding Portal Conduct)*

Based in large part on FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade), proposed Funding Portal Rule 200(a) provides that a funding portal member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade.

Based in large part on FINRA Rule 2020 (Use of Manipulative, Deceptive or Other Fraudulent Devices), proposed Funding Portal Rule 200(b) provides that no funding portal member shall effect any transaction in, or induce the purchase or sale of, any security by means of, or by aiding or abetting, any manipulative, deceptive or other fraudulent device or contrivance.

Proposed Funding Portal Rule 200(c) (Communications with the Public) is aimed at prohibiting false and misleading statements. The proposed rule is a streamlined version of FINRA Rule 2210 (Communications with the

<sup>29</sup> FINRA Rule 9120 among other things defines "Review Subcommittee" to mean a body appointed by the National Adjudicatory Council pursuant to the FINRA Regulation By-Laws.

<sup>30</sup> 15 U.S.C. 78s(d)(2).

Public) and sets forth the following requirements:<sup>31</sup>

- Paragraph 200(c)(1) of the rule defines the term “funding portal communication” to mean any electronic or other written communication that is distributed or made available by a funding portal member to one or more investors.

- Paragraph 200(c)(2) of the rule addresses content standards. Paragraph 200(c)(2)(A) provides that no funding portal communication may:

- Include any false, exaggerated, unwarranted, promissory or misleading statement or claim;

- omit any material fact or qualification if the omission, in light of the context of the material presented, would cause the communication to be misleading;

- state or imply that FINRA, or any other corporate name or facility owned by FINRA, or any other regulatory organization endorses, indemnifies, or guarantees the funding portal member’s business practices; or

- predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast. A hypothetical illustration of mathematical principles is permitted, provided that it does not predict or project the performance of an investment. Further, paragraph (c)(2)(B) of the rule provides that all funding portal member communications must be based on principles of fair dealing and good faith and must be fair and balanced. Paragraph (c)(2)(C) of the rule provides that all funding portal member communications must prominently disclose the name of the funding portal member, or the name under which the funding portal member primarily conducts business as disclosed on the member’s Form FP–NMA.

- Paragraph 200(c)(3) of the rule addresses issuer communications. Specifically, the rule provides that the content standards of paragraphs (c)(2)(A) and (B) of the rule shall not apply to any communication on the funding portal member’s Web site that is prepared solely by an issuer; provided, however, that no funding portal member may include on its Web site any issuer communication that the funding portal member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.

<sup>31</sup> FINRA has further streamlined the rule vis-à-vis the version published in the *Notice* to reflect the limited scope of activity permitted by funding portals. See note 6 *supra*.

#### *D. Proposed Funding Portal Rule 300 (Funding Portal Compliance)*

##### 1. Proposed Funding Portal Rule 300(a) (Supervisory System)

Proposed Funding Portal Rule 300(a) is a streamlined version of FINRA’s supervision rules and is designed to permit funding portal members flexibility to tailor their supervisory systems to their business models. Paragraph (a)(1) of the rule requires that each funding portal member establish and maintain a system to supervise the activities of each associated person of the funding portal member that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Funding Portal Rules. The rule provides that a funding portal member’s supervisory system must provide, at a minimum, for:

- The establishment and maintenance of written procedures to supervise the activities of the funding portal and its associated persons;

- the designation of a person with authority to carry out the supervisory responsibilities of the funding portal member; and

- reasonable efforts to determine that all supervisory personnel are qualified by virtue of experience or training to carry out their assigned responsibilities.

Paragraph (a)(2) of the rule is designed to align in large part with the inspections and examinations provisions of proposed Rule 403(c) under Regulation Crowdfunding. Proposed Funding Portal Rule 300(a)(2) provides that a funding portal member must permit the examination and inspection of all of its businesses and business operations that relate to its activities as a funding portal, such as its premises, systems, platforms and records, by representatives of FINRA and the Commission, and must cooperate with the examination, inspection or investigation of any persons directly or indirectly using its platform.

##### 2. Proposed Funding Portal Rule 300(b) (Executive Representative)

As discussed above, the General Standards under proposed Funding Portal Rule 100 provide in part that all funding portal members and persons associated with funding portal members shall be subject to the FINRA By-Laws and FINRA Regulation By-Laws, unless the context requires otherwise. Article IV, Section 3 of the FINRA By-Laws requires, in brief, that each FINRA member appoint and certify to FINRA an executive representative to represent, vote, and act for the member in FINRA

affairs. Consistent with FINRA Rule 4517(b),<sup>32</sup> proposed Funding Portal Rule 300(b) requires each funding portal member to designate to FINRA, for purposes of Article IV, Section 3 of the FINRA By-Laws, an executive representative. The rule requires that each funding portal member must update its executive representative designation in the manner prescribed by proposed Funding Portal Rule 300(d), as discussed below.

##### 3. Proposed Funding Portal Rule 300(c) (Reporting Requirements)

Proposed Funding Portal Rule 300(c) requires funding portal members to report to FINRA (and sets forth the obligations of such members’ associated persons to report to the member) regulatory proceedings, disciplinary and other events.<sup>33</sup> The rule is largely based on current FINRA Rule 4530 (Reporting Requirements). Specifically, the rule sets forth the following requirements.

- Paragraph (c)(1) of the rule requires each funding portal member to promptly report to FINRA, within 30 calendar days, through such means as FINRA may specify, after the member knows or should have known of the existence of any of the following:

- The funding portal member or an associated person of the funding portal member:<sup>34</sup>

- Is named as a defendant or respondent in any regulatory proceeding, whether foreign or domestic, involving an alleged violation of any securities-, insurance-, commodities-, financial- or investment-related laws, rules, regulations, standards of conduct or by-laws, or has been found by a regulatory body or self-regulatory organization, whether foreign or domestic, to have violated any securities-, insurance-, commodities-, financial- or investment-related laws, rules, regulations or standards of conduct;<sup>35</sup>

- is the subject of any written complaint involving allegations of fraudulent conduct or misuse or misappropriation of funds or assets;<sup>36</sup>

<sup>32</sup> The executive representative requirement is an addition to the proposal vis-à-vis the proposed rules as published in the *Notice*. FINRA believes it is helpful to prospective funding portal members to add this administrative requirement to the Funding Portal Rules for purposes of clarity.

<sup>33</sup> Funding portal members would use the Funding Portal Rule 300(c) Form for their reporting requirements pursuant to the rule. See Exhibit 3c of this filing.

<sup>34</sup> See proposed Funding Portal Rule 300(c)(1)(A) in Exhibit 5.

<sup>35</sup> See proposed Funding Portal Rule 300(c)(1)(A)(i) in Exhibit 5.

<sup>36</sup> See proposed Funding Portal Rule 300(c)(1)(A)(ii) in Exhibit 5.

➤ is denied registration or is expelled, enjoined, directed to cease and desist, suspended or otherwise disciplined by any securities-, insurance-, commodities-, financial- or investment-related regulatory body or self-regulatory organization, whether foreign or domestic, or is denied membership or continued membership in any such self-regulatory organization; or is barred from becoming associated with any member of any such self-regulatory organization;<sup>37</sup>

➤ is indicted, or convicted of, or pleads guilty to, or pleads no contest to, any felony; or any misdemeanor that involves the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds, or securities, or a conspiracy to commit any of these offenses, or substantially equivalent activity in a domestic, military or foreign court;<sup>38</sup>

➤ is a director, controlling stockholder, partner, officer or sole proprietor of, or an associated person with, a broker, dealer, investment company, investment advisor, funding portal, underwriter or insurance company that was suspended, expelled or had its registration denied or revoked by any regulatory body, jurisdiction or organization, whether foreign or domestic, or is associated in such a capacity with a bank, trust company or other financial institution that was convicted of or pleaded no contest to, any felony or misdemeanor in a foreign or domestic court;<sup>39</sup>

➤ is a defendant or respondent in any securities- or commodities-related civil litigation or arbitration, is a defendant or respondent in any financial-related insurance civil litigation or arbitration, or is the subject of any claim for damages by an investor, broker, dealer or funding portal member that relates to the provision of financial services or relates to a financial transaction, and such civil litigation, arbitration or claim for damages has been disposed of by judgment, award or settlement for an amount exceeding \$15,000. However, when the funding portal member is the defendant or respondent or is the subject of any claim for damages by an investor, broker, dealer or funding portal member, then

the reporting to FINRA shall be required only when such judgment, award or settlement is for an amount exceeding \$25,000;<sup>40</sup>

➤ is, or is involved in the sale of any financial instrument, the provision of any investment advice or the financing of any such activities with any person who is, subject to a “statutory disqualification” as that term is defined in the Exchange Act, provided, however, that this requirement shall not apply to activities with a member or an associated person that has been approved (or is otherwise permitted pursuant to FINRA rules and the federal securities laws) to be a member or to be associated with a member. The report shall include the name of the person subject to the statutory disqualification and details concerning the disqualification;<sup>41</sup> or

○ an associated person of the funding portal member is the subject of any disciplinary action taken by the funding portal member involving suspension, termination, the withholding of compensation or of any other remuneration in excess of \$2,500, the imposition of fines in excess of \$2,500 or is otherwise disciplined in any manner that would have a significant limitation on the individual’s activities on a temporary or permanent basis.<sup>42</sup>

• Paragraph (c)(2) of the rule provides that each funding portal member shall promptly report to FINRA, within 30 calendar days, through such means as FINRA may specify, after the funding portal member has concluded or reasonably should have concluded that an associated person of the funding portal member or the funding portal member itself has violated any securities-, commodities-, financial- or investment-related laws, rules, regulations or standards of conduct of any foreign or domestic regulatory body or self-regulatory organization.

• Paragraph (c)(3) of the rule provides each person associated with a funding portal member must promptly report to the funding portal member the existence of any of the events set forth in paragraph (c)(1)(A) of the rule.

• Paragraph (c)(4) of the rule provides that nothing contained in the rule shall eliminate, reduce or otherwise abrogate the responsibilities of a funding portal member to promptly disclose required information on SEC Form Funding Portal as applicable, to make any other required filings or to respond to FINRA

with respect to any investor complaint, examination or inquiry. The rule provides that, in addition, a member need not report an event otherwise required to be reported under paragraph (c)(1)(A) of the rule if the member discloses the event on SEC Form Funding Portal, consistent with the requirements of that form, or as required pursuant to proposed Funding Portal Rule 800(b)(2).<sup>43</sup>

• Paragraph (c)(5) of the rule provides that, for purposes of the rule, Supplementary Material .01 through .07, .09 and .10 of FINRA Rule 4530 (the “Supplementary Material”) shall apply,<sup>44</sup> provided, however, that, as the context requires:

○ the term “member” as used in the Supplementary Material shall mean “funding portal member” as defined pursuant to proposed Funding Portal Rule 100(b);

○ the term “associated person” as used in the Supplementary Material shall mean “associated person of a funding portal member” or “person associated with a funding portal member” as defined pursuant to proposed Funding Portal Rule 100(b);

○ Supplementary Material .01 shall apply to paragraphs (c)(1)(B) and (c)(2) of proposed Funding Portal Rule 300;

○ Supplementary Material .02 and .03 shall apply to paragraphs (c)(1)(A)(i) and (c)(2) of the rule;

○ Supplementary Material .05 and .07 shall apply to paragraphs (c)(1) and (c)(2) of the rule;

○ Supplementary Material .06 shall apply to paragraph (c)(1)(A)(vi) of the rule; and

○ Supplementary Material .10 shall apply to paragraphs (c)(1)(A)(i) and (c)(1)(A)(iii) of the rule.

<sup>43</sup> As further discussed below, proposed Funding Portal Rule 800(b) addresses the public disclosure of information on funding portals by FINRA and requires, among other things, that funding portal members provide and update information regarding statutory disqualifications.

