CLIENT ALERTS & INSIGHTS

SEC Adopts Rules Permitting Crowdfunding

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Authors: Megan L. Mehalko

On October 30, 2015, the Securities and Exchange Commission ("SEC") approved by a 3 to 1 vote, new regulations designed to provide additional avenues for small businesses to raise capital via a fundraising method commonly called "crowdfunding." The final rules, entitled "Regulation Crowdfunding" provide requirements regarding crowdfunding for companies seeking to raise capital, for investors desiring to invest in equity securities, and for broker-dealers and funding portals looking to facilitate these transactions.

Issuer Capital-Raising Limitations

The new rules allow a company to raise a maximum aggregate of $1,000,000 in a 12-month period through crowdfunding for the issuance of its equity securities. Such sales of securities are required to take place though a broker-dealer or funding portal that is registered with the SEC.

Ineligible Issuers

Not all issuers are able to raise equity capital using crowdfunding. Issuers prohibited from relying on the new exemption include those that are not United States entities, entities that are already subject to the reporting obligations under the Securities Exchange Act of 1934, certain investment companies, and companies that have no specific business plan or has a business plan to engage in a merger or acquisition with an unidentified company or companies.

Investor Purchase Limitations

The amount that individuals may purchase is dependent on their annual income or net worth.

If an investor's annual income or net worth is less than $100,000, such individual may invest in the aggregate the greater of $2,000 or 5% of the lesser of their annual income or net worth.

If an investor's annual income and net worth are both equal to or greater than $100,000, the investor may invest up to 10% of the lesser of the investor's annual income or net worth.

In any event, the aggregate amount of securities sold to an individual through crowdfunding offerings may not exceed $100,000 in a 12-month period. This limitation was highlighted by the one dissenting commissioner as being overly restrictive, stating "even if you are Warren Buffet or Bill Gates, you are limited to investing no more than $100,000 during any 12-month period in all crowdfunding investments."

Company Disclosure

Companies that rely on Regulation Crowdfunding as a method of raising capital will be subject to certain disclosure requirements and filing obligations with the SEC. In addition to filing an annual report to the SEC, some of the items that the company must disclose to both the SEC registered intermediary (either a broker-dealer or funding portal) and its investors are:

- The names of the directors and officers (and any persons occupying a similar status or performing a similar function), and each person holding more than 20% of the shares of the company;
- A description of the business of the company and the anticipated business plan of the company;
- A description of the financial condition of the company;
- A description of the stated purpose and intended use of the proceeds of the offering sought by the company with respect to the target offering amount;
- The target offering amount, the deadline to reach the target offering amount and regular updates about the progress of the company in meeting the target offering amount;
- Financial statements of the company, which depending on the size of the offering and sale, will need to be accompanied by information from the company's tax return, or reviewed or audited by an independent accountant (although first-time crowdfunding companies that are offering between $500,000 and $1,000,000 would only need to provide reviewed financial statements if audited statements were not otherwise available);
- The price to the public of the securities or the method for determining the price; and
- A description of the ownership and capital structure of the company.

Crowdfunding Platforms

Each issuer availing itself of the crowdfunding rules will be required to conduct its offering through a registered broker-dealer or a funding portal. Funding portals, a common method used to solicit crowdfunding investments, would also be subject to various rules which seek to prevent fraudulent issuances from being conducted and to prevent individuals who do not meet the regulatory requirements from investing. Funding portals will be more limited than a broker dealer in what activities they may conduct. The rules provide that funding portals are prohibited from offering investment advice, soliciting purchases of securities and compensating others for solicitations. The SEC views these intermediaries as "gatekeepers", protecting investors from issuer fraud.

Effective Date

The new rules will be effective 180 days after they are published in the Federal Register, except for the forms allowing funding portals to register with the SEC, which will be available January 29, 2016.

A Few Concluding Observations

These rules represent the last significant rulemaking by the SEC under the Jumpstart Our Business Startups (or JOBS) Act, passed by Congress in 2012. Crowdfunding provides a unique opportunity for small businesses to raise capital and for ordinary Americans to invest in start-ups and early-stage businesses. Crowdfunding via the Internet is an evolving enterprise and the SEC has stated that its staff will submit a report on the impact of these regulations no later than three years following their effective date.

For More Information

A copy of the 686-page final rules can be found here and the SEC's press release can be found here.

Please contact one of the attorneys listed below or any of the attorneys in the Corporate & Securities Practice Group at Benesch to discuss the implications and effective strategies for your company of this rule change.

Megan L. Mehalko | mmehalko@beneschlaw.com | 216.363.4487