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SEC Adopts Regulation Crowdfunding

After three years of analysis and discussion, the SEC has issued final rules for equity crowdfunding, which was legalized in the JOBS Act of 2012.

New rules take effect in 2016

On October 30, 2015, after three and a half years of proposals, comments, and discussion, the Securities and Exchange Commission (SEC) announced its final rules on equity crowdfunding for small businesses. The forms that funding portals use to register with the SEC become effective on January 29, 2016, while the final regulations take effect on May 16, 2016.

Small businesses considering this new financing alternative will want to review the new regulations carefully.

Background

Equity crowdfunding--or the ability for everyday investors to invest small amounts of money in start-ups and emerging businesses via the Internet--was actually included as part of the Jumpstart Our Business Startups (JOBS) Act of 2012. Specifically, Title III of the JOBS Act created a federal exemption under the existing securities laws to allow for this 21st-century form of offering and selling securities. Prior to the law's signing, only "accredited investors"--those with annual incomes exceeding $200,000 and assets exceeding $1 million--could invest in small start-ups.

At the time of the bill's signing, President Obama deemed the law "a potential game-changer" for emerging businesses, and budding entrepreneurs celebrated this innovative way to raise capital.* However, since that time, the SEC has faced challenges in finalizing specific regulations that would provide adequate protection for small investors without placing an undue burden on small business owners.

Regulation Crowdfunding specifics

Regulation Crowdfunding, as it's now called, puts the following rules in place:

- A small company can raise an aggregate of $1 million over a 12-month period through crowdfunding. (Some exceptions apply.)
- Individual investors can invest certain amounts over a 12-month period across all crowdfunding offerings based on their annual income and asset levels. Investors whose annual income or net worth is less than $100,000 can invest the greater of $2,000 or 5% of the lesser of their annual income or net worth. Investors whose annual income and net worth are both at least $100,000 may invest up to 10% of the lesser of their annual income or net worth.
- No more than an aggregate of $100,000 in equity crowdfunding offerings may be sold to an investor in a 12-month period.
- Securities generally cannot be resold for at least one year.

In addition, small businesses will be required to provide certain information to the SEC, potential investors, and the crowdfunding platforms facilitating the transactions. Among other details, this information includes:

- The price of the securities or the method of determining the price
- The target offering amount, the fundraising deadline, and whether the company will accept investments exceeding the target amount
- Financial statements that may need to be accompanied by the company's tax returns and reviewed by an independent public accountant or audited by an independent auditor (Note: For companies offering

securities for the first time, reviewed statements will meet the regulations)

- A description of the business and how the crowdfunding proceeds will be used
- Information about company officers, directors, and 20% or more owners

Moreover, crowdfunding companies will have to file an annual report with the SEC and provide it to investors.

Companies that will serve as funding portals have their own set of regulations to follow. Among them are the requirements to take certain measures to reduce fraud risk, to make crowdfunding company information available on their websites, and to provide communication channels that allow discussion about platform offerings.

Finally, before making any investment commitment, an investor must provide a representation that he or she has reviewed the intermediary's educational materials, understands that the entire amount of his or her investment may be lost and is in a financial condition to bear the loss of the investment, and has completed a questionnaire demonstrating an understanding of the risks of any potential investment and other required statutory elements.

Will crowdfunding be a "game-changer"?

Although some industry observers contend that the new regulations are a highly risky proposition for small investors, others say they will provide a greatly needed opportunity for entrepreneurs to raise capital. As part of its notification of adoption of the regulations, the SEC said that it will undertake a three-year study on the impact on "capital formation and investor protection."

For more information and important details including access to the final rules, please visit the SEC's website.

**Source: "S.E.C. Gives Small Investors Access to Equity Crowdfunding," Stacy Cowley, The New York Times, Oct. 30,2015*
