

New Crowdfunding Regulations Expand Financing Options for Start-Ups

05.26.2016

Last week new regulations ("**Regulation Crowdfunding**") went into effect that implement the crowdfunding provisions of Title III of the Jumpstart Our Business Startups Act (the "JOBS Act"). These provisions allow private companies to raise up to an aggregate amount of \$1 million in start-up capital from the general public using online crowdfunding platforms. Already three dozen companies have filed **Form C** and related documents with the Securities and Exchange Commission (the "SEC") launching their equity crowdfunding campaigns.

Before the JOBS Act, companies could not solicit capital by offering to sell equity in their companies to the general public without triggering Section 5 of the Securities Act of 1933, which criminalizes the use of the mails for the sale of securities that are not covered by a registration statement. A registration statement is a lengthy and expensive process that requires audited financial statements and extensive disclosures.

What You Need to Know

To qualify for this new exemption from registration, crowdfunding transactions must meet specific requirements. The company can raise no more than \$1 million via crowdfunding during any 12-month period. There is also a cap on the maximum amount of crowdfunding investments that any individual investor may make in any 12-month period. Equity crowdfunding is only available through an **online portal** that has been approved by the SEC and is a member of the Financial Industry Regulatory Authority. Securities purchased in a crowdfunding transaction are restricted securities. They generally cannot be resold for a period of one year. Regulation Crowdfunding also restricts advertising, bars certain issuers from using this method of fundraising, and imposes certain disclosure and reporting requirements. It also creates a regulatory framework for the online portals that facilitate the crowdfunding transaction.

Individual Investor Cap

Individual investors are permitted to use crowdfunding to invest up to the following thresholds in any 12-month period:

- If the individual investor has either an annual income or net worth that is less than \$100,000, then the maximum crowdfunding investment that he or she can make is the greater of \$2,000 or 5% of the individual's annual income or net worth (whichever is lower).
- If the individual investor has both an annual income and a net worth that are each equal to or more than \$100,000, then he or she can invest up to 10% of the individual's annual income or net worth (whichever is lower).

CAPABILITIES

CornerStone Program

Corporate and Business Law

Emerging Companies

Net worth is calculated by adding all of an individual's assets and subtracting all liabilities, excluding the value of one's primary residence. For further details regarding this calculation, see the **Investor Bulletin**, issued by the SEC's Office of Investor Education and Advocacy.

The above thresholds apply to the aggregate of all of that individual investor's crowdfunding investments over the course of a 12-month period. In no event may the aggregate amount of securities sold to an investor through all crowdfunding offerings exceed \$100,000 in any given 12-month period. This limit applies to all investors, including accredited and institutional investors.

Disclosure Requirements

Regulation Crowdfunding requires issuers to file the following information with the SEC, and to provide this information to investors and the online portal that will facilitate the crowdfunding offering:

- Information regarding the issuer (including its website), its officers, directors and owners of 20% or more of the outstanding voting equity securities of the company;
- Transactions with any officer, director, or beneficial owner of 20% or more of the outstanding voting equity securities of the issuer since the last fiscal year that, in the aggregate, exceed 5% of the offering;
- A description of the issuer's business, including business plan, the anticipated use of crowdfunded proceeds, and the number of employees;
- The price of the securities or the method to be used for calculating the price;
- The target offering amount;
- The deadline for reaching the target offering amount and the process by which an investor may cancel an investment commitment;
- A description of the ownership and capital structure of the issuer and any related-party transactions;
- A discussion of the financial condition of the issuer, including financial statements;
- The identity and compensation of the online portal;
- A specified legend regarding the risks of investing in a crowdfunding transaction;
- Risk factors;
- Material terms of any indebtedness of the issuer;
- Prior exempt offerings conducted in the previous three years;
- Any material information necessary in order to make the statements made, in light of the circumstances, not misleading; and

- A statement regarding whether the issuer or any of its predecessors previously failed to comply with the ongoing reporting requirements of Regulation Crowdfunding.

The financial disclosures required in the offering statement are determined by reference to a tiered framework established by the regulations. This framework ties the disclosure requirements to aggregate target offering amounts of the current offering and all other crowdfunded offerings made within the previous 12-month period.

All required financial disclosures must include a narrative component. However, whether reviewed or audited financial statements must also be provided depends upon the following matrix:

Audited financial statements prepared by an independent CPA.

Amount of Offering

Required Disclosure to SEC, Investors, and Online Portals

\$100,000

Total income, taxable income, and total tax as reflected in issuer's federal tax returns:

And _____

Financial statements certified by the issuer's principal executive officer to be true and complete.

> \$100,000 and \$500,000

Financial statements reviewed by an independent CPA.

> \$500,000 but \$1M

If the issuer is using Regulation Crowdfunding for the first time:

Financial statements reviewed by an independent CPA.

If the issuer has previously sold securities using Regulation Crowdfunding:

Audited financial statements prepared by an independent CPA.