



## CLIENT ALERT

Capital Markets Practice Group Update

November 5, 2015

### REGULATION CROWDFUNDING

On October 30, 2015, the Securities and Exchange Commission (SEC) approved Regulation Crowdfunding, providing small businesses a new option to publicly sell up to \$1 million in equity securities through registered intermediaries over the internet. Regulation Crowdfunding finally provides the particular rules governing the new “federal crowdfunding” offering exemption under Section 4(a)(6) of the Securities Act of 1933, as amended, which was passed into law three and a half years ago in Title III of the JOBS Act.<sup>1</sup> You can read more about the passage of the JOBS Act [here](#).

Regulation Crowdfunding is intended to facilitate the raising of capital from numerous investors, while avoiding the expense of traditional SEC registration. As described below, there are still disclosure requirements and intermediary restrictions that must be followed in order to take advantage of the exemption, but companies following these requirements can raise up to \$1 million annually through the internet.

**Offering and Investment Limits:** Offerings relying on the federal crowdfunding exemption are subject to annual limits on (1) the total amount of money raised by a company, and (2) the total amount each investor may invest. Specifically, an issuer can raise a maximum of \$1 million through crowdfunding offerings in any 12-month period. Individual investors may annually invest, in the aggregate across all crowdfunding offerings, up to:

- The greater of (a) \$2,000 or (b) 5% of the lesser of the investor’s annual income or net worth if either the investor’s annual income or net worth is less than \$100,000; or
- 10% of the lesser of the investor’s annual income or net worth if the investor’s annual income and net worth are both greater than \$100,000.

In any event, the aggregate amount of securities an individual investor may purchase from all crowdfunding offerings in any 12-month period may not exceed \$100,000.

**Integration:** Offerings made in reliance on federal crowdfunding will not be integrated with other exempt offerings (provided each offering complies with its applicable requirements). Similarly, capital raised through other exempt transactions would not be counted in determining the aggregate amount sold in reliance on Section 4(a)(6).

**Offering Intermediary:** All transactions that rely on federal crowdfunding must take place through an SEC-registered intermediary, either a broker-dealer or a new type of entity called a “funding portal.”<sup>2</sup> Funding portals must provide certain educational materials and disclosures about the funding portal and issuing company to investors, as well as take certain measures to reduce the risk of fraud. None of an intermediary’s directors, officers or partners (or individuals in similar roles) may have a financial interest in the issuer using that intermediary, nor can any such persons

<sup>1</sup>Pub. L. No. 112-106, 126 Stat. 306 (2012).

<sup>2</sup>Securities Exchange Act of 1934 Section 3(a)(80) defines a “funding portal” as any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to Securities Act Section 4(a)(6), that does not: (1) offer investment advice or recommendations; (2) solicit purchases, sales or offers to buy the securities offered or displayed on its website or portal; (3) compensate employees, agents or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal; (4) hold, manage, possess or otherwise handle investor funds or securities; or (5) engage in such other activities as the Commission, by rule, determines appropriate.

receive a financial interest in the issuer as compensation for the intermediary services. However, the intermediary itself is permitted to take an interest in the issuer, subject to certain conditions.

**Resale Restrictions:** Securities purchased in a crowdfunding transaction may not be resold by the purchaser for one year after the date of purchase, except when transferred (1) to the issuing company, (2) to an accredited investor as defined in Rule 501 of Regulation D, (3) as part of registered offering, or (4) to a family member of the purchaser.

**Eligibility:** Companies ineligible to use federal crowdfunding include non-U.S. companies, public companies reporting under the Securities Exchange Act of 1934, certain investment companies, companies that failed to comply with Regulation Crowdfunding requirements in the past two years preceding the proposed offering, and “shell” companies without a specific business plan or that indicate their business plan is to engage in a merger or acquisition with an unidentified company.

**Disclosure Requirements:** Issuers relying on federal crowdfunding must file the following information with the SEC and provide the same information to investors and the intermediary facilitating the offering:

- Financial statements, with the level of review depending on the amount of securities offered and sold under the federal crowdfunding exemption in the preceding 12-month period
  - \$100,000 or less – financial statements certified by principal executive officer,
  - More than \$100,000 but not more than \$500,000 – financial statements reviewed by an independent public accountant,
  - More than \$500,000 and first-time issuer under federal crowdfunding – financial statements reviewed by an independent public accountant, or
  - More than \$500,000 and not first-time issuer under federal crowdfunding – audited financial statements;
- Tax return information;
- Information about officers, directors and 20+% owners;
- Description of issuer’s business and use of crowdfunding proceeds;
- Offering price of securities (or method of determining price)
- Related-party transactions; and
- Discussion of the issuer’s financial condition.

**Annual Report:** Issuers must file an annual report with the SEC and make the same report available to investors. The annual report must include the non-offering-specific information originally filed with the SEC and provided to investors and the crowdfunding intermediary, except that the annual report only requires financial statements to be certified by the principal executive officer of the issuer (unless audited or reviewed financial statements are available). Issuers are not required to file or provide more frequent reports to the SEC or investors.

**Effectiveness:** The new Regulation Crowdfunding rules and forms will not be effective until sometime in May 2016, 180 days after they are published in the Federal Register. The specific forms enabling intermediary funding portals to register with the SEC will be effective January 29, 2016.

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If you have any questions regarding this client alert or the specific impact of the JOBS Act on you or your business, please call (919-781-4000) or email your Wyrick Robbins contact or one of the following members of our Capital Markets/M&A Practice Group: Practice Group Leader Don Reynolds ([dreynolds@wyrick.com](mailto:dreynolds@wyrick.com)); Alec Donaldson ([adonaldson@wyrick.com](mailto:adonaldson@wyrick.com)); Chris Lynch ([clynch@wyrick.com](mailto:clynch@wyrick.com)); Mital Patel ([mpatel@wyrick.com](mailto:mpatel@wyrick.com)); David Creekman ([dcreekman@wyrick.com](mailto:dcreekman@wyrick.com)); Clay Martin ([cmartin@wyrick.com](mailto:cmartin@wyrick.com)); Brian Sullivan ([bsullivan@wyrick.com](mailto:bsullivan@wyrick.com)); Halle Vakani ([hvakani@wyrick.com](mailto:hvakani@wyrick.com)); or Dan Tracey ([dtracey@wyrick.com](mailto:dtracey@wyrick.com)).

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