FTC FinTech Series: Crowdfunding & Peer-to-Peer Payments
October 26, 2016
Segment 2
Transcript

[SIDE CONVERSATIONS]

EVAN ZULLOW: All right. Welcome back, everyone. This is going to be our second panel of the day on crowdfunding. Again, my name is Evan Zullow. I'm with the FTC's Division of Financial Practices, and I and Elizabeth Kwok, who's an investigator with the Division of Financial Practices, will be co-moderating this panel. We'd like to really thank our six panelists for coming here today from other parts of the country, in part.

And so I wanted to just go ahead and introduce them briefly, starting from our right to left. First we have Andrew Dix, who's the CEO and founder of Crowdfund Insider, a news and information site covering disruptive finance, including crowdfunding, for us, peer-to-peer and online lending, and other forms of FinTech.

Next to Andrew is Joe Magee, the co-founder and Chief Operating Officer of RallyBound, which is a fundraising platform that does work with nonprofit organizations. Next to Joe is Ira Rheingold, the Executive Director of the National Association of Consumer Advocates, an organization dedicated to protecting consumers from unfair and deceptive business practices. Next to Ira is Michal Rosenn. She's the General Counsel at Kickstarter, the very well-known crowdfunding platform for funding projects.

Next to Michal is Tom Selz, who's a founding partner of Frankfurt, Kurnit, Klein and Selz. And he's worked on behalf of clients in the crowdfunding space. And last, but not least, is our own Helen Wong, who's currently serving as counsel to the FTC's Director of the Bureau of Consumer Protection. And she's worked extensively on FinTech issues, both there and in our own Division of Financial Practices. So again, thank you all so much for coming here today.

MICHAL ROSENN: Yeah. So Kickstarter is a rewards-based crowdfunding platform. And what that means is that a project creator comes and presents a project on the platform. It's a finite project, looking to create something new. And backers can come take a look at it and pledge to it if they want to see the creator try to make this thing or do a dance performance or put on a music festival or something like that.

And in exchange for backing the project, they receive a reward. They can elect to receive a reward. They can also pledge without receiving one. But in contrast to equity-based crowdfunding, which we can discuss next, the backer doesn't receive any interest in the project or in the company or anything like that. All they get is the reward.

EVAN ZULLOW: All right. And, actually, on the equity front-- Tom, you mentioned it for a moment. Would you be willing to describe the equity crowdfunding ecosystem?

THOMAS D. SELZ: Yeah. I mean, we're really not here to talk about equity crowdfunding

ANDREW DIX: Yeah. I'd like to add one thing there. And I agree with everything that was said down there. But what you are seeing, within the investment-based crowdfunding sector or the securities-based sector-- debt equity, preferred, or convertibles going to get into the security space, which will mix things up a little bit and make it more interesting for you guys at Kickstarter.

ELIZABETH KWOK: Michal, do you have any thoughts about what growth and other trends will look like?

MICHAL ROSENN: Yeah. I think that the direction these things are going to move is you're going to see a development of the different silos within crowdfunding. So as equity crowdfunding develops, and certain platforms move into that, I think you're going to see people developing an expertise and really move on from this initial stage of everyone kind of exploring crowdfunding in a more general sense and really stake out their ground of--

So Kickstarter, for example, is in creative projects. So we're going to, very much, expand our idea of what it means to be a crowdfunding platform for creative projects. Indiegogo, for example, is going to be moving into equity crowdfunding, and I think has developed in demand, for example, and exploring pre-sales and things like that. So I think you'll see an increase in specialization.

ELIZABETH KWOK: One of the trends that we have observed is this idea that crowdfunding is a space where you can get your initial round of funding. And then, after you've gotten some publicity and, perhaps, demonstrated a success, you can seek out more traditional forms of financing such as venture capital or other private equity. Does anyone on the panel have any thoughts about this development and, perhaps, where it's going to go?

THOMAS D. SELZ: I do think that people trying to raise money should think about it sequentially because, I think, even for something like Title III with the SEC confuse the matter even more by calling that regulation crowdfunding, whereas that's just merely one of the crowdfunding opportunities for raising money-- that, if you think about things sequentially, you can think about how much money do I need to get this project off the ground?

