



National Crowdfunding Services, LLC

March 9, 2015

William Michael Cunningham  
National Crowdfunding Services, LLC  
641 S Street, NW  
Washington, DC 20001

TO THE: Massachusetts Securities Division

I'm writing on behalf of National Crowdfunding Services, LLC concerning the Code of Massachusetts Regulations at 950 C.M.R. 14.402(B)(13)(o) (the "Crowdfunding Exemption" or the "Exemption").

### **Background**

William Michael Cunningham holds a Master's in Economics and an MBA in Finance, both from the University of Chicago, and is a graduate of Howard University.

Mr. Cunningham manages an investment advisory and research firm, Creative Investment Research, Inc. The firm researches and creates socially responsible investments and provides socially responsible investment advisory services. He is also Managing Partner at National Crowdfunding Services, LLC.

Creative Investment Research, Incorporated is an independent investment research and management firm, founded in 1989. For clients, our services save millions, if not billions: on December 22, 2003, December 22, 2005, and February 6, 2006, we warned the S.E.C. and other regulators that statistical models using our proprietary Fully Adjusted Return® Methodology signaled the probability of system-wide economic and market failure (see below). Clients who heeded our warning adjusted their investment portfolios in a manner that allowed them to escape much of the damage caused by the crisis. The firm was formerly in the pool of Corporate Governance Advisors and Diversity Investing Advisors to CalPERS.

Mr. Cunningham is a Global Member of ISOC, the Internet Society (ISOC), a Public Member of W3C, the World Wide Web Consortium, and an Invited Expert Member in the eGovernment Group of the W3C. On November 16, 1995, he launched one of the first investment advisor websites at [www.ari.net/cirm](http://www.ari.net/cirm) (now [www.creativeinvest.com](http://www.creativeinvest.com)).

### **Track Record**

On July 3, 1993, Mr. Cunningham wrote to US Securities and Exchange Commissioner (SEC) Mary Schapiro to notify the Commission about a specific investing scam, the "Nigerian letter scam." A timely warning was not issued to the investing public, members of the public were damaged, and the SEC launched retaliatory regulatory actions against Mr. Cunningham.

He designed the first mortgage security backed by home mortgage loans to low and moderate income persons and originated by minority-owned institutions. (See: *Security Backed Exclusively by Minority Loans*, The American Banker Newspaper. Friday, December 2, 1994.)

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Mr. Cunningham opposed the application, approved by the Federal Reserve Board on September 23, 1998, by Travelers Group Inc., New York, New York, to become a bank holding company. In October 1998, in a petition to the United States Court of Appeals (Case Number 98-1459) concerning the Travelers Group Inc./Citicorp merger, Mr. Cunningham cited evidence that growing financial market malfeasance greatly exacerbated risks in financial markets, reducing the safety and soundness of large financial institutions. <http://www.creativeinvest.com/USAppealsCourt.pdf>

From October 1999 to March 2002, Mr. Cunningham was responsible for proxy voting activity for the Board of Pensions of the Evangelical Lutheran Church in America. In 2001, he voted on 1395 issues impacting 401 companies. In 2000, he voted on 1903 issues impacting 422 companies. We managed fund efforts and corporate governance matters related to Talisman Energy and its' operations in the Sudan. We researched the issue, contacting various groups involved in the process. For the fund, our efforts also included researching fund policies and procedures. Our collaborative, risk controlled strategy helped lead the firm out of the Sudan. On February 1, 2000, Mr. Cunningham wrote to the office of U.S. Senator Samuel Brownback (R-KS) urging him to encourage pension funds to divest from the Sudan.

On June 15, 2000, Mr. Cunningham testified before the Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises (GSE's) of the U.S. House of Representatives and suggested that GSEs Fannie Mae and Freddie Mac be subject to a Social Audit. A social audit is an examination of the performance of an enterprise relative to certain social return objectives. It includes a review of ethical practices. Had the GSE's been subject to this audit, certain flaws in their operation, including ethical shortcomings, would have been revealed earlier, in a better market in which to make corrections.

In 2001, Mr. Cunningham participated in the first wide scale home mortgage loan modification project. The Minneapolis-based effort helped 50 families victimized by predatory lending practices. See: Property Flipping Remediation Yields Investment-grade Security.

