

ALERTS

Corporate, Securities And Financial Institutions Law Alert - Final Crowdfunding Rules Approved By The SEC

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On October 30, 2015, the Securities and Exchange Commission (SEC) adopted final rules to permit companies to offer and sell securities to a wide range of investors through the use of the Internet without registration under the federal securities laws – a method of capital raising commonly known as “crowdfunding.” The federal crowdfunding exemption was originally authorized under Title III of the Jumpstart Our Business Startups, or “JOBS,” Act of 2012, subject to the adoption of final implementing regulations by the SEC. After more than two years, the SEC has, at long last, adopted the final rules to permit crowdfunding securities offerings.

The final rules, styled “Regulation Crowdfunding,” enable individuals to purchase securities in crowdfunding offerings subject to certain limits, require companies to disclose certain information about their business and securities offering, and create a regulatory framework for the intermediaries facilitating crowdfunding transactions. These rules finalize the proposed crowdfunding rules originally released in October 2013. Following is a summary of the final Regulation Crowdfunding.

General Provisions

The final crowdfunding rules contain the following provisions:

- The rules permit a company to raise a maximum aggregate amount of \$1 million through crowdfunding offerings in a 12-month period.
- The rules permit individual investors, over a 12-month period, to invest in the aggregate across all crowdfunding offerings up to:
 - If either their annual income or net worth is less than \$100,000, then the greater of \$2,000 or 5% of the lesser of their annual income or net worth; or
 - If both their annual income and net worth are equal to or more than \$100,000, 10% of the lesser of their annual income or net worth.
- During the above-referenced 12-month period, the aggregate amount of securities purchased by an investor through all crowdfunding offerings may not exceed \$100,000.

Under the final rules, certain companies would not be eligible to use the

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exemption, including non-U.S. companies, publicly-traded SEC-reporting companies, certain investment companies, companies that are subject to disqualification under Regulation Crowdfunding, companies that have failed to comply with the annual reporting requirements under Regulation Crowdfunding during the two years immediately preceding the filing of the offering statement, and shell companies with no specific business plan or have indicated that their business plan is to engage in a merger or acquisition with an unidentified company or companies (i.e., reverse merger shell companies).

Securities purchased in a crowdfunding transaction are restricted securities and generally cannot be resold for one year. In addition, all crowdfunding transactions relying on the new rules would be required to take place through an SEC-registered intermediary, either a registered broker-dealer or a “funding portal.”

Disclosure Requirements

A company relying on Regulation Crowdfunding for its offering must file certain information with the SEC and provide this information to investors and the crowdfunding intermediary, including the following:

- The price of the securities offered or the method for determining the price, the target offering amount, the deadline to reach the target offering amount, and whether the company will accept investments in excess of the target offering amount;
- A discussion of the company’s financial condition;
- Financial statements of the company that, depending on the amount offered and sold during a 12-month period, are accompanied by information from the company’s tax returns, reviewed by an independent public accountant, or audited by an independent auditor. A company offering more than \$500,000 but not more than \$1 million of securities relying on Regulation Crowdfunding for the first time would be permitted to provide reviewed rather than audited financial statements, unless financial statements of the company are available that have been audited by an independent auditor;
- A description of the business and the use of proceeds from the offering;
- Information about officers and directors as well as owners of 20 percent or more of the company; and
- Certain related-party transactions.

In addition, companies relying on Regulation Crowdfunding are required to file an annual report with the SEC and provide the annual report to investors.

Crowdfunding Platforms

A funding portal acting as intermediary for a crowdfunding offering is required to register with the SEC using a new form, Form Funding Portal, and become a member of the FINRA. A company relying on the final rules would be required to conduct its offering exclusively through one crowdfunding intermediary platform at a time.

The final rules require crowdfunding intermediaries to, among other things:

- Provide investors with educational materials that explain, among other things, the process for investing on the platform, the types of securities being offered and information a company must provide to investors, resale restrictions, and investment limits;
- Take certain measures to reduce the risk of fraud, including having a reasonable basis for believing that a company complies with Regulation Crowdfunding and that the company has established means to keep accurate records of securities holders;
- Make information that a company is required to disclose available to the public on its platform throughout the offering period and for a minimum of 21 days before any security may be sold in the offering;
- Provide communication channels to permit discussions about offerings on the platform;
- Provide disclosures to investors about the compensation the crowdfunding intermediary receives;
- Accept an investment commitment from an investor only after that investor has opened an account;
- Have a reasonable basis for believing an investor complies with the investment limitations and caps described above;
- Provide investors notices once they have made investment commitments and confirmations at or before completion of a transaction;
- Comply with maintenance and transmission of funds requirements; and
- Comply with completion, cancellation, and reconfirmation of offerings requirements.

The rules also prohibit crowdfunding intermediaries from engaging in the following activities:

- Providing access to their platforms to companies that they have a reasonable basis for believing have the potential for fraud or other investor protection concerns;
- Having a financial interest in a company that is offering or selling securities on its platform unless the intermediary receives the financial interest as compensation for the services, subject to certain conditions; and
- Compensating any person for providing the intermediary with personally identifiable information of any investor or potential investor.

Regulation Crowdfunding also prohibits funding portals from, among other things: offering investment advice or making recommendations; soliciting purchases, sales, or offers to buy securities; compensating promoters and other persons for solicitations or based on the sale of securities; and holding, possessing, or handling investor funds or securities. The final rules also require funding portals to maintain certain books and records related to their transactions and business.

Effective Dates

The new rules and forms are expected to become effective in May 2016 (180 days after the rules are published in the Federal Register), except that the forms enabling funding portals to register with the SEC will be effective on January 29, 2016.

To obtain more information regarding this alert, contact the Barnes & Thornburg attorney with whom you work or David P. Hooper at (317) 231-7333 or dhooper@btlaw.com.

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