

PUBLICATION

They've Arrived: Long-Awaited Federal Crowdfunding Rules Adopted by SEC

October 30, 2015

On October 30, 2015, the U.S. Securities and Exchange Commission (SEC) voted three to one to adopt equity crowdfunding rules pursuant to Title III of the Jumpstart Our Business Startup Act of 2012 (JOBS Act). The final rules, which are scheduled to be issued in early 2016, had been delayed for several years as the SEC balanced the demand for expanded access to the capital markets by investors, start-ups and small businesses, among other participants, with concerns regarding the risk for fraud and the protection of investors.

The recommended final crowdfunding rules will, among other things:

- Permit a company to raise a maximum aggregate amount of \$1 million through crowdfunding offerings in a 12-month period.
- Permit individual investors, over a 12-month period, to invest in the aggregate across all crowdfunding offerings based on the following formulas:
 - 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.
 - 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 12-month period, the aggregate amount of securities sold to a single investor through all crowdfunding offerings may not exceed \$100,000.

Eligible companies would be required to make certain disclosures to the SEC, investors and the intermediary facilitating the offering, including:

- A discussion about the size and scope of the offering.
- Information about the securities being sold to the public.
- A description of the company's business operations.
- Information about officers, directors and significant holders of the company's securities.
- A discussion of the company's financial condition and financial statements, tiered in accordance with the size of the offering:
 - Offerings of \$100,000 or less require financial statements certified by the company's principal financial officer.
 - Offerings of more than \$100,000, up to \$500,000, require financial statements reviewed by an outside auditor, an option which is only available to companies relying on the crowdfunding exemption for the first time, unless audited financial statements are available.
 - Offerings of more than \$500,000, up to \$1,000,000, require audited financial statements.

Certain companies would not be eligible to use the exemption from registration provided by the crowdfunding rules, including non-U.S. companies and Exchange Act reporting companies (i.e., public companies).

The recommended rules also establish additional intermediaries for selling crowdfunding securities. Although the use of traditional registered broker-dealers is still available, crowdfunding companies may instead choose

to work with online platforms called "funding portals." Funding portals may help to facilitate an offering by, among other things:

- Providing investors with basic information about the company and its securities, but not investment advice or recommendations whether to purchase securities.
- Taking certain measures to reduce the risk of fraud by establishing standards for ensuring compliance among issuers and potential investors.
- Assisting with administrative tasks, such as providing notices to investors and transmitting orders, but not holding, possessing or handling investor funds.

In explaining the decision to either tighten or loosen standards to the previously proposed crowdfunding rules, SEC Chair Mary Jo White remarked that the process "involved revisiting some parts of the proposal to ensure that there are adequate measures in place to facilitate capital raising by an issuer population that we expect to be quite different from [established issuers]." To that end, the SEC deemed it necessary to reevaluate "the investor protections provided in the proposal, and those have been tightened where necessary."

Despite initial excitement regarding the announcement of the much-anticipated rules, crowdfunding will be scrutinized going forward, and the SEC staff has been ordered to submit a report to the SEC no later than three years after the effective date of the rules to assess how crowdfunding markets are evolving, and their continued use by issuers and investors.

The rules and forms relating to the funding portals will take effect on January 29, 2016. The crowdfunding rules will be effective 180 days after they are published in the Federal Register.

For more information about how these rules may affect your business or related matters, contact a member of the Firm's Corporate Finance and Securities Group.