On December 22, 2003, he warned US regulators that statistical models he created using the proprietary Fully Adjusted Return® Methodology signaled the probability of system-wide economic and market failure. See Page 6.

In 2005, Mr. Cunningham served as an expert witness in a case that sought to hold Credit Suisse First Boston, Fairbanks/SPS, Moody's and Standard and Poor's, US National Bank Association, and other parties legally responsible for supporting and facilitating fraudulent subprime lending market activities. Had this single case been successful, we believe the credit crisis would have been less severe.

On December 22, 2005, he issued a strongly worded warning that system-wide economic and market failure was a growing possibility in a meeting at the SEC with Ms. Elaine M. Hartmann of the Division of Market Regulation.

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On February 6, 2006, he again warned regulators that statistical models created using the proprietary Fully Adjusted Return® Methodology confirmed that system-wide economic and market failure was a growing possibility. He stated that: Without meaningful reform there is a small, but significant and growing, risk that our (market) system will simply cease functioning. This is, of course, exactly what happened. See pages 2 and 8. <http://www.sec.gov/rules/proposed/s71005/wcunningham5867.pdf>

On June 18, 2009, Mr. Cunningham testified before the House Ways and Means Select Revenue Measures Subcommittee at a joint hearing with the Subcommittee on Domestic Monetary Policy and Technology of the Financial Services Committee: Testimony on the New Markets Tax Credit Program.

On August 13, 2012, Mr. Cunningham filed a "Friend of the Court" brief in United States Securities & Exchange Commission vs. Citigroup Global Markets Inc. (Second Circuit Court of Appeals Case Number 11-5227). The case concerned the rejection, by a Federal Judge, of a settlement agreed to by the United States Securities & Exchange Commission (SEC) and Citigroup Global Markets Inc. (Citigroup), the latter accused of securities fraud. <http://www.prlog.org/11948760-william-michael-cunningham-files-revised-brief-in-sec-vs-citigroup-2nd-cir-ct-of-ap.html>

On December 9, 2013, Mr. Cunningham filed a "Friend of the Court" brief in the United States District Court, Central District of California in an action that the U.S. Department of Justice brought against McGraw-Hill Companies, Inc., and Standard & Poor's Financial Services LLC, et. al., (Defendants) under 12 U.S.C. § 1833a; 18 U.S.C. §§ 1341, 1343 & 1344. My comments led to a significant change in enforcement strategy, including the first ever, albeit temporary, rating firm suspension. . <http://www.prlog.org/12256590-william-michael-cunningham-files-amicus-brief-in-us-vs-sp-us-district-court-central-district-ca.html>

On February 3, 2015, Mr. Cunningham commented on an effort by Apple Computer to utilize women and minority-owned brokerage firms: <http://www.usatoday.com/story/tech/2015/02/03/apple-debt-offering-minority-firms-jesse-jackson-diversity-silicon-valley/22805673/>

Mr. Cunningham writes commentary on small business topics for the Washington Post. For more background information, please see:

Global Market Turmoil Graphic [http://www.creativeinvest.com/Global\\_Turmoil.pdf](http://www.creativeinvest.com/Global_Turmoil.pdf) and Financial Crisis Calendar Graphic <http://www.creativeinvest.com/FinCrisisCalendarGraphicFINAL.pdf> Creative Investment Research, Inc., December, 2008 and November, 2009.

Equity Crowdfunding: <https://www.youtube.com/watch?v=HfZuroZG51Y> and <http://youtu.be/1802x3V-EhA>

National Crowdfunding Services, LLC (NCS) partnered with the Government of the District of Columbia to provide crowdfunding services to local small businesses. Specifically, NCS provided crowdfunding services to selected grantees of the District's Great Streets Initiative through a pilot program called "The Washington DC Crowdfunding Challenge." This program supplements the Small Business Capital Improvement Grant to support small businesses, retail corridors, and the goals of the Great Streets

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Initiative. . <http://www.prlog.org/12355164-ncs-selected-as-crowdfunding-advisor-to-the-government-of-the-district-of-columbia.html>

Event Review: <http://youtu.be/ODjgBojz6OQ?list=UUPcuBRyEWs2ZgUaBmldnCjw> and <http://www.slideshare.net/wmcunningham/nov-18-dc-crowdfunding-challenge-press-41867326>

I am the author of **The JOBS Act: Crowdfunding for Small Businesses and Startups**:  
<http://www.amazon.com/JOBS-Act-Crowdfunding-Businesses-Startups/dp/143024755X/>

## **SPECIFIC QUESTIONS REGARDING THE CROWDFUNDING EXEMPTION**

1) Relationship to the Federal Intrastate Offering Exemption. The Crowdfunding Exemption is tied to the federal intra-state offering exemption under section 3(a)(11) of the Securities Act of 1933 and SEC Rule 147. That exemption is available for a security which is part of an issue offered and sold only to persons resident within a single state where the issuer of such security has been formed and is doing business in that state.