And if you can do that successfully, by setting a low enough goal that you're not trying to do all or nothing, you can then have a better shot at raising money in the next round because you have demonstrated success in the first round. You've demonstrated that there really is-- there are people out there who want to contribute to this cause, or there are people who want to give some money for this. There are people who think that the reward that you are going to be making available is something worth taking a look at.

And so you can have raised money for development, for example. You can raise money for an initial prototype. You can raise money to do a charitable event or charitable cause on a more limited basis before you go wider with it. So I think there's a variety of different ways to think about crowdfunding as a sequential opportunity, rather than just trying to raise all the money you need for what you're going to be doing.

ANDREW DIX: Yeah. So I'd like to add that rewards-based crowdfunding has clearly become a solid step in the capital ladder. It's a methodology for start-ups, early-stage products, or projects to prove the marketability or viability of what they're attempting to achieve. And that's pretty cool because it saves a heck of a lot of time in accomplishing your goal. You can fail fast or you can succeed quickly. So that's a good thing.

On the other side, you also have seen established companies utilize a rewards-based crowdfunding platform like Kickstarter or Indiegogo to market their product or their project. It really wasn't so much about raising the money. They didn't necessarily need that. But it was a way for them to push an initial product out to the market and gain feedback. And there's value to that.

JOE MAGEE: Yeah. As a co-founder of a tech company, you're able to provide product market fit and market it and validation much more quickly in launching a product that is to a smaller community, at a smaller price point, to get them in the door. As a consumer, I've been able to get sunglasses and t-shirts at first buys and early access, too, by supporting projects early, say, on Kickstarter or Indiegogo.

On the donation side, it also applies where we look at crowdfunding specific to nonprofits, as the first touch point in that donor or fundraiser journey. So if you're able to get, say, your mom and dad to reach out to their friends and family and get that initial $10 or $5, you're now in the database, the donor record database. And you're able to remarket to them about cause presentation before, that most of the platforms at the top 20 that had been reviewed did not stay counties within the state and had to figure out what the local sales tax was in each of the counties. And the amount of money that they raised wasn't worth the effort that had to go in to figuring that out.

So you have to be aware of the tax consequences of what you're doing for rewards-based crowdfunding. You have to think of the costs that are involved and the time that goes into it, in terms of staying in touch with people.

EVAN ZULLOW: All right. And pivoting to potential benefits to consumers in addition to the campaigns-- does anyone have additional thoughts?

JOE MAGEE: I mean, for nonprofits, they're able to, having intrinsic motives to support causes or have philanthropic efforts-- I think, that for an individual to say that they've given money to a loved one or in memory of or in honor of-- I mean, I think, one, it just feels good. But, two, there's a really strong trend in our industry to really try to define tangible impacts of what, say, a $10 donation is going towards for a nonprofit organization.

So you're able to have a feedback loop in which you could see, I helped build that well in Africa, or I helped fund drug research in this specific disease. So for not only feeling good about it, but you actually get to see tangible results of where your money is going. It's one of the big draws for consumers to continuing support donation-based.

MICHAL ROSENN: Yeah. And I think that extends beyond donations-based, as well. And what we see is backers being just really thrilled to have the opportunity to be part of the creative process and to see the development of a film or a product that they really have always loved, a new project by a game producer that they've always loved.

I mean, one of the more famous projects that ran on Kickstarter was the Veronica Mars movie, which took--

MICHAL ROSENN: Absolutely.

ANDREW DIX: I mean, that's how we live today.

JOE MAGEE: I think there's also being the first one, being able to be in-the-know, being an early supporter as it relates to creative projects or, say, new technologies or even new apparel-- to be able to have the first one, to get it, or to be able to say that I contributed to the project, I think, is also pretty special and allows consumers to have that sense of feeling in crowdfunding.

ANDREW DIX: And I agree with that. I think there is an opportunity. There's some value there to get something that's unique or be early or at a lower price. But as Kickstarter likes to say, they're not a store. And I think that too frequently people just treat it like it's a trip to Amazon.