<sup>44</sup> The Supplementary Materials provide additional guidance as to specified requirements under the rule. Supplementary Materials .01 and .02 address members’ conclusions of violative conduct. Supplementary Material .03 addresses the meaning of the term “found” as used in the specified provisions of the rule. Supplementary Material .04 addresses the meaning of the term “regulatory body” for purposes of the rule. Supplementary Material .05 provides additional guidance as to reporting of individual and related events. Supplementary Material .06 addresses the calculation of monetary thresholds. Supplementary Material .07 addresses former associated persons. Supplementary Material .09 defines the meaning of the term “financial related” for purposes of the rule. Supplementary Material .10 provides guidance as to findings and actions by FINRA.

<sup>37</sup> See proposed Funding Portal Rule 300(c)(1)(A)(iii) in Exhibit 5.

<sup>38</sup> See proposed Funding Portal Rule 300(c)(1)(A)(iv) in Exhibit 5.

<sup>39</sup> See proposed Funding Portal Rule 300(c)(1)(A)(v) in Exhibit 5.

<sup>40</sup> See proposed Funding Portal Rule 300(c)(1)(A)(vi) in Exhibit 5.

<sup>41</sup> See proposed Funding Portal Rule 300(c)(1)(A)(vii) in Exhibit 5.

<sup>42</sup> See proposed Funding Portal Rule 300(c)(1)(B) in Exhibit 5.

4. Proposed Funding Portal Rule 300(d) (Contact Information Requirements)

Proposed Funding Portal Rule 300(d), based in large part on the contact information requirements set forth in FINRA Rule 4517(c), is designed to require funding portal members to report to FINRA specified contact information. Specifically, the rule provides:

- Each funding portal member must report to FINRA all contact information required by FINRA through such means as FINRA may specify.
- Each funding portal member must promptly update its required contact information (including its executive representative designation and contact information as required by Article IV, Section 3 of the FINRA By-Laws), but in any event not later than 30 days following any change in such information. In addition, each member shall review and, if necessary, update its required contact information, through such means as FINRA may specify, within 17 business days after the end of each calendar year.
- Each funding portal member must comply with any FINRA request for such information promptly, but in any event not later than 15 days following the request, or such longer period that may be agreed to by FINRA staff.

5. Proposed Funding Portal Rule 300(e) (Statement of Gross Revenue)

Proposed Funding Portal Rule 300(e) requires each funding portal member each year to report to FINRA, in the manner prescribed by FINRA, the member's gross revenue on Form FP-Statement of Revenue, no later than 60 calendar days following each calendar year-end.<sup>45</sup> The rule requires that the statement of gross revenue must be prepared in accordance with U.S. Generally Accepted Accounting Principles.

6. Proposed Funding Portal Rule 300(f) (Record of Associated Persons of the Funding Portal Member)

Proposed Funding Portal Rule 300(f) is based in large part on SEA Rule 17a-3(a)(12)(ii) (17 CFR 240.17a-3(a)(12)(ii)), which requires broker-dealers to make and keep current a record listing every associated person of the broker-dealer. FINRA believes that requiring funding

portals to keep such a record is prudent both for supervisory and regulatory oversight purposes.<sup>46</sup> The rule requires each funding portal member to make and keep current a record listing every associated person of the funding portal member that shows, for each such associated person, every office of the funding portal member where the associated person regularly conducts any business for the funding portal member, and any registration number, if any, to be prescribed by FINRA, and every identification number or code assigned to the associated person by the funding portal member. The rule requires each funding portal member to preserve all records made pursuant to the rule for five years, the first two in an easily accessible place, which aligns with the retention period that the SEC has prescribed for records that funding portals would have to make and preserve pursuant to proposed Rule 404 under Regulation Crowdfunding.

E. Proposed Funding Portal Rule 800 (Investigations and Sanctions)

1. Proposed Funding Portal Rule 800(a) (Application of FINRA Rule 8000 Series (Investigations and Sanctions) to Funding Portals)

Proposed Funding Portal Rule 800(a) is designed to provide that funding portal members will be subject to specified FINRA rules governing investigations and sanctions. Specifically, the rule provides that, except for FINRA Rules 8110 (Availability of Manual to Customers), 8211 (Automated Submission of Trading Data Requested by FINRA), 8213 (Automated Submission of Trading Data for Non-Exchange-Listed Securities Requested by FINRA) and 8312 (FINRA BrokerCheck Disclosure),<sup>47</sup> all funding portal members shall be subject to the FINRA Rule 8000 Series, unless the

<sup>46</sup> Proposed Funding Portal Rule 300(f) is an addition to the proposal vis-à-vis the proposed rules as published in the *Notice*. FINRA believes the requirement is a useful complement to proposed Rule 404 under the SEC's Regulation Crowdfunding, which sets forth specified records requirements for funding portals but does not include the requirement as to listing associated persons of the funding portal.

<sup>47</sup> FINRA does not propose to apply FINRA Rule 8110 as part of the Funding Portal Rules as the rule addresses availability of the complete FINRA Manual and FINRA is not proposing to apply the complete Manual to funding portal members. FINRA Rules 8211 and 8213 address trading data and are not applicable to funding portals by virtue of the limited nature of their business. With respect to FINRA Rule 8312, as discussed below, FINRA is proposing Funding Portal Rule 800(b) as a streamlined version of the rule to apply to funding portal members.

context requires otherwise, provided, however, that:

- The term "member" as used in the FINRA Rule 8000 Series shall mean "funding portal member" as defined pursuant to Funding Portal Rule 100(b);
- the term "associated person" as used in the FINRA Rule 8000 Series shall mean "associated person of a funding portal member" or "person associated with a funding portal member" as defined pursuant to Funding Portal Rule 100(b);
- the terms "rules" and "FINRA rules" as used in the FINRA Rule 8000 Series shall include the Funding Portal Rules;
- for purposes of FINRA Rule 8210(d):<sup>48</sup>
  - a notice under FINRA Rule 8210 shall be deemed received by the funding portal member to whom it is directed by mailing or otherwise transmitting the notice to the last known business address of the funding portal member as reflected in the SEC Form Funding Portal. With respect to a person who is currently associated with a funding portal member, the rule provides that a notice under FINRA Rule 8210 shall be deemed received by the person by mailing or otherwise transmitting the notice to the last known business address of the funding portal member as reflected in the SEC Form Funding Portal. With respect to a person subject to FINRA's jurisdiction who was formerly associated with a funding portal member, the rule provides that a notice under FINRA Rule 8210 shall be deemed received by the person upon personal service, as set forth in FINRA Rule 9134(a)(1).<sup>49</sup> The rule further provides that if the Adjudicator or FINRA staff responsible for mailing or otherwise transmitting the notice to the funding portal member or person currently associated with the funding portal member has actual knowledge that the funding portal member's address in the SEC Form Funding Portal is out of date or inaccurate, then a copy of the notice shall be mailed or otherwise transmitted to:
    - (i) the last known business address of the funding portal member as reflected in the SEC Form Funding Portal; and
    - (ii) any other more current address of the funding portal member or the person currently associated with the funding portal member known to the Adjudicator or FINRA staff who is responsible for mailing or otherwise transmitting the notice; and

<sup>48</sup> FINRA Rule 8210(d) addresses notices mailed or otherwise transmitted under the rule.

<sup>49</sup> FINRA Rule 9134 addresses methods of and procedures for service for purposes of the Rule 9000 Series.

<sup>45</sup> The requirement to submit the Statement of Gross Revenue using Form FP-Statement of Revenue is an addition to the proposal vis-à-vis the proposed rules as published in the *Notice*. Proposed Form FP-Statement of Revenue is set forth in Exhibit 3d of this filing. The Statement of Gross Revenue will be used to determine a funding portal member's annual fees, which FINRA is establishing as part of a separate rulemaking. See note 12 *supra*.

○ if the Adjudicator or FINRA staff responsible for mailing or otherwise transmitting the notice to the funding portal member or person knows that the funding portal member or person is represented by counsel regarding the investigation, complaint, examination, or proceeding that is the subject of the notice, then the notice shall be served upon counsel by mailing or otherwise transmitting the notice to the counsel in lieu of the funding portal member or person, and any notice served upon counsel shall be deemed received by the funding portal member or person.

## 2. Proposed Funding Portal Rule 800(b) (Public Disclosure of Information on Funding Portals)

Proposed Funding Portal Rule 800(b) is a streamlined version of FINRA Rule 8312 (FINRA BrokerCheck Disclosure) and addresses specified information that FINRA shall make available to the public.<sup>50</sup> Specifically, paragraph (b)(1) of the rule provides that FINRA may provide access to the public, via an appropriate link on the FINRA Web site, to a funding portal member's current SEC Form Funding Portal, including amendments and registration withdrawal requests, as filed with the SEC pursuant to SEC Regulation Crowdfunding, in the form made publicly available by the SEC. The rule provides that, with respect to a former funding portal member, FINRA may provide similar access to the public to the former funding portal member's most recent SEC Form Funding Portal, and any amendments and registration withdrawal requests, as filed with the SEC.

Paragraph (b)(2) of the rule provides that FINRA shall make available to the public information filed by a funding portal member, in a format to be prescribed by FINRA, indicating whether the funding portal member or any associated person of the funding portal member is subject to an event described in Section 3(a)(39) of the Exchange Act. The rule provides that the funding portal member must keep this information current and must update such information promptly, but in any event not later than 10 days following any change in such information.

Paragraph (b)(3) of the rule provides that, with respect to the information provided pursuant to paragraph (b)(2) of the rule, FINRA shall not make available information reported as a Social Security number, information that

FINRA is otherwise prohibited from releasing under Federal law, or information that is provided solely for use by FINRA. The rule provides that FINRA reserves the right to exclude, on a case-by-case basis, information that contains confidential customer information, offensive or potentially defamatory language or information that raises significant identity theft, personal safety or privacy concerns that are not outweighed by investor protection concerns or information that was reported in error by a funding portal member.

## F. Code of Procedure (Proposed Funding Portal Rule 900)

### 1. Proposed Funding Portal Rule 900(a) (Application of FINRA Rule 9000 Series (Code of Procedure) to Funding Portals)

Proposed Funding Portal Rule 900(a) is designed to provide that funding portal members will be subject to specified FINRA rules setting forth FINRA's Code of Procedure. Specifically, except for the FINRA Rule 9520 Series, FINRA Rule 9557, and the FINRA Rule 9700 Series,<sup>51</sup> the rule provides that all funding portal members shall be subject to the FINRA Rule 9000 Series, unless the context requires otherwise, provided, however, that:

- The term "member" as used in the FINRA Rule 9000 Series shall mean "funding portal member" as defined pursuant to Funding Portal Rule 100(b);
- the term "associated person" as used in the FINRA Rule 9000 Series shall mean "associated person of a funding portal member" or "person associated with a funding portal member" as defined pursuant to Funding Portal Rule 100(b);
- the terms "rules" and "FINRA rules" as used in the FINRA Rule 9000 Series shall include the Funding Portal Rules;
- for purposes of FINRA Rule 9217, a funding portal member may be subject

<sup>51</sup> The FINRA Rule 9520 Series addresses "eligibility proceedings" in the context of statutory qualifications which, as discussed further below, FINRA is proposing to address under Funding Portal Rule 900(b). FINRA Rule 9557 addresses service of notice to members that are experiencing financial or operational difficulties under net capital or similar financial responsibility requirements. Because funding portals would not be subject to such requirements, Rule 9557 would not be applicable. Similarly, the FINRA Rule 9700 Series addresses the automated quotation, execution or communication systems owned or operated by FINRA, which are outside the scope of funding portal business activity. Accordingly FINRA does not propose to apply the Rule 9700 Series to funding portals.

to a fine under FINRA Rule 9216(b) with respect to any of the following:<sup>52</sup>