It is anticipated that most crowdfunding issuers will wish to offer securities via the Internet. Does the federal requirement that offers and sales be made only to persons resident within a single state limit the usefulness of the Exemption?

**The federal requirement does not limit the usefulness of the Exemption, given the lack of progress on Title III of the JOBS Act at the SEC.**

Should the Securities Division consider adopting alternative or additional regulations that would work with other federal rules that permit offerings not strictly limited to a single state (for example, Rule 504 of SEC Regulation D or SEC Regulation A)?

**Yes, the Securities Division should consider adopting alternative or additional regulations that would work with other federal rules that permit offerings not strictly limited to a single state. I suggest reviewing the California Local Economies Securities Act (LESA) and "Venture Exchanges."**

2) Alternatives to Single-State Offering Exemption. Should the Securities Division consider adopting rules to facilitate offerings made in more than one state?

**Yes. One tactic to consider is a regional compact of offerings in contiguous States: New Hampshire, Rhode Island, New York, and Vermont.**

If so, would regulatory cooperation and coordination among the states be desirable with respect to such offerings?

**Regulatory cooperation and coordination among the states would be desirable but, given technology, is not required.**

3) Limitation on Forms of Security: Equity or Debt. The Exemption is limited to equity or debt securities. Should the Securities Division consider making the Exemption available for other forms of securities?

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**No. An exemption does not need to be made available for other forms of securities.**

If so, what other types of securities should be specified in the Crowdfunding Regulation?

**N/A**

Will permitting the offer and sale of other forms of securities require issuers to provide special disclosures to investors in order to accurately disclose the characteristics of the investment?

**N/A**

4) Offering Amount Limit. The Crowdfunding Exemption permits an issuer to offer and sell up to \$1,000,000 of securities in a 12-month period. (See Sec. 4 of the Exemption.) This limit increases to \$2,000,000 if the issuer has audited GAAP financial statements. The Securities Division requests comments on these offering size limits. If the offering limits were raised, would the Exemption, which applies only limited requirements to crowdfunding offerings, provide adequate protections for investors and local markets?

**The limits are consistent with those in other States, and are a good start.**

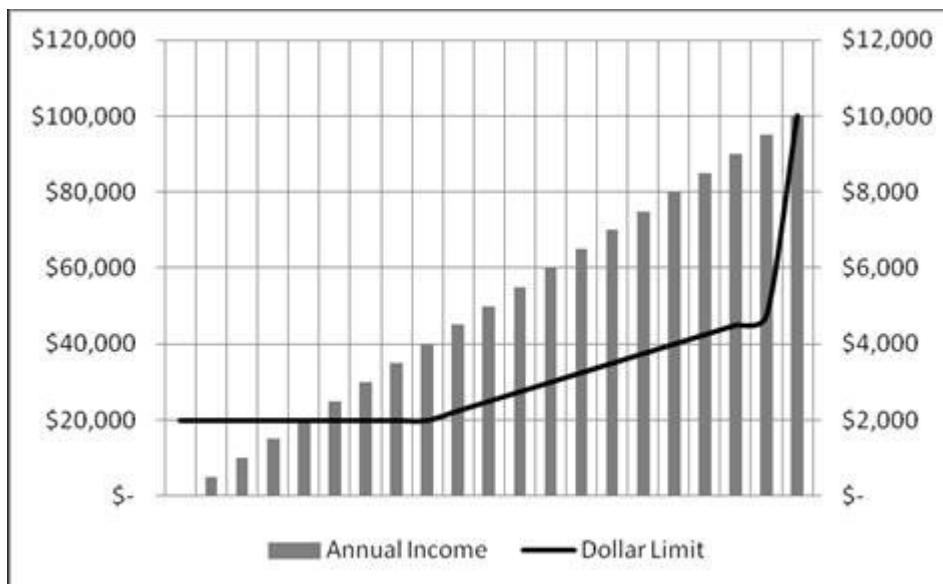
The Securities Division also seeks comments on the requirement for issuers to obtain audited statements in order to raise between \$1,000,000 and \$2,000,000. The Division solicits information about the costs and/or potential benefits of requiring that audited financial statements be included in a securities offering document.