EVAN ZULLOW: Well, that was a nice little pivot into the next topic, that, of course, we would want to address, which is the potential risks. Of course, this is, as you saw on our first panel, it's across financial technologies. Some of the themes are somewhat similar. But we want to drill down a little bit as to what some of the challenges are in the consumer experience and also, of course, because we're the FTC, the potential for deceptive or unlawful conduct.

And so just to start things off, as a jumping off point, we're hoping that Helen-- who led the action that the agency took in the Forking Path matter-- we're hoping you could briefly describe the conduct that was at issue there for our panelists and the audience.

HELEN WONG: Yeah. Sure. Commissioner McSweeney talked about it briefly.

So the FTC's first crowdfunding case was FTC v. Eric Chevalier. And there, the concept was very simple. The campaign organizer promised his backers that, if the campaign raised $35,000, the backers would receive certain rewards like the board game and certain specialized pewter figurines. He ended up raising over $122,000, but, instead of using that money to create the board game, he used it on himself-- on rent, on moving fees, on licensing fees for another project. So that was deceptive because he didn't create the game, and he didn't provide refunds to consumers.

And that is an example of something that we would find to be deceptive and a problem. And I do want to note that deceptive conduct can apply across the board. It doesn't really matter whether it's the campaign organizer or the platform. At the FTC, we really are concerned about what representations are being made to consumers and whether those representations are true.

THOMAS D. SELZ: And the FTC should really be commended for this particular action. One of the things that Helen didn't mention is that, when the people who had been contributing for this board game, in fact, never got it, they went to the state attorney general where the person had moved. And the state attorney general declined to pursue it and said, I'm sorry. You're just out of luck.

And it was the FTC that stepped in and helped. I don't think they could get any money back, but they were able to fine. And they, really, gave some sense of closure to the people who had been misled by the person who was using this campaign. So the FTC should be commended for that. And it is another alternative where people can go if they feel that they haven't gotten what they're supposed to be getting.

HELEN WONG: I will just add that-- so thank you for that. And I don't know the background with the AG's office, but we really do partner with AG's offices. And we see them as partners. So to the extent that consumers see a problem, we tell them to complain to the FTC, complain to the AG's offices. We're always happy to work with different states.

IRA RHEINGOLD: Right. And one of the first actions, actually, was the Washington state AG who took an action against an actor who was engaged in deceptive practices. I've been doing consumer protection work for a long time. And so, while I think the whole notion of crowdfunding is a good one-- I fought with financial services companies for a long time. So any way you can get them out of the picture, in some ways, is never a bad thing. And finding new and creative ways to fund important projects is good.

But when there's large amounts of money involved, the danger of fraud grows. And I think that the question for me is, what kind of duties, what kind of due diligence, needs to be put in place for the platforms who are actually making money on this whole process. So where the FTC, what we've gone af4(s)-1(J [(i)-2(s)-1(g)10(o)-10(od.)]TJ ( )Tj E [vd(G)2(')10(soi)-2(m)-2(e)4(. A)2(nd(d i)[(B)7(

responsibility for the content on its site, even though it was fraudulent. They cited the Communications Decency Act, the CDA, section 230, and said that precluded the platform from having liability for the fraudulent content.

That doesn't mean that the platforms themselves, in many cases, disclose any liability if they say on their sites, we are not responsible. I mean, Michal, you can talk about that.

ANDREW DIX: Well, I think that you're right because they say quite clearly on their sites that they're not responsible. They're just matching creator and contributor. That being said, I think many people who are backing these campaigns don't quite grasp that concept. And so I think it's a bit of a struggle and a challenge there.

I do think that both main platforms have continued to push forward and find better, more effective ways to effectively vet campaigns that may be fraudulent or bogus. And I think they're going to continue to do that. And I think they should. I think that's part of the evolutionary process. And I'm sure you can share your perspective.

EVAN ZULLOW: So just to take a quick step back. And these are the exact issues that we wanted to walk through step-by-step. But at even a more rudimentary level, when thinking about an egregious case of the sort that Helen described-- how common is this kind of thing, in your views, in the marketplace? How common has it been? How common is it now? And just how much of an issue is it and could it be?

