

SEC Adopts Final Crowdfunding Rules under the JOBS Act

On October 30, 2015, the U.S. Securities and Exchange Commission (SEC) adopted final rules under Title III of the JOBS Act to enable U.S. companies to offer and sell securities through crowdfunding (Regulation Crowdfunding). This alert provides an overview of the SEC crowdfunding rules slated to become effective in early May 2016, with certain related forms, such as Form Funding Portal (which will be used to register as a funding portal), becoming effective at the end of January 2016.

Generally, Regulation Crowdfunding implements a JOBS Act exemption for certain activities related to crowdfunding from the registration requirements of the U.S. Securities Act of 1933 (Securities Act), subject to investment limitations on investors, as well as disclosure requirements for issuers and intermediaries engaged in crowdfunding transactions. The JOBS Act also exempts certain crowdfunding intermediaries (funding portals) from broker-dealer registration under the U.S. Securities Exchange Act of 1934 (Exchange Act).

“Crowdfunding” is a term for internet-based fundraising characterized by decentralized groups of donors/investors individually committing relatively modest amounts of capital to small businesses, social projects, artistic performances, etc. Popular sites such as Kickstarter and IndieGoGo already provide a crowdfunding platform for the solicitation of donations, while sites like Fundrise, CircleUp and Angellist facilitate securities offerings using existing securities registration exemptions such as Regulation A and Regulation D. However, under current federal securities laws and regulations, participation in crowdfunding offerings under Regulation D generally cannot be extended to non-accredited investors, and the use of Regulation A involves an onerous disclosure and review process at both the state and federal levels. The JOBS Act and the recently adopted final rules are intended to provide a regulatory regime that narrowly but effectively permits certain issuers, investors and intermediaries to participate in investment-based crowdfunding while limiting the potential occurrences of fraud.

Overview of Regulation Crowdfunding

For Investors/Issuers:

Investor’s maximum permitted aggregate investment in all offerings relying on Regulation Crowdfunding per 12 month period		
Max. investment	Investor income under \$100k	Investor income at or over \$100k
Investor net worth under \$100k	Greater of: <ul style="list-style-type: none"> • \$2,000, and • 5% of the lesser of net worth and income 	Greater of: <ul style="list-style-type: none"> • \$2,000, and • 5% of the lesser of net worth and income
Investor net worth at or over \$100k	Greater of: <ul style="list-style-type: none"> • \$2,000, and • 5% of the lesser of net worth and income 	Lesser of: <ul style="list-style-type: none"> • 10% net worth, and • 10% income
The aggregate amount of securities sold to an investor through all crowdfunding offerings is limited to \$100k per 12 month period.		

Additional restrictions

Max. capital raise	\$1 million per 12 month period (aggregate all affiliates; only includes capital raised under Regulation Crowdfunding, not other exemptions (e.g., Regulation D))
Issuers disqualified from relying on Regulation Crowdfunding	<ul style="list-style-type: none"> • Non-U.S. companies • Reporting companies under the Exchange Act • Investment companies required to be registered under the Investment Company Act, and companies relying on certain Investment Company Act exemptions • Companies with no specific business plan or that merely indicate plan to merge with or acquire an unidentified company • Previous users of Regulation Crowdfunding exemption that are not compliant with disclosure requirements • Affiliates, directors, officers, 20%+ voting equity holders, promoters, etc. convicted of certain crimes, false filings, etc. (bad actors)

Issuer financial disclosure requirements

Offering amount, under Regulation Crowdfunding, within 12 month period	Required financial information
Less than or at \$100k	<ul style="list-style-type: none"> • Total income, taxable income and tax as reflected in the issuer's federal income tax return, and • Financial statements certified by principal executive officer
\$100k to \$500k	<ul style="list-style-type: none"> • Financial statements reviewed by independent public accountant
More than or at \$500k	<ul style="list-style-type: none"> • Financial statements reviewed by independent public accountant for first offering, and audited financial statements thereafter

Issuers must provide higher level financials where available, e.g., must provide any available audited financials even if offering less than \$500k in 12 month period.

Issuers must file this information with the SEC, provide it to investors and the funding portal or broker-dealer intermediary, and make it available to potential investors.

Issuer non-financial disclosure requirements

<ul style="list-style-type: none"> • Name, legal status, address and website (including webpage where issuer's annual report can be found) • Directors, officers and 20%+ owners • Business description and material risk factors, and use of offering proceeds • Number of employees • Target offering amount and deadline • Whether issuer will accept investments above target offering amount • Progress updates on meeting target offering amount • Identity of and compensation paid to intermediary • Any past failure to comply with Regulation Crowdfunding 	<ul style="list-style-type: none"> • Description of financial condition • Price (or method for determining price) of securities • Certain related-party transactions • Bad actor events prior to effective date of final rules • Process to complete transaction/cancel investment • Ownership and capital structure, classes of securities and related rights and restrictions • Description of issuer's indebtedness • 3 year exempt offering history under Securities Act • Any information necessary to make the statements made, in light of the circumstances under which they were made, not misleading • Certain legends evidencing transfer restrictions to be included
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For Funding Portals:

In addition to allowing registered broker-dealers to act as crowdfunding intermediaries under the JOBS Act, Regulation Crowdfunding creates a newly designated crowdfunding intermediary called a "funding portal," facilitating primary issuances of securities on behalf of issuers without the burden of registering as a broker-dealer under the Exchange Act. While funding portals do not need to register as broker-dealers to be crowdfunding intermediaries, there are certain activities that funding portals are prohibited from engaging in.

Prohibited activities for funding portals

- Compensating others for finding investors
- Providing investment advice
- Soliciting purchases or offers to purchase securities or compensating others to do so
- Holding or managing investor funds
- Funding portal or its officers, partners or directors having financial interest in an issuer

Because these broad prohibitions include certain activities funding portals were meant to engage in, the proposed rules include certain safe harbors.

Funding portal safe harbor activities notwithstanding prohibitions

- Determine whether and under what terms to allow an issuer relying on Regulation Crowdfunding to use its platform
- Highlighting issuers and providing search and sort functionality (must be broad and objective)
- Advertising funding portal's existence and compensating others to refer investors to portal (without providing personally identifiable information about potential investors)
- Facilitating and moderating (but not participating in) communications among investors and issuers
- Advising issuers on structure and content of offering
- Receiving compensation, even transaction-based compensation, from a broker-dealer for providing referrals to the broker-dealer relating to a crowdfunding offering
- Receiving a financial interest in an issuer as compensation from the issuer, only if of the same class of securities offered to investors through funding portal

Marketplace Evolution

The SEC has completed its crowdfunding rulemaking process under the JOBS Act. In the coming years the interpretation and enforcement of Regulation Crowdfunding may be tested as the SEC seeks to balance the promotion of capital formation against the protection of investors. Global crowdfunding activity is expected to reach between \$90 billion and \$96 billion by 2025 (almost twice the size of the global venture capital industry today) according to a 2013 World Bank study. This rapid growth in funding size and the corresponding number of offerings expected to rely on Regulation Crowdfunding will likely challenge regulators and make rule enforcement difficult. In the meantime, market entrants are already quickly developing rule enforcement and fraud mitigation technology that is not possible within traditional offerings in an attempt to ensure that market participants (issuers, investors and service vendors) enjoy the rewards of an efficient, transparent crowdfunding market.

Should you have any questions on Regulation Crowdfunding, please contact one of the following attorneys:

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