**Acquiring audited statements is a factor in determining the probability of venture success. In addition, as the crowdfunding market develops new methods of creating and obtaining audited financial statements will be developed. These new technologies will result in lower costs over time.**

5) Investment Limitations. Under Sec. 5 of the Crowdfunding Exemption, most investors may invest up to the greater of \$2,000 or 5% of income or net worth. The percentage investment limit is higher for investors with higher incomes or net worth. The limitation included in the Exemption substantially resembles the limit included in the SEC's proposed regulations for the federal crowdfunding exemption. Is this investment limit an effective way to control the risk of an investor over-investing in a crowdfunding offering?



**Yes, as long as the limit is a global, not per security limit. See the chart below, from my book:**



Should the limit be higher or lower?

**For now, the limit is appropriate.**

The Exemption will be lost if the issuer sells securities to any investor in excess of the investment limitations. Should the issuer be permitted to meet this standard based on a good faith reasonable belief about the purchaser’s income and/or net worth? If the issuer can meet the requirement based on good faith reasonable belief, should the issuer be required to take reasonable steps to verify the income and/or net worth of purchasers?

**We are aware of several tools that allow one to verify the income and/or net worth of purchasers. Other tools will be developed. We suggest the State impose a requirement as a way to spur the development of these types of tools.**

Unlike the SEC’s proposed crowdfunding rule, the Crowdfunding Exemption does not attempt to limit the amount an investor may invest in crowdfunding offerings as a category. Should the Securities Division consider adding a limit that would apply to investors’ investments in crowdfunding offerings as a category?

**Yes, this in conjunction with the verification and validation tools noted above.**

6) Excluded Types of Issuers. Under sec. 6, the Exemption is not available to: blank check/blind pool offerings; investment companies; hedge funds or similar investment vehicles; '34 Act reporting companies; companies engage in oil, mining, or other extractive industries. The Securities Division solicits comments on these limitations.

**These are appropriate limits for a new industry and new tool.**

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7) Minimum Offering Amount requirement. Sec. 8 of the Crowdfunding Exemption requires the issuer to establish a minimum offering amount that is needed to accomplish the business plan. The minimum offering amount shall be not less than 30% of the maximum offering amount. The Securities Division requests comments on all aspects of this requirement, including the 30% standard for a minimum offering amount.

**This is an innovative approach that I believe will be helpful as a risk control mechanism.**

8) Escrow of Funds until Minimum Offering Amount is Reached. Pursuant to Sec. 9 of the Crowdfunding Exemption, funds raised in a crowdfunding offering must be placed in an escrow account at an insured bank until the minimum offering amount is reached. The Securities Division requests comments on the practicability of this escrow requirement. Should the Securities Division consider any alternatives to requiring that escrowed funds be held in an insured bank account?

**An escrow account is a good idea, but it should not limit or be a barrier to crowdfunding.**

9) Bad Actor Disqualification. The disqualification language in Sec. 10 of the Exemption is modeled on the bad actor disqualification under Rule 506 of SEC Regulation D. The Securities Division requests comments on this provision.

**A Bad Actor provision is a risk control mechanism, but we believe the “bad actor” definition should include firms (and people) that have been found guilty of violating rules and regulations regarding the financial crisis and fraud. This would specifically exclude Goldman Sachs, S&P and JP Morgan.**

10) Required Disclosures. Under Sec. 11 of the Crowdfunding Exemption, issuers are required to provide certain disclosures. The regulation also reminds issuers of their obligation to provide full and fair disclosure of all material facts relating to the offering.

Would it be appropriate for the Exemption to spell out more details about required disclosures?

**Yes. You will have to do so anyway since you will get many requests for clarification, so we suggest you provide initial guidance at the start.**

Would such disclosure requirements provide useful guidance to issuers?