- failure to timely submit amendments to SEC Form Funding Portal;
- Funding Portal Rule 200(c) (Communications with the Public);
- Funding Portal Rule 300(a)—failure to maintain adequate written supervisory procedures where the underlying conduct is subject to Rule 9217;
- Funding Portal Rule 300(c)—failure to timely file reports;
- failure to provide or update contact information as required by Funding Portal Rule 300(d);
- Rule 303(f) of SEC Regulation Crowdfunding—confirmation of transactions; and
- Rule 404 of SEC Regulation Crowdfunding—failure to make and preserve records in conformance with all applicable laws, rules, regulations and statements of policy promulgated thereunder, and with the Funding Portal Rules;
  - for purposes of FINRA Rules 9134(b)(1) and 9134(b)(2), the residential or business address, as applicable, as reflected in SEC Form Funding Portal, in lieu of the Central Registration Depository, shall be acceptable;
  - for purposes of FINRA Rule 9134(b)(2), service on a contact employee, or United States agent for service of process, as set forth in SEC Form Funding Portal, in lieu of Form BD, shall be acceptable;
  - for purposes of FINRA Rule 9551(a),<sup>53</sup> FINRA staff may issue a written notice requiring a funding portal member to file communications with the FINRA Advertising Regulation Department at least ten days prior to use if FINRA staff determines that the member has departed from the standards of Funding Portal Rule 200(c);
  - for purposes of FINRA Rule 9551(d), the pre-use filing requirement referenced in a notice issued and served under FINRA Rule 9551 shall become effective 21 days after service of the notice, unless stayed by a request for a hearing pursuant to FINRA Rule 9559;

<sup>52</sup> FINRA Rule 9216(b) sets forth procedures for disposition of specified rule violations designated as minor rule violations pursuant to a plan (referred to as an "MRVP") declared effective by the SEC in accordance with SEA Section 19(d)(1) (15 U.S.C. 78s(d)(1)) and Rule 19d-1(c)(2) (17 CFR 240.19d-1(c)(2)) thereunder. FINRA Rule 9217 sets forth the rules that are eligible for such disposition. FINRA's MRVP allows FINRA to impose a fine of up to \$2,500 on any firm it regulates or person associated with a FINRA regulated firm for a minor violation of an eligible rule.

<sup>53</sup> FINRA Rule 9551 addresses expedited proceedings by FINRA for failure to comply with public communication standards.

<sup>50</sup> FINRA has further streamlined the proposed rule vis-à-vis the version published in the *Notice* in the interest of clarity.

- for purposes of proceedings pursuant to FINRA Rule 9810(a),<sup>54</sup> proceedings may be initiated with respect to alleged violations of Section 10(b) of the Exchange Act (15 U.S.C. 78j(b)) and SEA Rule 10b-5 (17 CFR 240.10b-5), Funding Portal Rule 200(a) (if the alleged violation is misuse of investor funds or assets, or based on violations of Section 17(a) of the Securities Act (15 U.S.C. 77q(a)) and Funding Portal Rule 200(b).

## 2. Proposed Funding Portal Rule 900(b) (Eligibility Proceedings)

Proposed Funding Portal Rule 900(b) is a streamlined version of the current FINRA Rule 9520 Series. The rule sets forth procedures for a person to become or remain associated with a funding portal member, notwithstanding the existence of a statutory disqualification as defined in Article III, Section 4 of the FINRA By-Laws and for a funding portal member or person associated with a funding portal member to obtain relief from the eligibility or qualification requirements of the FINRA By-Laws and Funding Portal Rules. Such actions hereinafter are referred to as “eligibility proceedings.” The rule requirements are set forth below.

### • *Definitions (Proposed Funding Portal Rule 900(b)(2))*

Paragraph (b)(2) of the rule sets forth the following definitions:

- The term “Application” means FINRA’s Form MC-400 for individuals or Form MC-400A for funding portal members, filed with the Department of Registration and Disclosure (“RAD”).
- The term “disqualified funding portal member” means a funding portal member that is or becomes subject to a disqualification or is otherwise ineligible for membership under Article III, Section 3 of the FINRA By-Laws.
- The term “disqualified person” means an associated person of a funding portal member or person seeking to become an associated person of a funding portal member who is or becomes subject to a disqualification or is otherwise ineligible for association under Article III, Section 3 of the FINRA By-Laws.
- The term “sponsoring funding portal member” means the funding portal member or applicant for membership pursuant to Funding Portal Rule 110(a) that is sponsoring the association or continued association of a disqualified person to be admitted, readmitted, or permitted to continue in association.

<sup>54</sup> FINRA Rule 9810 addresses initiation of cease and desist proceedings by FINRA for specified violations.

### • *Initiation of Eligibility Proceeding; Department of Member Regulation Consideration (Proposed Funding Portal Rule 900(b)(3))*

Proposed Funding Portal Rule 900(b)(3)(A) addresses initiation of eligibility proceedings.

#### ○ *Issuance of Notice of Disqualification or Ineligibility*

Proposed Funding Portal Rule 900(b)(3)(A)(i) provides that if FINRA staff has reason to believe that a disqualification exists or that a funding portal member or person associated with a funding portal member otherwise fails to meet the eligibility requirements of FINRA, FINRA staff shall issue a written notice to the funding portal member or applicant for funding portal membership under proposed Funding Portal Rule 110(a). The rule provides that the notice shall specify the grounds for such disqualification or ineligibility. FINRA staff shall not issue such written notice to funding portal members or applicants for funding portal membership when no Application is required pursuant to proposed Funding Portal Rule 900(b)(7), as discussed below.

#### ○ *Notice Regarding a Funding Portal Member*

Proposed Funding Portal Rule 900(b)(3)(A)(ii) provides that a notice issued to a disqualified funding portal member shall state that the disqualified funding portal member may apply for relief by filing an Application or, in the case of a matter set forth in proposed Funding Portal Rule 900(b)(8)(A), as discussed below, a written request for relief, within 10 business days after service of the notice. The rule provides that if the funding portal member fails to file the Application or, where appropriate, the written request for relief, within the 10-day period, the membership of the funding portal member shall be canceled, unless the Department of Member Regulation grants an extension for good cause shown.

#### ○ *Notice Regarding an Associated Person*

Proposed Funding Portal Rule 900(b)(3)(A)(iii) provides that a notice issued regarding a disqualified person to a funding portal member or applicant for funding portal membership under Funding Portal Rule 110(a) shall state that such funding portal member or applicant for funding portal membership may file an Application on behalf of itself and such person or, in the case of a matter set forth in Funding Portal Rule 900(b)(8)(A) a written request for relief, within 10 business

days after service of the notice. The rule provides that if the funding portal member fails to file the Application or, where appropriate, the written request for relief, within the 10-day period, the funding portal member may not associate or continue to associate with the disqualified person, unless the Department of Member Regulation grants an extension for good cause shown.

#### ○ *Service*

Paragraph (b)(3)(A)(iv) of the proposed rule provides that a notice issued under paragraph (b)(3)(A) of the rule shall be served by facsimile or electronic mail, or pursuant to FINRA Rules 9131<sup>55</sup> and 9134, as adopted pursuant to proposed Funding Portal Rule 900(a).

### • *Obligation of Funding Portal Member To Initiate Eligibility Proceeding (Proposed Funding Portal Rule 900(b)(4))*

Proposed Funding Portal Rule 900(b)(4)(A) addresses the obligation of a funding portal member to initiate eligibility proceedings. Specifically, the rule provides that a funding portal member must file an Application or, in the case of a matter set forth in proposed Funding Portal Rule 900(b)(8)(A) a written request for relief, with RAD, if the funding portal member determines prior to receiving a notice under paragraph (b)(3)(A) of this Rule that:

- It has become a disqualified funding portal member;
  - A person associated with such funding portal member or whose association is proposed by an applicant for funding portal membership under Funding Portal Rule 110(a) has become a disqualified person; or
  - The funding portal member or applicant for funding portal membership under Funding Portal Rule 110(a) wishes to sponsor the association of a person who is a disqualified person.
- *Withdrawal of Application or Written Request for Relief (Proposed Funding Portal Rule 900(b)(5))*

Proposed Funding Portal Rule 900(b)(5)(A) provides that a funding portal member may withdraw its Application or, as set forth in proposed Funding Portal Rule 900(b)(8)(A) its written request for relief, at any time prior to an appeal by filing a written notice with the Department of Member Regulation and RAD pursuant to FINRA Rules 9135 (Filing of Papers with Adjudicator: Procedure), 9136 (Filing of Papers: Form), and 9137 (Filing of

<sup>55</sup> FINRA Rule 9131 addresses service of a complaint by FINRA for purposes of the Rule 9000 Series.

Papers: Signature Requirement and Effect), as adopted pursuant to Funding Portal Rule 900(a). The rule provides that a funding portal member may withdraw its Application after the start of an appeal but prior to the issuance of a decision by the National Adjudicatory Council by filing a written notice with the Department of Member Regulation and the Office of General Counsel pursuant to FINRA Rules 9135, 9136, and 9137, as adopted pursuant to Funding Portal Rule 900(a).

• *Ex Parte Communications (Proposed Funding Portal Rule 900(b)(6))*

Proposed Funding Portal Rule 900(b)(6) provides that the prohibitions against ex parte communications set forth in FINRA Rule 9143, as adopted pursuant to Funding Portal Rule 900(a), shall become effective under Funding Portal Rule 900(b) when FINRA staff has initiated the eligibility proceeding and FINRA staff has knowledge that a funding portal member intends to file an Application or written request for relief pursuant to Funding Portal Rule 900(b).

• *Relief From Eligibility Proceedings (Proposed Funding Portal Rule 900(b)(7))*

Proposed Funding Portal Rule 900(b)(7) provides that a funding portal member is not required to file an Application if:<sup>56</sup>

- The disqualification arises solely from findings in Exchange Act Section 15(b)(4)(D) or (E) by the SEC, the Commodity Futures Trading Commission or a self-regulatory organization, and the sanction is no longer in effect.<sup>57</sup>

- The disqualification arises solely from a final order specified in Exchange Act Section 15(b)(4)(H)(i), and the bar is no longer in effect, provided that there is no final order specified in Exchange Act Section 15(b)(4)(H)(ii), in which case paragraph (b)(7)(C) of the rule, as discussed below, applies.<sup>58</sup>

<sup>56</sup> The disqualifications set forth under paragraph (b)(7) of the rule reflect the three additional categories of disqualification that FINRA addressed in 2009, specifically, willful violations of the federal securities or commodities laws, grounds for statutory disqualification that were enacted by the Sarbanes-Oxley Act, and associations with specified other persons subject to statutory disqualification. See *Regulatory Notice* 09-19 (Eligibility Proceedings) (April 2009). See also Securities Exchange Act Release No. 59586 (March 17, 2009), 74 FR 12166 (March 23, 2009) (Order Approving Proposed Rule Change, as Modified by Amendment No. 1; File No. SR-FINRA-2008-045); Securities Exchange Act Release No. 59722 (April 7, 2009), 74 FR 17267 (April 14, 2009) (Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change; File No. SR-FINRA-2009-022).

<sup>57</sup> See proposed Funding Portal Rule 900(b)(7)(A) in Exhibit 5.

<sup>58</sup> See proposed Funding Portal Rule 900(b)(7)(B) in Exhibit 5.