IRA RHEINGOLD: I'm not sure it's that common yet. Again, as we've talked about before, there's nothing particularly new here. We're talking about fundraising. We're talking about money for investing in products. So whenever you see money being taken from one person for someone else, there will be scam artists. There will be people who will be looking to take advantage of it.

I think we're still in the early stages here. And I think the risk is, as the amount of money grows, as the opportunity grows, the risk becomes greater. And I think we're still early enough in this process that we can create the rules of the road to make sure that people aren't harmed because you can be damn sure, if there's an opportunity to collect money from a large group of people, there will be people looking to take advantage of it.

EVAN ZULLOW: So do you think that the platform should be creating those rules or the government entity stepping in and determining that?

I think it's important. I think the industry should take the first step in really doing that self-regulation. And may, in fact, be sufficient. But I think, ultimately, there's got to be some sort of rules that everyone recognizes about what their duties are.

JOE MAGEE: From a platform perspective, as we are one, we have a little different benefits in that we sell the platform. It's not a free platform. It's a software that we sell to nonprofit organizations. So there's a higher barrier to entry for our clients, specifically. But just like technology has enabled crowdfunding, it is, in my opinion, that the volume and scale will be such that technology should help solve the issues that come up.

For instance, Stripe, one of the payment processors, just released some artificial intelligence and algorithms to start preventing fraud and fraudulent submissions through, say, hackers, using machine learning to start doing predictive analytics around submissions and transactions. So the volume and scale at which some of these projects are being created and funded at-- we're going to have to use a technological approach to address some of these issues as it relates to consumer protection.

EVAN ZULLOW: Thank you. And that leads to another interesting question, of course, which is, in the current environment and looking ahead, what's being done by the platforms, for example, and any of the other players in the industry to take steps before something bubbles up, a potential fraud or unlawful activity or even just problematic conduct that inconveniences or bothers consumers. What are some of those steps that take place? Michal?

MICHAL ROSENN: Yeah. To answer that as well as a few other questions-- so first, when we're talking about actual fraud of the type that occurred in the Chevalier case that Helen worked on, and, I think, what we're talking about here-- and Ira, I think you mentioned that this is very rare. And it is. It's extremely rare on our platform. It's happened, literally, maybe, a handful of times, potentially.

And there are all sorts of reasons for that. As a platform, we make it a high barrier to entry so that it's not a place where you can just come and get money. It is, as Tom mentioned, it's difficult to run a crowdfunding campaign on a platform like ours. It is not easy. We have an all-or-nothing platform so that you have to meet the goal that you set before you get any money.

But I want to take a step back and differentiate the two kinds of concerns we have when it comes to consumers. And one is that classic fraud, a scam artist coming on the platform to raise money for illegitimate purposes. And the other is the fulfillment risk that we see of a project not fulfilling on the rewards that were offered in the campaign.

And I think it's imperative that we think about these and address them in completely different ways. So a lot of times, when people in the press or consumers talk about the consumer issues around crowdfunding, what they're talking about is the latter. The fact that they pledged for a reward and didn't get it. And those are the majority of investigations that we've seen by regulators, by state AGs.

Our integrity team is one of the largest teams at our company. And they are monitoring
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have happened, potentially. What are everyone's understanding as to the sorts of recourse that are available now for consumers in this ecosystem?

MICHAL ROSENN: So what we see is a variety of different paths backers follow when, let's say, an estimated delivery date has passed, or there hasn't been an update in a while. You see them interacting with each other on comments on the project, speculating, writing in to us, in to our community support team. And what we do is, first of all, clarify expectations, say that an estimated delivery date is only an estimate, that this isn't a product that was purchased, and also reach out to the creator and remind them, as Tom said earlier, the importance of communication.

I think that's the number one thing that we impress upon our community and make the core of the message behind our platform, which is open and honest and transparent communication. That's what people want to see, that, if you're running into problems, if you're being honest about them, there will always be people who are angry, but, at the end of the day, that's the important thing, is to keep communication open.