**Yes. It will prevent people from wasting time and will give rise to new services designed to meet this reporting requirement.**

Should the Securities Division consider requiring the use of a disclosure form?

**Yes. There are many example forms. I suggest you review forms provided by other States.**

Are the specified items of disclosure sufficient to protect investors’ interests in crowdfunding transactions?





**Yes. See the chart below (from my book):**

The name, legal status, physical address, and website address	The target offering amount, deadline and regular updates regarding progress	A description of the stated purpose and use of the proceeds. A description of the business of the issuer and the anticipated business plan
The names of the directors and officers (and any persons occupying a similar status or performing a similar function), and each person holding more than twenty percent (20%) of the shares	The price to the public of the EGC securities or the method for determining the price. final price and all required disclosures, with an opportunity to rescind.	How the securities being offered are being valued, and examples of future valuation methods, including during subsequent corporate actions;
A description of the EGC financial condition, including,	A description of the EGC ownership and capital structure, including:	Risks relating to minority ownership, corporate actions, additional issuances, sale, assets sale, or transactions with related parties
<i>\$100,000 or less—income tax returns for the most recently completed year (if any) and financial statements..certified by the principal executive officer..</i>	<i>terms of securities offered and each other class of security, including rules to modify, summary of the differences between securities, including how rights may be limited, diluted, qualified</i>	
<i>More than \$100,000, but not more than \$500,000, financial statements reviewed by an independent public accountant</i>	<i>a description of exercise rights held by the principal shareholders could negatively impact</i>	
<i>More than \$500,000 - audited financial statements;</i>	<i>name and ownership level of each existing shareholder with more than 20 percent</i>	





11) Specific Required Risk Disclosures. Section 12 of the Exemption requires that specific risks of crowd-funded securities be disclosed, particularly the risks that there will probably be no ready market for the securities and that the securities will be illiquid. The Securities Division requests comments regarding these disclosures.

**A simple disclosure should be all that is required. We have developed new tools to calculate the illiquidity premium. These will be placed online.**

12) Annual Reporting by the Issuer. Sec. 14 of the Exemption requires that issuers provide a report to the Securities Division after 12 months, or when the offering has been completed or terminated. The Securities Division requests comments on this requirement.

**This requirement is appropriate and not unduly burdensome. New tools will be developed to make this reporting requirement easier.**

13) Ongoing Company Reporting. The Crowdfunding Exemption does not mandate that issuers provide ongoing reports to investors about the business and financial condition of the company. Should the Exemption require such reports? If the Exemption does not require such reports, will there be any way for investors to receive ongoing information about the issuer?

**Yes. Ongoing reports should be required. We envision a website that has current, up-to-date financial information for all issuers, accessible only to investors. The State should foster the creation of such websites.**

14) Sellers of Crowdfunding Securities. Unlike the proposed SEC rules for crowdfunding, the Crowdfunding Regulation does not require the use of a crowdfunding portal to offer and sell crowd-funded securities. Only broker-dealers may receive compensation for offering and selling securities. At this time, it is anticipated that issuers would sell their own crowdfunding offerings or that they would be sold through licensed broker-dealers.

The Securities Division seeks information about how it is anticipated that these offerings will be sold.

Should the Crowdfunding Exemption require or permit the use of a crowdfunding portal to offer and sell the securities?

**You should not require the use of a crowdfunding platform, but you should monitor the development of sales tools and platforms. In this way, you can encourage the development of new approaches and technologies while monitoring risk. In addition, the freedom this entails will be a competitive advantage for the State.**

If so, what would be the characteristics of such a portal?

**We have developed a business model that incorporates this, but the details are confidential. Should the State want more confidential commentary on this subject, please email me at [williamcunningham840@gmail.com](mailto:williamcunningham840@gmail.com)**



What kinds of regulation and registration should apply to such a portal?

**Safety, soundness, transparency and ethics guidelines and requirements.**

15) Investor Feedback – The “Wisdom of the Crowd.” The Crowdfunding Exemption currently does not require that there be an Internet-based forum for potential investors to comment on and discuss these offerings. Should such a forum be required under the Exemption?

**Yes. These will develop organically as the market develops, but having a requirement for a forum will help spur development. Any number of online platforms can be used, from Google Groups, to Facebook, to LinkedIn.**

Thank you

*William Michael Cunningham*