- The disqualification arises solely from a final order specified in Exchange Act Section 15(b)(4)(H)(ii), and:

- the sanctions do not involve licensing or registration revocation or suspension (or analogous sanctions), and the sanctions are no longer in effect; or

- the sanctions do involve licensing or registration revocation or suspension (or analogous sanctions), the sanctions are no longer in effect, and the order was entered ten or more years ago.<sup>59</sup>

- The disqualification arises solely under Exchange Act Section 3(a)(39)(E), and the disqualified funding portal member or person is subject to the disqualification solely because the member or person has associated with it any person who is known, or in the exercise of reasonable care should be known, to the disqualified member or person to be a person described by subparagraph (A), (B), (C), or (D) of Exchange Act Section 3(a)(39), unless the associated person controls such disqualified member or person, or is a general partner or officer (or person occupying a similar status or performing similar functions) of such disqualified member.<sup>60</sup>

• *Matters That May Be Approved After the Filing of an Application or Written Request for Relief (Proposed Funding Portal Rule 900(b)(8))*

Paragraph (b)(8)(A) of the proposed rule provides that the Department of Member Regulation, as it deems consistent with the public interest and the protection of investors, is authorized to approve a written request for relief from the eligibility requirements by a disqualified funding portal member or a sponsoring funding portal member without the filing of an Application by such disqualified funding portal member or sponsoring funding portal member if a disqualified funding portal member or disqualified person is subject to one or more of the following conditions, but is not otherwise subject to disqualification:

- An injunction as described in Section 15(b)(4)(C) of the Exchange Act that was entered ten or more years prior to the proposed admission or continuance; or

- a request to change the supervisor of a disqualified person.

Paragraph (b)(8)(B) of the rule provides that the Department of Member Regulation, as it deems consistent with the public interest and the protection of investors, may approve, upon the filing

<sup>59</sup> See proposed Funding Portal Rule 900(b)(7)(C) in Exhibit 5.

<sup>60</sup> See proposed Funding Portal Rule 900(b)(7)(D) in Exhibit 5.

of an Application by a disqualified funding portal member or a sponsoring funding portal member and written consent to a heightened supervisory plan, all Applications seeking relief from disqualifications arising under Section 3(a)(39) of the Exchange Act.

Paragraph (b)(8)(B)(i) of the rule provides that, by the submission of a written consent to a heightened supervisory plan, the disqualified funding portal member, sponsoring funding portal member and disqualified person waive:

- The right of appeal to the National Adjudicatory Council, the SEC, and the courts, or otherwise challenge the validity of the supervisory plan, if the supervisory plan is accepted;

- any right of the disqualified funding portal member, sponsoring funding portal member, and disqualified person to claim bias or prejudice by the Department of Member Regulation, the General Counsel, the National Adjudicatory Council, or any member of the National Adjudicatory Council, in connection with such person's or body's participation in discussions regarding the terms and conditions of the Department of Member Regulation's approval or the supervisory plan, or other consideration of the approval or supervisory plan, including acceptance or rejection of such approval or supervisory plan; and

- any right of the disqualified funding portal member, sponsoring funding portal member, and disqualified person to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, as adopted pursuant to Funding Portal Rule 900(a), in connection with such person's or body's participation in discussions regarding the terms and conditions of the approval or supervisory plan, or other consideration of the approval or supervisory plan, including acceptance or rejection of such approval or supervisory plan.

Paragraph (b)(8)(B)(ii) of the rule provides that if the heightened supervisory plan is rejected, the disqualified funding portal member, sponsoring funding portal member, or disqualified person shall be bound by the waivers made under paragraph (b)(8)(B)(i) of the rule for conduct by persons or bodies occurring during the period beginning on the date the heightened supervisory plan was submitted and ending upon the rejection of the heightened supervisory plan and shall have the right to appeal such decision pursuant to proposed Funding Portal Rule 900(b)(11), as discussed below.

• *Department of Member Regulation Consideration of Applications for New Funding Portal Members (Proposed Funding Portal Rule 900(b)(9))*

Proposed Funding Portal Rule 900(b)(9) provides that in all instances where FINRA receives a Form MC-400 or Form MC-400A under this rule, and such Application is submitted on behalf of an applicant for membership as a funding portal member under Funding Portal Rule 110(a), the Department of Member Regulation shall defer a decision on such Form MC-400 or Form MC-400A until such time as FINRA has issued a determination on the application submitted pursuant to Funding Portal Rule 110(a).

• *Rights of Disqualified Funding Portal Member, Sponsoring Funding Portal Member, Disqualified Person, and Department of Member Regulation (Proposed Funding Portal Rule 900(b)(10))*

Proposed Funding Portal Rule 900(b)(10)(A) provides that in the event the Department of Member Regulation does not approve a written request for relief from the eligibility requirements pursuant to Funding Portal Rule 900(b)(8)(A), the disqualified funding portal member or sponsoring funding portal member may file an Application under Funding Portal Rule 900(b)(8)(B). The rule provides that the Department of Member Regulation may require a disqualified funding portal member or sponsoring funding portal member to file an Application with RAD, notwithstanding the provisions of proposed Funding Portal Rule 900(b)(8)(A).

FINRA has revised paragraph (b)(10)(B) of the rule vis-à-vis the proposal as published in the *Notice* so as to better align the rule with existing provisions for broker-dealer members. Based in large part on FINRA Rule 9522(e)(3), proposed Funding Portal Rule 900(b)(10)(B), as revised, provides that, in the event the Department of Member Regulation does not approve an Application pursuant to Funding Portal Rule 900(b)(8)(B), the Department of Member Regulation shall inform the disqualified funding portal member or sponsoring funding portal member of its decision in writing. Further, as revised, the rule provides that the decision shall explain in detail the reason for denial. The rule states that the disqualified funding portal member or sponsoring funding portal member shall have the right to appeal such decision pursuant to proposed Funding Portal Rule 900(b)(11), as discussed below. If not timely appealed pursuant to paragraph

(b)(11) of the rule, the decision issued by the Department of Member Regulation shall constitute final action of FINRA and shall become effective immediately.

• *Appeal of Department of Member Regulation's Decision To Deny an Application or a Written Request for Relief (Proposed Funding Portal Rule 900(b)(11))*

Paragraph (b)(11) of the proposed rule addresses appeal of the Department of Member Regulation's decision to deny an application or a written request for relief. Based in large part on FINRA Rules 9524 and 9525, FINRA has revised the proposed rule vis-à-vis the proposal as published in the *Notice* so as to better align the rule with existing provisions for broker-dealer members. As revised, the proposed rule sets forth among other things procedures for a hearing when one is requested, including notice of the hearing, the rights of parties at the hearing, transmission of documents, extensions of time, postponements and adjournments, and requirements as to the hearing record. In addition, FINRA has made other conforming revisions. The specific requirements of the proposed rule as revised are set forth below.

○ *Notice (Proposed Funding Portal Rule 900(b)(11)(A))*

Paragraph (b)(11)(A) of the proposed rule provides that a funding portal member or sponsoring funding portal member may file a written notice of appeal within 14 days after service of a decision issued under Funding Portal Rule 900(b). The rule provides that the notice of appeal shall be filed with the Office of General Counsel, with a copy to the Department of Member Regulation. The notice of appeal shall state with specificity why the appellant believes the Department of Member Regulation's decision is not consistent with the public interest or should otherwise be set aside, and shall state whether a hearing is requested. The notice of appeal shall be signed by the appellant.

○ *Stay of Decision (Proposed Funding Portal Rule 900(b)(11)(B))*

Paragraph (b)(11)(B) of the proposed rule provides that an appeal of the Department of Member Regulation's decision to deny an Application or a written request for relief shall operate as a stay of that decision while the appeal is pending.

○ *Subcommittee (Proposed Funding Portal Rule 900(b)(11)(C))*

Paragraph (b)(11)(C) of the proposed rule provides that after an appellant

files a timely appeal, the National Adjudicatory Council or the Statutory Disqualification Committee shall appoint two or more members, who shall be current or former members of the National Adjudicatory Council, Statutory Disqualification Committee, or former Directors or Governors, to form a subcommittee. The rule provides that the subcommittee shall conduct a hearing when one is requested, review the appeal, and recommend a decision to the Statutory Disqualification Committee.

○ *Notice of Hearing and Rights of Parties at Hearing (Proposed Funding Portal Rule 900(b)(11)(D))*

Paragraph (b)(11)(D) of the proposed rule provides that, if a hearing is requested, the hearing shall be held no later than 90 days after the filing of a notice of appeal unless the subcommittee determines that there is good cause shown for extending the time period. The rule provides that the appellant and the Department of Member Regulation shall be notified via mail, email, facsimile, or overnight courier of the location, time, and date of the hearing not less than 14 business days before the hearing, unless the parties agree to shorten the time period or where good cause has been shown for an expedited proceeding under paragraph (b)(11)(F) of the rule as discussed further below. The appellant and the Department of Member Regulation shall be entitled to be heard in person at a hearing, to be represented by an attorney, and to submit any relevant evidence.

○ *Withdrawal or Abandonment (Proposed Funding Portal Rule 900(b)(11)(E))*

Paragraph (b)(11)(E) of the proposed rule provides that, if an appellant abandons or withdraws the Application, the Department of Member Regulation's decision shall constitute final action by FINRA.

○ *Expedited Review (Proposed Funding Portal Rule 900(b)(11)(F))*

Paragraph 900(b)(11)(F) of the proposed rule provides that where the failure to promptly review a decision to deny an Application would unduly or unfairly harm the funding portal member or sponsoring funding portal member, the subcommittee shall provide an expedited hearing upon a showing of good cause. The subcommittee would have the authority to set deadlines to prepare for the expedited hearing that would be shorter than the dates for a non-expedited review under Funding Portal Rule 900(b)(11)(G).

- Transmission of Documents (Proposed Funding Portal Rule 900(b)(11)(G))

Paragraph (b)(11)(G)(i) of the proposed rule provides that, within 14 days after the filing of a notice of appeal, the Department of Member Regulation shall transmit to the Office of General Counsel, and serve on the appellant to the extent that any such documents have not been previously provided, copies of all documents that were considered in connection with the Department of Member Regulation's decision to deny the Application and an index to the documents.

Paragraph (b)(11)(G)(ii) of the proposed rule provides that, not less than 10 business days before the hearing, the Department of Member Regulation and the appellant shall serve proposed exhibit and witness lists on each other and the Office of General Counsel. The rule provides that the exhibit and witness lists shall be served by email, facsimile or overnight courier.

Paragraph (b)(11)(G)(iii) of the proposed rule provides that, at any time prior to the issuance of its recommendation, the subcommittee may order the parties to supplement the record with any additional information that the subcommittee deems necessary. The rule provides that the subcommittee may also order the appellant and the Department of Member Regulation to file legal briefs.

- Extensions of Time, Postponements, and Adjournments (Proposed Funding Portal Rule 900(b)(11)(H))

Paragraph (b)(11)(H) of the proposed rule provides that the subcommittee may shorten any time limits prescribed by these rules for the filing of any papers after obtaining consent of all the parties, and may postpone or adjourn any hearing. The rule provides that the subcommittee may extend any time limits prescribed by these rules for the filing of any papers.

- Recordation of Hearing (Proposed Funding Portal Rule 900(b)(11)(I))

Paragraph (b)(11)(I) of the proposed rule provides that the hearing shall be recorded and a transcript prepared by a court reporter.

- Record (Proposed Funding Portal Rule 900(b)(11)(J))

Paragraph (b)(11)(J) of the proposed rule provides that the record shall consist of:

- the decision issued under Funding Portal Rule 900(b),<sup>61</sup>

- all documents relied upon in issuing the decision issued under Funding Portal Rule 900(b);<sup>62</sup>
  - the notice of appeal;<sup>63</sup>
  - any other submissions by the appellant and the Department of Member Regulation;<sup>64</sup>
  - any evidence considered at the hearing;<sup>65</sup> and
  - the transcript of the hearing and any corrections thereto.<sup>66</sup>
- Evidence Not Admitted (Proposed Funding Portal Rule 900(b)(11)(K))

Paragraph (b)(11)(K) of the proposed rule provides that evidence that is proffered but not admitted during the hearing shall not be part of the record, but shall be retained by the Office of General Counsel, as custodian of the record, until the date when FINRA's decision becomes final or, if applicable, upon the conclusion of any review by the SEC or the federal courts.

- Recommendation (Proposed Funding Portal Rule 900(b)(11)(L))

Paragraph (b)(11)(L) of the proposed rule provides that, on the basis of the record, the subcommittee shall present a recommended decision in writing on the request for relief to the Statutory Disqualification Committee. After considering the record and recommendation of the subcommittee, the Statutory Disqualification Committee shall present its recommended decision in writing to the National Adjudicatory Council.

