Entrepreneurial Services Alert: SEC Adopts Regulation Crowdfunding

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More than three years after its adoption was mandated by the JOBS Act, the SEC recently adopted Regulation Crowdfunding. This regulation is intended to provide a mechanism whereby businesses seeking capital can use the internet to raise small amounts of money from a large group of investors by selling an ownership stake in the business. There are many details in the SEC adopting release, which is 686 pages long, but below is a brief summary of some of the key provisions:

- It isn't yet legal to sell equity under Regulation Crowdfunding. The regulation will become effective 180 days after publication in the Federal Register, likely in May of 2016. The form permitting the establishment of a funding portal will become effective on Jan. 29, 2016, presumably to permit portals to rollout simultaneously with the regulation in the second quarter.
- The maximum gross amount permitted to be raised in a crowdfunding offering (before paying any offering expense, including the expenses of a funding portal or licensed broker-dealer) is $1 million during any 12-month period. The SEC clarified that concurrent offerings using other available exemptions (e.g. Rule 506 of Regulation D) are permitted and will not be integrated for the purposes of complying with other securities regulations.
- A crowdfunding equity offering must be conducted through an online platform of either a funding portal or a licensed broker-dealer.
- Financial statements are required and they must be reviewed or—if the amount being raised is over $500k and it isn't the first equity crowdfunding offering of the issuer—audited by an independent accountant.
- The SEC adopted an XML-based fillable form titled Form C, which includes an optional Q&A format for portions of the required disclosure. The disclosure materials must be filed with the SEC prior to the start of the crowdfunding offering and are required to include:
  - Details regarding the securities and the offering parameters;
  - The company's financial condition and the required financial statements;
  - A description of use of proceeds, the business, and business plan;
  - The company's ownership and capital structure;
  - Information regarding officers, directors, and owners of at least 20% of outstanding equity;
  - Details regarding intermediary identification and compensation;
  - Risk factors and certain legends; and
  - Descriptions of related-party transactions
- Annual reports are required to be filed with the SEC within 120 days after fiscal year end, unless:
  - At least one annual report has been filed and the issuer has fewer than 300 shareholders of record;
  - At least three annual reports have been filed and the issuer's total assets are not in excess of $10 million;
  - The issuer becomes a reporting (public) company;
  - All crowdfunding shares have been repurchased; or

- The business has been liquidated or dissolved.
- The annual per investor limits (which are aggregated over all of the investor's crowdfunded offerings) are:
  - For investors with annual income OR net worth less than $100k, the greater of $2,000 or 5% of the lesser of their annual income or net worth.
  - For investors with annual income AND net worth of at least $100k, 10% of the lesser of their annual income or net worth.
- Crowdfunding investors can be excluded from an issuer's shareholder count for the purposes of determining whether it needs to become a reporting company if the issuer has:
  - Filed required annual reports under the rules;
  - Total assets of less than $25 million; and
  - Retained the services of a registered transfer agent.
- Issuers can only provide limited advertising regarding the terms of the offering (like "tombstone ads") and certain factual information about the issuer, along with a link to the intermediary's platform where additional information is available.
- With certain exceptions for transfers to family members, back to the issuer, or to accredited investors, the transfer of any securities acquired in a crowdfunding offering is restricted for one year.
- Certain issuers (e.g. foreign companies, reporting companies, certain investment companies, and "disqualified" entities) are ineligible to use the crowdfunding exemption.
- While issuers still have liability for untrue statements or material omissions, the rules do make it clear that the regulation preempts registration requirements under state law.

Of course, there are many other rules that apply to issuers and to funding portals in connection with Regulation Crowdfunding. The securities and entrepreneurial services teams at Gray Plant Mooty are glad to answer any questions you may have.

Related People

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