NORTHCAPITAL

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North Capital Private Securities Corporation
315 Montgomery Street, Suite 900
San Francisco, CA 94104

Marcia E. Asquith
Office of the Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506

By EMAIL

RE: Regulatory Notice 12-34 – Comment on Proposed Regulation of Crowdfunding

Thank you for the opportunity to submit comments on the crowdfunding provisions of the JOBS Act. As the principals of an independent broker-dealer that provides equity and debt placement services for private companies, private funds, and investors in private securities, we can state with confidence that access to capital is of paramount importance to our clients.

Also of great importance are the responsibilities associated with the private securities placement business: to act in the best interests of clients, to conduct due diligence on investments, and to undertake suitability reviews of prospective investors. Regulatory authorities must develop and maintain rules and standards that acknowledge these responsibilities, and ensure that they are upheld as a condition of participation. Meanwhile, the free market system must be able to connect the widest array of companies seeking risk capital with the largest number of investors prepared to offer it.

In the following comments, we will offer our perspective about how to balance the public interest goals of expanding access to capital and investor access to investments, with the need to ensure integrity and public trust in securities markets.

In our opinion, the JOBS Act has the potential to correct two failures of the current system.

First, it will open new sources of risk capital to entrepreneurs who require modest investments. A one million dollar investment is too large for many entrepreneurs to source through their personal networks, and is too small to attract serious interest from most broker-dealers. Moreover, these types of deals tend to incur extremely high transaction costs because the market is fragmented, deal terms are bespoke, and the time and materials required to develop offering materials are about the same for a $1 million deal as a $10 million or $100 million deal.

Second, the current private placement rules, which are designed to protect investors by limiting access through accreditation, are grossly unfair to non-accredited investors who are unable to allocate their risk capital to startups or other private investments. Ironically, the current rules allow an accredited investor to allocate all of his net worth to a single risky investment, but a $1,000 private investment by an individual with a $500,000 portfolio is effectively prohibited. The allowances for non-accredited investors are immaterial, since the number of investment "slots" is so limited. In short, many entrepreneurs who need risk capital cannot get it, and investors who wish to offer risk capital are prevented from doing so.

Some have argued that crowdfunding will either not provide much additional funding to new businesses or, at the other extreme, will channel capital to businesses that do not deserve it. We would contend that the free market is more capable of making such determinations than individuals who have a vested interest in preserving the status quo. Moreover, if critics are correct, and crowdfunding produces more disappointments than successes, investors will become stingier with their risk capital, and the quality and profitability of offerings will improve. Such is the self-correcting nature of markets.

This is not to say that regulators should not delineate clear rules for the nascent crowdfunding market—we believe they should. But in considering alternative approaches, regulators should consider the weaknesses of the current system. It would adversely impact the public interest if the existing rules, which have completely stifled a segment of the market, were supplanted by new rules that had the same effect.

We respectfully offer four specific policy recommendations for your consideration.

(1) A Simple Due Diligence Disclosure Document. Issuers and placement agents should be required to complete a brief, standardized questionnaire and disclosure document that ordinary investors can understand. A simple disclosure document would help ensure that investors receive the basic information needed to evaluate an investment proposal and conduct further due diligence.

(2) Management Attestation. The principals of a company seeking financing should be required to attest to the truthfulness, fairness, and accuracy of the information they present. This requirement would lead entrepreneurs to make more careful, balanced presentations of their investment opportunities, would mitigate the hyperbole that runs rampant among start-ups, and would protect investors through fair disclosure. This rule should come with stiff penalties to deter anyone who might be tempted to misrepresent their offering.

(3) Standardized Financial Reporting Requirement. Issuers should be required to publicly disclose critical financial information before offering securities to the public. At a minimum, a standard disclosure package should include a recent balance sheet, income statement, and statement of cash flows prepared in accordance with GAAP. We believe this is a reasonable prerequisite for raising money in a public securities market. Disclosure of related-party transactions and the compensation received by the highest-paid employees would also be useful to an investor considering backing a start-up. We are confident that if investors had access to standardized financial reports prior to an offering, they would be able to assess and compare investment opportunities and to hold companies and placement agents accountable.

(4) Consistent Regulation of Financial Intermediaries. Placement agents and intermediary platforms should be required to follow the same rules as broker-dealers in regard to securities offerings and professional standards of conduct. Investment fraud has been occurring for as long as markets have existed, even in well-established, highly regulated securities markets. The JOBS Act has the potential to increase fraud by permitting large numbers of transactions between many participants, including inexperienced investors. Intermediaries, especially crowdfunding platforms, will likely play an integral role in the distribution and transaction process. The framework of securities regulation that has been developed for broker-dealers over a span of many years should be the model for regulating these crowdfunding intermediaries.

What type of due diligence should a promoter conduct before making an offer? How should prospective investors be vetted? How should advertising be regulated? Where should investors take their grievances? Who will ensure that employees of a promoter receive appropriate training and understand securities laws? How can money laundering and other criminal activity be mitigated?

These are issues that have been addressed within the current regulatory framework. By applying existing rules to new crowdfunding platforms and other intermediaries, regulators can focus on improving deterrence and detection of fraud across all markets, instead of on developing bespoke policies and structures that will create disparities between different classes of firms conducting the same types of business.

Thank you for the opportunity to share these comments. We appreciate the difficult work that FINRA and other regulators are undertaking to maintain the integrity of our securities markets. We hope that our comments will contribute positively to these efforts.

Sincerely,

James P. Dowd, CFA
Managing Director

Craig Goos
Managing Director