- Decision (Proposed Funding Portal Rule 900(b)(11)(M))

Paragraph (b)(11)(M) of the proposed rule provides that, after considering all the matters presented in the request for relief, the Statutory Disqualification Committee's recommendation, the public interest and the protection of investors, the National Adjudicatory Council may affirm, modify, or reverse in writing the Department of Member Regulation's decision. The rule provides that the National Adjudicatory Council shall provide its proposed decision to the FINRA Board. If the FINRA Board does not call the decision for review, the decision shall be served pursuant to Funding Portal Rule 900(b)(3)(A)(iv) and shall constitute final action of FINRA. A decision to affirm the Department of Member Regulation's decision shall be

<sup>62</sup> See proposed Funding Portal Rule 900(b)(11)(J)(ii) in Exhibit 5.

<sup>63</sup> See proposed Funding Portal Rule 900(b)(11)(J)(iii) in Exhibit 5.

<sup>64</sup> See proposed Funding Portal Rule 900(b)(11)(J)(iv) in Exhibit 5.

<sup>65</sup> See proposed Funding Portal Rule 900(b)(11)(J)(v) in Exhibit 5.

<sup>66</sup> See proposed Funding Portal Rule 900(b)(11)(J)(vi) in Exhibit 5.

effective immediately. A decision to approve the Application shall be effective after the SEC issues an order or acknowledgement letter, as the case may be.

- *Discretionary Review by the FINRA Board (Proposed Funding Portal Rule 900(b)(12))*

- Call for Review by the FINRA Board (Proposed Funding Portal Rule 900(b)(12)(A))

Paragraph (b)(12)(A) of the proposed rule provides that a Governor may call a proposed National Adjudicatory Council decision regarding an eligibility proceeding for review by the FINRA Board if the call for review is made within the period prescribed in paragraph (b)(12)(B) of the rule, as discussed below.

- 15 Day Period; Waiver (Proposed Funding Portal Rule 900(b)(12)(B))

Paragraph (b)(12)(B) of the proposed rule provides that a Governor shall make his or her call for review not later than the next meeting of the FINRA Board that is at least 15 days after the date on which the FINRA Board receives the proposed written decision of the National Adjudicatory Council. The rule provides that by a unanimous vote of the FINRA Board, the FINRA Board may shorten the period to less than 15 days. By an affirmative vote of the majority of the FINRA Board then in office, the FINRA Board may, during the 15 day period, vote to extend the period to more than 15 days.

- Review at Next Meeting (Proposed Funding Portal Rule 900(b)(12)(C))

Paragraph (b)(12)(C) of the proposed rule provides that if a Governor calls an eligibility proceeding for review within the period prescribed in paragraph (b)(12)(B) of the rule, the FINRA Board shall review the eligibility proceeding not later than the next meeting of the FINRA Board. The FINRA Board may order the filing of briefs in connection with its review proceedings pursuant to this Rule.

- Decision of FINRA Board, Including Remand (Proposed Funding Portal Rule 900(b)(12)(D))

Paragraph (b)(12)(D) of the rule provides that, after review, the FINRA Board may affirm, modify, or reverse the proposed written decision of the National Adjudicatory Council. Alternatively, the FINRA Board may remand the eligibility proceeding with instructions.

- Issuance of Decision (Proposed Funding Portal Rule 900(b)(12)(E))

Paragraph (b)(12)(E) of the proposed rule provides that the FINRA Board

<sup>61</sup> See proposed Funding Portal Rule 900(b)(11)(J)(i) in Exhibit 5.

shall issue and serve its written decision on the disqualified funding portal member, sponsoring funding portal member, or disqualified person, and the Department of Member Regulation pursuant to FINRA Rules 9132 and 9134, as adopted pursuant to proposed Funding Portal Rule 900(a). The rule provides that the decision shall constitute the final action of FINRA, unless the FINRA Board remands the proceeding. A decision to deny re-entry or continued association shall be effective immediately. The rule provides that a decision to approve shall be effective after the SEC issues an acknowledgment letter or, in cases involving SEC-ordered sanctions, an order.

• *Application to SEC for Review (Proposed Funding Portal Rule 900(b)(13))*

Proposed Funding Portal Rule 900(b)(13) provides that the right to have any action taken pursuant to this Rule Series reviewed by the SEC is governed by Section 19 of the Exchange Act. The rule provides that filing of an application for review shall not stay the effectiveness of final action by FINRA, unless the SEC otherwise orders.

G. Arbitration and Mediation (Proposed Funding Portal Rule 1200)

Proposed Funding Portal Rule 1200(a) is designed to provide that funding portal members will be subject to the FINRA Rule 12000 Series (Code of Arbitration Procedure for Customer Disputes), FINRA Rule 13000 Series (Code of Arbitration Procedure for Industry Disputes) and FINRA Rule 14000 Series (Code of Mediation Procedure), unless the context requires otherwise. The rule provides that:

- the term “member” as used in the FINRA Rule 12000 Series, FINRA Rule 13000 Series and FINRA Rule 14000 Series shall mean “funding portal member” as defined pursuant to Funding Portal Rule 100(b);
- the term “associated person” as used in the FINRA Rule 12000 Series, FINRA Rule 13000 Series and FINRA Rule 14000 Series shall mean “associated person of a funding portal member” or “person associated with a funding portal member” as defined pursuant to Funding Portal Rule 100(b);
- the terms “rules” and “FINRA rules” as used in the FINRA Rule 12000, FINRA Rule 13000 Series and FINRA Rule 14000 Series shall include the Funding Portal Rules; and
- the term “customer” as used in the FINRA Rule 12000, FINRA Rule 13000 Series and FINRA Rule 14000 Series shall include investors as such term is

used throughout the Funding Portal Rules.

Paragraph (b) of the rule addresses predispute arbitration agreements for investor accounts. The rule is a streamlined version of current FINRA Rule 2268 (Requirements When Using Predispute Arbitration Agreements for Customer Agreements). Paragraph (b)(1) of the rule provides that any predispute arbitration clause must be highlighted and must be immediately preceded by the following language in outline form:

“This agreement contains a predispute arbitration clause. By signing an arbitration agreement the parties agree as follows:

(A) All parties to this agreement are giving up the right to sue each other in court, including the right to a trial by jury, except as provided by the rules of the arbitration forum in which a claim is filed.

(B) Arbitration awards are generally final and binding; a party’s ability to have a court reverse or modify an arbitration award is very limited.

(C) The ability of the parties to obtain documents, witness statements and other discovery is generally more limited in arbitration than in court proceedings.

(D) The arbitrators do not have to explain the reason(s) for their award unless, in an eligible case, a joint request for an explained decision has been submitted by all parties to the panel at least 20 days prior to the first scheduled hearing date.

(E) The panel of arbitrators may include a minority of arbitrators who were or are affiliated with the securities industry.

(F) The rules of some arbitration forums may impose time limits for bringing a claim in arbitration. In some cases, a claim that is ineligible for arbitration may be brought in court.

(G) The rules of the arbitration forum in which the claim is filed, and any amendments thereto, shall be incorporated into this agreement.”

Paragraph (b)(2)(A) of the rule provides that, in any agreement containing a predispute arbitration agreement, there must be a highlighted statement immediately preceding any signature line or other place for indicating agreement that states that the agreement contains a predispute arbitration clause. The statement must also indicate at what page and paragraph the arbitration clause is located. Paragraph (b)(2)(B) provides that, within 30 days of signing, a copy of the agreement containing any such clause must be given to the investor and the funding portal member must retain

proof of delivery or of the investor’s acknowledgement of receipt.

Paragraph (b)(3)(A) of the rule provides that, within ten business days of receipt of the investor’s request, a funding portal member must provide an investor with a copy of any predispute arbitration clause or investor agreement executed between the investor and the funding portal member. Paragraph (b)(3)(B) provides that, upon request by an investor, a funding portal member must provide the investor with the names of, and information on how to contact or obtain the rules of, all arbitration forums in which a claim may be filed under the agreement.

Paragraph (b)(4) of the rule provides that no predispute arbitration agreement shall include any condition that:

- Limits or contradicts the rules of any self-regulatory organization;
- limits the ability of a party to file any claim in arbitration;
- limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement;
- limits the ability of arbitrators to make any award.

Paragraph (b)(5) of the rule provides that, if an investor files a complaint in court against a funding portal member that contains claims that are subject to arbitration pursuant to a predispute arbitration agreement between the funding portal member and the investor, the funding portal member may seek to compel arbitration of the claims that are subject to arbitration. If the funding portal member seeks to compel arbitration of such claims, the funding portal member must agree to arbitrate all of the claims contained in the complaint if the investor so requests.

Paragraph (b)(6) of the rule provides that all agreements must include a statement that “No person shall bring a putative or certified class action to arbitration, nor seek to enforce any predispute arbitration agreement against any person who has initiated in court a putative class action; or who is a member of a putative class who has not opted out of the class with respect to any claims encompassed by the putative class action until: (i) The class certification is denied; or (ii) the class is decertified; or (iii) the investor is excluded from the class by the court. Such forbearance to enforce an agreement to arbitrate shall not constitute a waiver of any rights under this agreement except to the extent stated herein.”

*H. Notification to FINRA in Connection With the JOBS Act (Proposed Funding Portal Rule 4518)*

As discussed earlier, under Section 302 of the JOBS Act, an intermediary that engages in transactions involving the offer or sale of securities pursuant to the crowdfunding exemption is required to register with the SEC as a funding portal or broker and to register with an applicable self-regulatory organization.<sup>67</sup> As such, the statute contemplates activity by registered brokers pursuant to Title III of the JOBS Act, subject to specified conditions. In anticipation that registered broker members of FINRA may intend to act as intermediaries for transactions in connection with the crowdfunding exemption, FINRA is proposing to adopt, as part of the FINRA rulebook, new FINRA Rule 4518. The rule would apply to registered broker members. The rule provides that a FINRA member shall notify FINRA, in a manner prescribed by FINRA:

- prior to engaging, for the first time, in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act; or
- within 30 days of directly or indirectly controlling, or being controlled by or under common control with, a funding portal as defined pursuant to Rule 300(c)(2) of SEC Regulation Crowdfunding.

Proposed FINRA Rule 4518 is an addition to the proposal vis-à-vis the proposed rule change as published in the *Notice*. FINRA believes the requirement is a useful complement to the Funding Portal Rules, given that it would enable FINRA to keep accurate track as to which of its registered broker members, if any, are engaging in activity in connection with Title III of the JOBS Act and thereby assist FINRA in carrying out its regulatory responsibilities.

If the Commission approves the proposed rule change, FINRA will announce the effective date of the proposed rule change in a *Regulatory Notice* to be published no later than 90 days following Commission approval. The effective date will be no later than 365 days following Commission approval.

## 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>68</sup> which requires, among other things, that FINRA rules must be designed to

prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The Act, as amended by the JOBS Act, defines the permissible business activities of funding portals and requires that funding portals must become members of a national securities association. FINRA is the only registered national securities association. The Act requires that FINRA examine for and enforce against registered funding portals rules written specifically for registered funding portals.

FINRA believes that the proposal is consistent with the Act because FINRA has written the proposed rules specifically for funding portals, seeking to streamline the rules or otherwise appropriately modify them to reflect the limited nature of funding portal business, as set forth in the Act.