I think beyond that, there is absolutely a role for regulators and law enforcement to play, to pursue instances of actual fraud, perhaps to do some investigation to differentiate fraud from a creator who's gone silent but is working and is just scared to update. But where there is actual fraud, I think the kind of action that the FTC brought with the Forking Path game is a fantastic example of existing structures of law enforcement working to prevent fraud in a new space.

THOMAS D. SELZ: In the donation model area, each of the 50 states has a lot of different regulations dealing with raising money for donations, things like registration requirements of the organization which is trying to raise the money, possibly bonding requirements, reporting requirements, in terms of what they have to report, how they use the money that's been given, limits on the amounts that can be paid to third parties, in terms of helping to raise the money-- a whole host of different rules and regulations.

So from a consumer point of view, in terms of consumer protection, there is some duty on the consumer, if they are concerned about this, to check with the local AG's office of the organization which is raising this for these funds, and saying, is this something where they're offering a charitable donation, and, if so, have they complied with the state regulations? If they haven't, that's a warning sign.

JOE MAGEE: Yeah, nonprofits literally live and die by transparency and being open about communication of where their money is going. There isn't a one-for-one transaction reward in our space. So there's a whole lot of trust that a consumer has to have in an organization that they're going to do right by the money that they give them. But constant communication between the donor and the organization, as I mentioned before, it's sort of the first touch point to get them into your community, but being open and honest about what you're doing with that money, where it's going, and how quickly it's going to the program that they might be supporting is critical to a nonprofit's success in delivering on its mission.

EVAN ZULLOW: And just to touch upon it, if there's something to discuss-- in the nonprofit realm or the donations ecosystem, are any of the issues that have arisen, whether they be unlawful conduct or even just problematic practices-- are there any differences or distinctions worth fleshing out when compared to the rewards-based space?

JOE MAGEE: Well, I mean, I think around the industry, a lot of that stuff is pretty set in stone, as it relates to national and state regulations. But I mean, famously, there was a foundation in New York City that was recently shut down because they didn't have the proper licenses to be soliciting donations. So it's pretty well-defined, as it relates to what a foundation or nonprofit can do to solicit funds.

But I think it's pretty clear, as it relates to how an organization is going to solicit funds to a potential consumer. So a lot of the transparency and communication issues are the same across the board, but there's no fulfillment of duty upon that donation or obligation by the organization, frankly, to say, yes, your money went here, and this is what's happening. That's just going to be determined by the success of the organization.

IRA RHEINGOLD: And some of this has to do with whether or not, actually, a contract has been formed. Within the donation, we're not really thinking about a contract being formed. Although, if you give money to some place, and they turn out-- buying paintings of the person who runs the foundation, that might be a problem.

JOE MAGEE: Or football helmets.

IRA RHEINGOLD: Right-- or football helmets. When you're entering into some form of a contract, where you have an expectation that this money-- you will get something in return. Now, it gets a little fuzzy here. I think, in the equity funding, I think it's more clear. Then, you might actually have consumers with a private right of action, where an opportunity to actually pursue action by themselves for the entity who's not fulfilling the terms of the contract.

HELEN WONG: There could be more traditional types of fraud, too, in terms of charity crowdfunding. You could just say that you're raising money for someone and not be doing it. And that's also a concern.

THOMAS D. SELZ: One of my major concerns, Ira, going back to your point about scale, and what's going to happen as this whole crowdfunding area begins growing exponentially, is something that's not just about whether the campaign itself has a problem with it, it's the data of the people who are making the contributions, who are sending the money in.

I think there are going to be huge privacy and data protection issues that are going to arise. And I think that's something which is going to be very troubling. And I'm not exactly sure how we begin dealing with that. I'm not sure that anybody has really begun thinking about the fact that, when you're sending money in via the internet, from a smartphone, it's a two-way street. And the data that you're sending, as somebody said on the panel today, it may be publicly available.

Even if you're just going to the organization, and it's not publicly available, it is an aggregation of information, which is now available for hackers. And I think, as the value of this data becomes greater and greater, there's going to be greater and greater opportunities for hacks and other things to come into play. They're going to be very troubling.