The proposed rules address general standards applicable to funding portals (Funding Portal Rule 100), the member application process for funding portals (Funding Portal Rule 110(a)), and business conduct, including standards of commercial honor and principles of trade (Funding Portal Rule 200(a)), prohibitions against the use of manipulative, deceptive or other fraudulent devices (Funding Portal Rule 200(b)) and communications with the public (Funding Portal Rule 200(c)). The proposed rules further address supervisory systems (Funding Portal Rule 300(a)), designation of an executive representative (Funding Portal Rule 300(b)), reporting requirements (Funding Portal Rule 300(c)), contact information requirements (Funding Portal Rule 300(d)), submission of revenue statements to FINRA (Funding Portal Rule 300(e) and requirements as to making and keeping current records listing associated persons of the funding portal (Funding Portal Rule 300(f)). In addition, the rules address the application of FINRA's investigations and sanctions procedures to funding portals (Funding Portal Rule 800(a)), public disclosure by FINRA of information on funding portals (Funding Portal Rule 800(b)), the application of FINRA's Code of Procedure to funding portals (Funding Portal Rule 900(a)), eligibility proceedings in connection with statutory disqualifications under the Act (Funding Portal Rule 900(b)), the application of FINRA's Arbitration and Mediation Procedures to funding portals (Funding Portal Rule 1200(a) and rules governing predispute arbitration agreements for investor accounts (Funding Portal Rule 1200(b)).

Consistent with the Act, the proposed rules prohibit fraudulent and manipulative acts and practices and require that funding portal members observe just and equitable principles of trade, thereby conducting to the protection of investors. The proposal is consistent with the public interest because the streamlined requirements as set forth in the proposal, considered in combination with and in view of the restrictions imposed on funding portal business by the Act, are consistent with the Congressional intent of the JOBS Act, which sought to minimize regulatory burdens on funding portals and thereby enable them to play a role in increasing American job creation and economic growth through the new capital raising methods of crowdfunding.

## *B. Self-Regulatory Organization's Statement on Burden on Competition*

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Act, as amended by the JOBS Act, limits the permissible business activities of funding portals and requires that funding portals must become members of a national securities association. FINRA is the only registered national securities association. The Act requires that FINRA examine for and enforce against registered funding portals rules written specifically for funding portals. As such, FINRA has designed the proposed rules to streamline or otherwise appropriately modify existing FINRA rules to reflect the limited scope of business activity permitted to funding portals under the JOBS Act.

FINRA believes that the streamlined approach should minimize the potential costs and burdens on prospective funding portal members at this early stage of development of funding portal business, thereby helping to effectuate the Congressional intent to enable funding portals to play a role in increasing American job creation and economic growth through the new capital raising methods of crowdfunding. Further, FINRA believes the streamlined approach is appropriate given that regulatory experience with funding portals is at an early stage. Following are several requirements that FINRA has streamlined for funding portals vis-à-vis requirements that currently apply to broker-dealers:

- The proposed membership application process (MAP) under Funding Portal Rule 110(a) shortens the time frame for the Department of Member Regulation to provide a

<sup>67</sup> See Sections 4A(a)(1) and (2) of the Securities Act (15 U.S.C. 77d-1(a)(1) and (2)).

<sup>68</sup> 15 U.S.C. 78o-3(b)(6).

decision on a funding portal MAP to 60 days, versus 180 days under the broker-dealer MAP rules. FINRA believes that this shortened time frame is appropriate both in view of the limited nature of funding portal business and in the interest of enabling funding portals to begin their operations expeditiously, thereby supporting a basic purpose of the JOBS Act.

- The proposed MAP streamlines and consolidates, from 14 to five, the NASD Rule 1010 Series standards for granting or denying a funding portal's membership application. FINRA believes that this is consistent with the rationale underlying the shortened time frame for the funding portal MAP, as discussed above, which should ameliorate potential burdens on funding portal members.

- The proposed Form FP-NMA and Form FP-CMA require significantly less information than the broker-dealer counterpart forms, which FINRA believes is consistent with the limited scope of business to be conducted by funding portals. FINRA believes that, similar to the shortened MAP time frame and streamlined standards for granting or denying an application, this again ameliorates potential burdens on funding portal members.

- The proposal imposes no broker-dealer equivalent licensing or examination requirement on associated persons of funding portal members. FINRA believes that imposing examination and licensing requirements on funding portal members at this stage is not necessary in light of the limited activities of funding portals. However, as FINRA gains experience under the proposed rules, FINRA will consider whether additional rulemaking with respect to examination and licensing requirements is merited.

- The proposal as set forth in *Regulatory Notice* 13-34 would have required funding portal members to maintain fidelity bond coverage. As discussed earlier, FINRA is not proposing at this time a fidelity bond requirement. FINRA will monitor developments in this area and determine whether a subsequent rulemaking is merited.

- FINRA is not proposing at this time net capital or similar financial responsibility requirements for funding portals. FINRA believes that this approach is appropriate at this time in view of the limited nature of funding portal business, in particular the JOBS Act prohibition against funding portals holding, managing, possessing, or otherwise handling investor funds and securities. Again, however, FINRA will monitor developments in this area and

determine whether a subsequent rulemaking is merited.

FINRA has undertaken an economic impact assessment, as set forth below, to further analyze the need for the proposed rules, the regulatory objective of the rulemaking, the economic baseline of analysis, and the economic impacts.

#### A. Need for the Rules

Section 3(h)(2) of the Exchange Act,<sup>69</sup> as amended by the JOBS Act, requires that FINRA only examine for and enforce against registered funding portals rules that FINRA has written specifically for registered funding portals.

Under Title III of the JOBS Act, a funding portal is a new type of intermediary the business activities of which are of limited scope, as defined by the JOBS Act, relative to entities that register as brokers. Among other things, the JOBS Act adds Section 4(a)(6) to the Securities Act,<sup>70</sup> which creates an exemption (the "crowdfunding exemption") from registration requirements under the Securities Act for securities offered and sold pursuant to the crowdfunding exemption. Broadly, the crowdfunding exemption permits an issuer to offer and sell up to \$1 million in securities over a 12-month period. The amount of any such security sold to an investor by an issuer is not permitted to exceed specified thresholds. Further, the issuer must comply with other specified requirements under the JOBS Act and Commission rules. Any offering pursuant to the crowdfunding exemption must be conducted through a broker or a funding portal that is registered with the SEC.

Under the JOBS Act, a funding portal must become a member of a national securities association that is registered under Section 15A of the Exchange Act. FINRA is the only national securities association that is registered under Section 15A of the Exchange Act.

On October 23, 2013, the SEC proposed rules<sup>71</sup> to require registration of funding portals and to implement the provisions of Title III of the JOBS Act. Prospective funding portal operators have stated that they intend to register with the SEC pursuant to Regulation Crowdfunding as adopted by the SEC and to apply for FINRA membership.

#### B. Regulatory Objective

The crowdfunding exemption is designed to help provide startups and

small businesses with capital by making relatively low dollar offerings of securities less costly. The exemption creates a regulatory pathway for funding portals to facilitate the offer and sale of securities, as registered funding portals, without being required to register with the SEC as brokers,<sup>72</sup> provided they comply with specified limitations on their business activity.<sup>73</sup>

FINRA's proposal aims to create a streamlined set of regulations for funding portals with rules that reflect the limited scope of activity permitted by funding portals while also maintaining investor protection.

#### C. Economic Baseline

In the absence of FINRA's Funding Portal Rules, intermediaries intending to facilitate securities-based crowdfunding transactions in reliance on the crowdfunding exemption would be required to register with the SEC as brokers. The FINRA rules for registered brokers are intended to address a wider range of activities than is permissible to funding portals, and would place restrictions and costs not associated with such firms' crowdfunding activities. If all crowdfunding intermediaries were subject to the full requirements that apply to registered brokers, there might be several unintended consequences. First, the regulatory costs to operate the crowdfunding intermediary would likely be high, potentially restricting the number of registered crowdfunding intermediaries. These costs would include, but are not limited to, capital requirements, compliance costs and other restrictions on activities. Second, and relatedly, higher compliance costs may limit the activities of those crowdfunding intermediaries that do choose to register as these may restrict financial and other available resources. Third, limited numbers of registered crowdfunding intermediaries may reduce competition in the crowdfunding market and lead to less efficient capital allocation.

In addition to crowdfunding intermediaries, the absence of the proposed rules may also have an impact on: issuers, typically startups and small

<sup>72</sup> Exchange Act Section 3(h)(1) (15 U.S.C. 78c(h)(1)) directs the Commission by rule to exempt, conditionally or unconditionally, a registered funding portal from the requirement to register as a broker or dealer under Exchange Act Section 15(a)(1) (15 U.S.C. 78o(a)(1)), provided that the funding portal: (1) remains subject to the examination, enforcement and other rulemaking authority of the Commission; (2) is a member of a registered national securities association; and (3) is subject to other requirements that the Commission determines appropriate.

<sup>73</sup> See note 6 *supra*.

<sup>69</sup> 15 U.S.C. 78c(h)(2).

<sup>70</sup> 15 U.S.C. 77d(a)(6).

<sup>71</sup> See note 8 *supra*.

businesses seeking to raise capital by issuing securities; investors that purchase or may consider purchasing securities in such offerings; and other capital providers, broker-dealers and finders that currently participate in private offerings.

For the issuers seeking to raise capital through securities-based crowdfunding in reliance on the crowdfunding exemption, limited numbers of registered crowdfunding intermediaries may result in higher capital raising costs, decreased opportunities for selling securities through a given registered funding portal, or an aggregate reduction in the capacity of registered crowdfunding intermediaries. Higher regulatory costs to registered intermediaries may also be passed on to issuers. All of these impacts would collectively make it more difficult for startups and small businesses to efficiently find capital for their operations.

Limited numbers of registered intermediaries may also limit investor access to securities-based crowdfunding offerings. In addition, higher capital raising costs to issuers and higher regulatory costs to registered intermediaries could be passed on to potential investors.

The absence of the proposed Funding Portal Rules also might have an effect on broker-dealers and finders participating in private offerings. As discussed above, in the absence of FINRA's Funding Portal Rules, issuers intending to raise capital in reliance on the crowdfunding exemption may face higher costs. Some of these issuers may instead choose to raise capital through private offerings with the assistance of broker-dealers and finders. This could increase the revenue of finders and broker-dealers in the market for private offerings, but less competition in the fundraising market and greater restrictions on participation of investors may lead to less efficient allocation of capital.

#### D. Economic Impacts

The proposed rules are intended to provide investors with appropriate protections by applying the relevant controls and oversight to the limited activities of funding portals. FINRA recognizes that there are potential costs associated with compliance with the proposed rules. Prospective funding portal members will need to become members of FINRA and establish compliance procedures to comply with the proposed rules, both on an initial and ongoing basis. The proposed rules may also have an impact on other market participants such as issuers and investors. Benefits of the proposed rules

may include greater competition among crowdfunding intermediaries, better market oversight, and investor protection for those investing in offerings made through funding portals. Costs and benefits associated with FINRA's proposed rules are only a subset of the costs and benefits associated with securities-based crowdfunding regulations. Regulatory outcomes will depend on many other factors including the SEC rules.

#### 1. The SEC's Economic Analysis

The SEC's Regulation Crowdfunding Proposal<sup>74</sup> includes a detailed economic analysis that estimates the potential costs and benefits to various market participants. However, the scope of the SEC's proposed Regulation Crowdfunding is broader than the scope of FINRA's proposed rules. Regulation Crowdfunding, as proposed, prescribes rules governing the offer and sale of securities under the new crowdfunding provisions. It also provides a framework for the regulation of registered funding portals and brokers that issuers are required to use as intermediaries. In addition, it exempts securities sold pursuant to the crowdfunding exemption from registration requirements under the Securities Act. As a result, the SEC's economic analysis examines the impacts of securities-based crowdfunding in reliance on the crowdfunding exemption as a new fundraising channel. For example, it estimates the costs for registered brokers, and brokers that prospectively would register, to comply with the various requirements to engage in securities-based crowdfunding transactions. The SEC's economic analysis also estimates the costs for an intermediary to develop a platform to engage in such transactions.

In contrast, FINRA has written the proposed rules specifically for funding portals. In the absence of FINRA's Funding Portal Rules, securities-based crowdfunding in reliance on the crowdfunding exemption is still possible under the SEC rules, though intermediaries intending to facilitate such transactions would need to register as brokers.

#### 2. Benefits

FINRA's proposed Funding Portal Rules will make it possible for intermediaries intending to facilitate securities-based crowdfunding transactions in reliance on the crowdfunding exemption to register as funding portals, which is a lower cost alternative to registering as brokers. The

proposed rules encourage funding portals to become members of FINRA as they provide a streamlined set of regulations that are tailored to the activities of funding portals and avoid the imposition of burdens and costs not associated with permissible funding portal activity. The proposed rules will likely increase the number of registered crowdfunding intermediaries, promote competition, and in turn potentially reduce costs to issuers and investors.

Because funding portals will be required to comply with both the SEC's and FINRA's rules if adopted, FINRA's Funding Portal Rules will create additional regulatory oversight of registered funding portals and improve the SEC's ability to effectively regulate registered funding portals' activities. FINRA believes that the proposed rules will reduce the risk of misconduct and fraud and help create a healthy marketplace in which issuers are more comfortable using securities-based crowdfunding to raise capital and investors are more willing to participate.

#### 3. Costs to Funding Portals

FINRA recognizes that there will be costs to prospective funding portal members associated with each major set of provisions below. Because the proposed Funding Portal Rules have been streamlined to reflect the limited scope of activity permitted to funding portals, the compliance costs would be higher in the absence of the proposed rules where crowdfunding intermediaries would have to register as broker-dealers.

##### a. Registration and Other Costs

Certain costs to prospective funding portals are estimated in the economic impact analysis of FINRA's proposed rule change to adopt Section 15 of Schedule A to the FINRA By-Laws governing fees for funding portal members.<sup>75</sup>

##### b. Other Compliance Costs: Major Sets of Provisions

###### Funding Portal Conduct

Under proposed Funding Portal Rule 200, prospective funding portal members would need to develop and implement policies and processes designed to meet high standards of commercial honor and principles of trade, prevent use of manipulative, deceptive or other fraudulent devices, and comply with the specified proposed requirements on communications with the public.

<sup>74</sup> See note 8 *supra*.

<sup>75</sup> See note 12 *supra*.

### Funding Portal Compliance

Proposed Funding Portal Rule 300(a) requires that each funding portal member establish and maintain a system to supervise the activities of each associated person of the funding portal member that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Funding Portal Rules.

Proposed Funding Portal Rule 300(b) requires that each funding portal member must designate to FINRA an executive representative.

Proposed Funding Portal Rule 300(c) requires funding portal members to report to FINRA (and sets forth the obligations of such members' associated persons to report to the member) regulatory proceedings, disciplinary and other events. Funding portal members would need to establish policies and processes to detect the events that are required to be reported and ensure prompt reporting of the events.

Proposed Funding Portal Rule 300(d) is designed to require funding portal members to report to FINRA all contact information required by FINRA through such means as FINRA may specify.

Proposed Funding Portal Rule 300(e) requires each funding portal member to report to FINRA the member's gross revenue on Form FP-Statement of Revenue.

Proposed Funding Portal Rule 300(f) requires each funding portal member to make and keep current a record listing every associated person of the funding portal member that shows, for each such associated person, every office of the funding portal member where the associated person regularly conducts any business for the funding portal member, and any registration number, if any, to be prescribed by FINRA, and every identification number or code assigned to the associated person by the funding portal member. The rule requires a funding portal member to preserve all records made pursuant to the rule for five years, the first two in an easily accessible place.

The proposal would not require funding portals to implement an anti-money laundering program at this time. Alternatively, broker-dealers that operate a platform under the proposed rules would continue to have anti-money laundering program obligations, and those obligations would extend to any platform that they operate. While this represents an additional cost to registered broker-dealers over new entrants that register strictly as funding portals, these costs are likely small because broker-dealers are already required to have in place all the

requirements for an anti-money laundering program.

### Investigations and Sanctions

Proposed Funding Portal Rule 800(a) provides that except for FINRA Rules 8110, 8211, 8213 and 8312, all funding portal members shall be subject to the FINRA Rule 8000 Series unless the context requires otherwise.

Proposed Funding Portal Rule 800(b) addresses specified information that FINRA shall make available to the public. Proposed Funding Portal Rule 800(b)(2) provides that FINRA shall make available to the public information filed by a funding portal member indicating whether the funding portal member or any associated person of the funding portal member is subject to an event described in Section 3(a)(39)<sup>76</sup> of the Exchange Act, and that the funding portal member must keep this information current and must update such information promptly, but in any event not later than 10 days following any change in such information.

### Application of FINRA Rule 9000 Series to Funding Portals

Proposed Funding Portal Rule 900(a) provides that except for the FINRA Rule 9520 Series, FINRA Rule 9557, and the FINRA Rule 9700 Series, all funding portal members shall be subject to the FINRA Rule 9000 Series unless the context requires otherwise.

Proposed Funding Portal Rule 900(b) sets forth procedures for a person to become or remain associated with a funding portal member, notwithstanding the existence of a statutory disqualification as defined in Article III, Section 4 of the FINRA By-Laws and for a funding portal member or person associated with a funding portal member to obtain relief from the eligibility or qualification requirements of the FINRA By-Laws and Funding Portal Rules.

### Arbitration and Mediation

Proposed Funding Portal Rule 1200(a) is designed to provide that funding portal members will be subject to the FINRA Rule 12000 Series, FINRA Rule 13000 Series and FINRA Rule 14000 Series, unless the context requires otherwise. Proposed Funding Portal Rule 1200(b) addresses predispute arbitration agreements for investor accounts.

### c. Estimate of Costs

FINRA understands that the staffing and scope of the organization necessary

<sup>76</sup> 15 U.S.C. 78c(a)(39). Section 3(a)(39) of the Act sets forth the definition of "statutory disqualification."

to provide crowdfunding services may be comparable to that of a small broker-dealer. As such, FINRA looks to its experience with a sample of smaller broker-dealers to estimate the potential costs associated with the proposed rules. The sample firms do not appear to have a heavy investment in dedicated compliance infrastructure. For example, the designated contacts of these firms for FINRA tend to be a managing principal, who often serves several other roles such as executive representative, anti-money laundering representative, and continuing education representative. Required, routine compliance activities (such as annual certifications, email review, employee trading account reviews, etc.) are generally performed by these principals. In several instances, a firm will rely on a third-party compliance consulting firm to help with its general compliance functions. Several of the sample firms employ a model where their financial and operations principals are employed off-site, work part time or hold multiple registrations with different member firms. FINRA estimates that less than 50% of one internal person's time is typically spent on compliance activities at each of these firms. FINRA understands from a small sample of these firms that they currently pay \$1,000 to \$1,500 per month for compliance consulting services.

FINRA also understands that there are a few member firms that already offer private placement platforms for accredited investors. FINRA understands from various reports that these types of firms may have two full-time compliance officers and spend about \$100,000 to \$150,000 annually on ensuring that all regulations are followed. FINRA believes these estimates are likely for the full scope of broker-dealer activity and include the costs associated with compliance activities not covered by the rule proposal, and thus reflects compliance costs for activities beyond the scope of the permitted business activities of funding portals.

### 4. Costs to FINRA

FINRA has identified costs that it would likely incur as a result of the proposed rules. Specifically, FINRA needs to adapt its current regulatory infrastructure to manage regulatory processes for funding portals, including regulatory support to members and potential challenges to its decisions. To minimize these burdens, FINRA intends to use as much as possible of its in-place systems and processes.

## 5. Impact on Competition

In the absence of FINRA's Funding Portal Rules, intermediaries intending to facilitate securities-based crowdfunding transactions in reliance on the crowdfunding exemption are required to register with the SEC as brokers. As shown by the SEC's economic analysis in the Regulation Crowdfunding Proposal, the compliance cost associated with broker registration is expected to exceed the compliance cost associated with funding portal registration. By appropriately limiting the rule set and attendant compliance costs to match the permitted business activities of funding portals, FINRA's Funding Portal Rules will likely allow more registered intermediaries in the market and promote competition in the provision of crowdfunding services among funding portals and broker-dealers.

As noted above, funding portals may serve as a substitute for some private offerings currently offered through broker-dealers under other exemptions from registration, such as Regulation D (17 CFR 230.500 through 230.508). By enabling prospective funding portals to become members of FINRA and thereby engage in funding portal business, the proposed rules may provide a more efficient form of capital raising by issuers, resulting in a loss of underwriting business in these other private offering platforms. FINRA first notes that these private offerings serve only as a limited substitute for offerings pursuant to the crowdfunding exemption, as they have significant limitations on investor participation that make them inappropriate for many of the investments that could be made available under the crowdfunding exemption. Secondly, FINRA notes that any competitive impacts that might arise from substitution across platforms is mitigated by the ability of any broker-dealer to offer a crowdfunding platform or register a funding portal affiliate, and thus compete to retain the business.

Increasing competition among financial intermediaries who might assist startups and small businesses in obtaining capital will likely lead to lower costs for some issuers, which may enable more startups and small businesses to rely on securities-based crowdfunding as a new source of capital. An increased number of issuers in the fundraising market may promote competition and efficient allocation of capital among crowdfunding issuers.

Increased competition among crowdfunding intermediaries and issuers should also lead to more investment opportunities and lower

costs for investors. More investors and thus more capital may be made available to startups and small businesses, helping to achieve the regulatory objective of the crowdfunding provisions of the JOBS Act.

## 6. Alternatives

As discussed above, FINRA understands that under the SEC's proposed rules, securities-based crowdfunding pursuant to the crowdfunding exemption can occur in brokers that are members of a self-regulatory organization. As such, FINRA considered applying its full rule set to intermediaries providing crowdfunding services. FINRA determined that this approach would impose costs not associated with the activities of the intermediaries and would likely have negative consequences for market efficiency and competition. FINRA also considered the alternative of requiring persons associated with funding portal members to register with FINRA and decided it would not be necessary at this early stage in light of the limited activities of funding portals. As FINRA gains experience in regulating funding portal member activities, FINRA will reassess the alternative based on the nature and scope of the business activities of funding portals.

### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

The proposed rule change was published for comment in *Regulatory Notice* 13-34 (October 2013) (the "Notice"). Seven comments were received in response to the *Notice*. A copy of the *Notice* is attached as Exhibit 2a. A list of commenters<sup>77</sup> is attached as Exhibit 2b. Copies of the comment letters received in response to the *Notice* are attached as Exhibit 2c.

Some commenters expressed concerns that the rules as proposed in the *Notice* would impose too many requirements and, in combination with the requirements set forth in the SEC's Regulation Crowdfunding Proposal, would be costly and burdensome for prospective funding portals.<sup>78</sup> In contrast, other commenters expressed concern that the proposal should impose more requirements such as those that apply to current broker-dealer members or should include other requirements or specified guidelines for purposes of oversight of funding portal

activities.<sup>79</sup> Commenters' specific suggestions are discussed below.

## 1. Fidelity Bond

As discussed earlier, the proposal as published in the *Notice* would have required that funding portal members maintain fidelity bond coverage. Two commenters suggested that FINRA should eliminate or tailor the proposed rule.<sup>80</sup> One of the commenters suggested that, because the JOBS Act prohibits funding portals from holding, managing, possessing or otherwise handling investor funds or securities, funding portals pose limited risk in this area and the fidelity bond requirement would impose an unnecessary cost on funding portals.<sup>81</sup> One of the commenters suggested that, to help save on premiums for prospective funding portals, fidelity bond coverage should not be required until a funding portal member's membership application is approved.<sup>82</sup> On the other hand, two commenters suggested greater stringency in this area.<sup>83</sup> One commenter suggested that the proposed fidelity bond requirement would not be sufficient for purposes of oversight and that the proposed requirement should include financial responsibility requirements.<sup>84</sup> One commenter suggested that the proposal should be revised to include fines for failure to maintain adequate fidelity bonds.<sup>85</sup>

In response, as discussed earlier, FINRA is not proposing the fidelity bond requirement as part of this rulemaking. FINRA believes that this approach is appropriate in the interest of reducing potential burdens on prospective funding portal members given the limited nature of funding portal business and given that regulatory experience with funding portals is developing.<sup>86</sup>

<sup>79</sup> FSA Institute, FSI, NASAA and Wulff.