ANDREW DIX: I think that's an opportunity for this sector of the industry, be it donations or rewards, to get together and establish some best practices and set some basic, actually, high standards in which the platforms operate. And I think that would be a plus for all platforms that are engaged in the space.

IRA RHEINGOLD: Yeah. I mean, I couldn't agree more. I mean, I think the way this is going to grow is based on reputation-- the ability to be a place where people feel comfortable going, that their information is going to be protected, that the people they do business with are going to be trustworthy. The only way this is going to-- where we have a boom, here, really, is going to be dependent-- I mean, regulators can do what regulators can do. I'm a consumer advocate, so we'll always be looking at it from that perspective.

But if this industry fulfills where it thinks it can go, it really has a duty on itself to make sure that its integrity is protected. So I think that's something that, as we're still relatively early on in this process, before we get the scale, that, if you're interested in actually having a growing company,

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THOMAS D. SELZ: I'm going to turn this question around on the FTC. Has the FTC considered having any kind of public outreach, of warning people about some of the dangers and best practices that consumers might want to think about if they get involved with these different kind of--

MICHAL ROSENN: Yeah. I'm glad you brought that up. There is absolutely a professionalization of the market. And we see marketers and campaign consultants on both sides popping up. And a lot of them are great. And we're in the process of having a program where we identify certain organizations that we know have been successful and are above-board.

But it's also a source of fraud and the kind of danger that we're discussing here. And unfortunately, unscrupulous actors are extremely prevalent in this field. We've seen, just recently, an organization basic consumer protection principles. Keep your promises. Don't lie to consumers. And make adequate disclosures, especially if they are material to consumers.

ANDREW DIX: I'd just like to reaffirm what I said earlier, as I would really like to see-- personally I'd like to see-- industry participants to take a stand and create best practices, standards that they adhere to, and set them high. And if there are some platforms that won't abide by them, well, you know what? I mean, that's too bad for them because, then, they've been differentiated and because I think that you're right in saying that there's a lot of reputation at stake here.

And it's in the interest of these platforms to maintain a stellar and upstanding reputation for providing the best service possible and the transparency that's incumbent upon that. So I think that that is very important at this stage of the game.

IRA RHEINGOLD: And I think that's fair. I think that industry should have the first shot at creating some standards for themselves. I also think there's, obviously, a role, one, for enforcement. I think both AGs and the FTC are going to have to be vigorously enforcing this area and watching closely. I think standards are going to be important, what type of disclosures people get, what type of standards of due diligence are going to be necessary for a platform that's going to be doing business with people. I think those are all things that are going to be very important.

I'm actually not sure who that regulator is who will have to create it, whether it be--

ANDREW DIX: You have plenty to choose from.

IRA RHEINGOLD: Right. Although, not really because I'm not sure this fits into or under everybody's jurisdiction, except maybe on a state level. I'm not sure who the federal regulator would be in charge of creating some sort of standards. I think, again, I think, in some ways, the future is up to the industry. I don't think there's a gigantic rush for people to think about-- I mean, in FinTech, some of the regulators are fighting about how they can get in there, so they can regulate it or at least become part of-- to be able to collect the fees from the FinTech industry to register them and stuff like that.

JOE MAGEE: I mean, the fact of the matter is, if the platforms and operators of the technology solutions don't act in good faith, this won't be successful. The consumers won't trust this method of gaining access to products or causes.

IRA RHEINGOLD: I think that is absolutely right. But I also think, as long as you maintain control, as long as you maintain good standards, as long as we limit the amount of fraud and the unfair practices that exist, regulators will keep a light touch. I think the question becomes if, in fact, it grows at a point exponentially, without those protections in place, then you create the risk of regulators really stepping in with a heavier foot than otherwise might be necessary.

So I think, in some ways, the fate of this industry and regulation is going to be up to the folks who are sitting up here and the people in the industry to determine how much a role regulator is going to have to play.

EVAN ZULLOW: And speaking of a heavy foot, I apologize, but it looks like we've run out of time. So thank you so much, all of you, for coming here today and contributing to this