<sup>80</sup> CyberIssues and Heritage.

<sup>81</sup> Heritage.

<sup>82</sup> CyberIssues.

<sup>83</sup> NASAA and Wulff.

<sup>84</sup> Wulff.

<sup>85</sup> NASAA.

<sup>86</sup> Similarly, given the limited nature of funding portal business, in particular the prohibition against funding portals holding, managing, possessing or otherwise handling investor funds or securities, and given that funding portal business is at an early stage of development, FINRA is not proposing net capital or similar financial responsibility requirements for funding portal members at this time. As discussed earlier, FINRA will monitor the development of this area and determine whether a subsequent rulemaking regarding fidelity bonds or other financial responsibility requirements is merited.

<sup>77</sup> All references to commenters are to the commenters as listed in Exhibit 2b.

<sup>78</sup> CyberIssues, Heritage and Polanco.

## 2. Anti-Money Laundering Program

As discussed earlier, the proposal as published in the *Notice* included a proposed requirement that funding portal members implement a written anti-money laundering program. Two commenters opposed the proposed requirement.<sup>87</sup> One suggested that the anti-money laundering rules are too complex and expensive to comply with, and that the rule is unnecessary because funding portals are prohibited from holding, managing, possessing or otherwise handling investor funds or securities and are thereby not in a position to facilitate money laundering.<sup>88</sup> One commenter suggested that imposing the requirement on funding portals would be duplicative of functions already performed for instance by institutions where investor funds would be held in escrow.<sup>89</sup> On the other hand, one commenter expressed support for the proposed requirement.<sup>90</sup>

In response, as discussed earlier, the BSA and the implementing regulations thereunder apply to brokers and dealers in securities that are registered or required to be registered with the Commission. The BSA does not apply to funding portals at this time. Accordingly, FINRA is not proposing an anti-money laundering requirement at this time.

## 3. Additional Specific Comments

### a. Central Registration Depository

One commenter suggested that the proposal should expressly mandate that funding portal members file the SEC's Form Funding Portal and all related forms through the Central Registration Depository, similar to current FINRA Rule 1010(a).<sup>91</sup> In response, FINRA believes that it is sufficient, and consistent with the need for regulatory flexibility, that the proposal provides for submission of specified information by means and format prescribed by FINRA.<sup>92</sup> FINRA is in the process of developing systems for submission of specified information tailored to prospective funding portal members which, consistent with the Funding Portal Rules, FINRA will prescribe prior to the implementation of the proposal.

<sup>87</sup> CyberIssues and Heritage.

<sup>88</sup> Heritage.

<sup>89</sup> CyberIssues.

<sup>90</sup> CFA Institute.

<sup>91</sup> NASAA.

<sup>92</sup> See, e.g., proposed Funding Portal Rule 110(a)(3)(A), regarding submission of Form FP-NMA, and proposed Funding Portal Rule 110(a)(4)(B), regarding submission of Form FP-CMA.

### b. Associated Persons of a Funding Portal Member

One commenter suggested that FINRA should narrow the proposed definition of associated person of a funding portal member as set forth under proposed Funding Portal Rule 100(b).<sup>93</sup> The commenter suggested excluding from the definition employees of a funding portal whose functions exclusively relate to providing various services to issuers. In response, FINRA notes that the proposed definition is largely based on the current definition under the FINRA By-Laws that applies to broker-dealers and is meant to ensure among other things that the specified persons are subject to FINRA rules. FINRA notes that services that funding portals provide to issuers will potentially be an important component of the business model of many funding portals. Accordingly, FINRA does not propose to modify the definition.

Two commenters suggested that FINRA should institute examination and licensing requirements for at least some associated persons of funding portal members.<sup>94</sup> In response, FINRA notes that the funding portal business is at an early stage of development. Further, as discussed earlier, FINRA notes that the scope of activities permitted to funding portals is limited under the JOBS Act. Accordingly, FINRA is not imposing examination and licensing requirements on associated persons of funding portals at this time. However, as FINRA gains experience under the proposed rules, FINRA will consider whether additional rulemaking with respect to examination and licensing requirements is merited.

### c. Application of Additional Rules

Two commenters suggested that FINRA should apply to funding portal members additional rules from the FINRA rulebook that currently apply to broker-dealer members or that FINRA should duplicate, within the proposed Funding Portal Rules, standards adopted by the SEC in Regulation Crowdfunding.<sup>95</sup> One commenter proffered several current FINRA rules governing broker-dealer members that the commenter suggested should be replicated within the proposed Funding Portal Rules to address potential conflicts of interest, such as the prohibition against guarantees and sharing in accounts under FINRA Rule 2150, as well as elements under FINRA Rule 2210 (Communications with the Public), FINRA Rule 3220 (Influencing

<sup>93</sup> CyberIssues.

<sup>94</sup> NASAA and Wulff.

<sup>95</sup> CFA Institute and NASAA.

or Rewarding Employees of Others), FINRA Rule 3240 (Borrowing From or Lending to Customers), FINRA Rule 5230 (Payments Involving Publications that Influence the Market Price of a Security), and FINRA Rule 5110 (Corporate Financing Rule—Underwriting Terms and Arrangements).<sup>96</sup> The commenter further suggested that FINRA should adopt a distinct recordkeeping rule for funding portal members over and above the recordkeeping rule for funding portals adopted by the SEC.<sup>97</sup> One commenter suggested that the proposed Funding Portal Rules should duplicate rule language in the SEC's Regulation Crowdfunding aimed at limiting, in conformity with requirements of Title III of the JOBS Act,<sup>98</sup> the activities of funding portals, such as prohibiting funding portals from offering investment advice or recommendations.

In response, FINRA has stated in the *Notice* and in this filing its intent to streamline the proposed rules to the extent possible to reflect the limited scope of activity permitted by funding portals while also maintaining investor protection. Further, FINRA will enforce any rules for funding portals adopted by the SEC. As such, FINRA has indicated that its rules should not duplicate any rules adopted by the SEC in this area.<sup>99</sup> Title III of the JOBS Act sets specified limits on the activities of funding portals, for example, by expressly prohibiting funding portals from offering investment advice or recommendations and by prohibiting funding portals from holding, managing, possessing or otherwise handling investor funds or securities, which the SEC proposed to implement by rule.<sup>100</sup> The SEC has proposed to address such investor protection issues as measures to reduce the risk of fraud,<sup>101</sup> account opening,<sup>102</sup> requirements with respect to investor transactions,<sup>103</sup> payments to third parties,<sup>104</sup> and permissible communication channels.<sup>105</sup> All funding portal members of FINRA will be subject to these rules if they are

<sup>96</sup> NASAA.

<sup>97</sup> See proposed Regulation Crowdfunding Rule 404.

<sup>98</sup> See note 6 *supra*.

<sup>99</sup> See *Regulatory Notice* 12-34 (July 2012).

<sup>100</sup> See proposed Regulation Crowdfunding Rule 300(c)(2).

<sup>101</sup> See proposed Regulation Crowdfunding Rule 301.

<sup>102</sup> See proposed Regulation Crowdfunding Rule 302.

<sup>103</sup> See proposed Regulation Crowdfunding Rule 303.

<sup>104</sup> See proposed Regulation Crowdfunding Rule 305.

<sup>105</sup> See proposed Regulation Crowdfunding Rule 402.

adopted by the SEC. Further, as discussed earlier, FINRA is proposing specified conduct and compliance rules, also aimed at investor protection.<sup>106</sup> FINRA does not believe that it serves a regulatory purpose to reduplicate in the Funding Portal Rules standards that the SEC has proposed to address in its rulemaking, or to otherwise duplicate in multiple iterations prohibitions against specified activities already set forth under applicable statutes, proposed SEC rules or the proposed FINRA Funding Portal Rules. As such, FINRA is not proposing at this time the additional suggested rules and standards. However, FINRA may propose additional requirements at a later time should FINRA determine that such requirements, based on the development of funding portal business under the FINRA Funding Portal Rules, and any other applicable rules, are merited.

#### d. Miscellaneous

One commenter proffered suggestions to amend FINRA's arbitration procedures.<sup>107</sup> While the comment is outside the scope of the proposed rule change, FINRA notes that proposed Funding Portal Rule 1200 addresses arbitration issues for the purpose of ensuring that funding portal members shall be subject to the existing FINRA rules in this area, unless the context requires otherwise, and for streamlining the existing predispute arbitration rule (FINRA Rule 2268) as appropriate for funding portals.

One commenter suggested that FINRA should provide guidance regarding the scope of liability for firms and advisors when clients make inquiries regarding investments in crowdfunding offerings.<sup>108</sup> The commenter suggested the SEC and FINRA should provide waiver of liability language for advisors and an educational Web site on crowdfunding, and that FINRA should undertake a retrospective review of the Funding Portal Rules. In response, FINRA welcomes retrospective review of rules and has committed to such review.<sup>109</sup> Further, FINRA notes that it makes substantial commitments to investor education and has a robust and

vigorous investor education program. FINRA welcomes further dialogue on these issues as funding portal business develops under any rules implemented by the SEC and the FINRA Funding Portal Rules. FINRA does not propose at this time to provide waiver of liability language as outside the scope of the proposed rule change.

One commenter requested that FINRA provide a template for supervisory systems for funding portal members to follow.<sup>110</sup> In response, FINRA notes that under the proposed rules, it is the responsibility of a funding portal member to establish and maintain a system to supervise the activities of each associated person of the funding portal member that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Funding Portal Rules. Funding portal members will be expected to be mindful of their supervisory obligations under the FINRA Funding Portal Rules and other applicable rules to establish and maintain a supervisory system accordingly.

One commenter suggested that Form FP-NMA should not require FP Applicants to submit copies of contracts or agreements relating to business activities of the FP Applicant.<sup>111</sup> FINRA disagrees, as such information is directly relevant to assessing an FP Applicant for purposes of FINRA membership. Further, FINRA notes that the MAP as set forth under proposed Funding Portal Rule 110 already reflects extensive streamlining so as to tailor requirements to the permitted business of funding portal members. Accordingly, FINRA does not propose to make the suggested change. The same commenter sought clarification as to whether, under proposed Funding Portal Rule 1200(b), funding portal members are required to use predispute arbitration agreements with investors. FINRA notes that neither proposed Funding Portal Rule 1200(b), nor the FINRA rule upon which it is based (FINRA Rule 2268), impose such requirements.

### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or

(ii) as to which the self-regulatory organization consents, the Commission will:

- (A) By order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

### IV. Solicitation of Comments

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

#### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-FINRA-2015-040 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Robert W. Errett, Deputy Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-FINRA-2015-040. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2015-040 and

<sup>106</sup> See, e.g., proposed Funding Portal Rule 200 and Rule 300 in Exhibit 5.

<sup>107</sup> NASAA.

<sup>108</sup> FSI Institute.

<sup>109</sup> See, e.g., *Regulatory Notice* 14-14 (April 2014) (seeking comment in connection with retrospective review of the Communications with the Public rules); *Regulatory Notice* 14-15 (April 2014) (seeking comment in connection with retrospective review of the gifts and gratuities and non-cash compensation rules); and *Regulatory Notice* 15-10 (March 2015) (seeking comment in connection with retrospective review of FINRA's membership application rules).

<sup>110</sup> CyberIssues.

<sup>111</sup> CyberIssues.

should be submitted on or before  
November 18, 2015.

For the Commission, by the Division of  
Trading and Markets, pursuant to delegated  
authority.<sup>112</sup>

**Brent J. Fields,**

*Secretary.*

[FR Doc. 2015-27370 Filed 10-27-15; 8:45 am]

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<sup>112</sup> 17 CFR 200.30-3(a)(12).