

## SEC Issues Final Crowdfunding Rules

November 9, 2015

On October 30, 2015 the Securities and Exchange Commission (the “SEC”) issued final rules<sup>1</sup> that will allow private issuers to utilize innovative new “crowdfunding” techniques for offering and selling securities. The long-awaited Regulation Crowdfunding (“Reg. C”) implements key provisions of the Jumpstart Our Business Startups Act<sup>2</sup> (the “JOBS Act”), and includes many of the proposed rules that were submitted for public comment in October 2013.<sup>3</sup>

### Background

As part of the JOBS Act, the United States Congress sought to establish new avenues for startups and small businesses to raise capital, including new provisions that would allow qualifying companies to conduct “crowdfunding” securities offerings via the Internet. Crowdfunding is an innovative new means of capital generation in which small-scale investment opportunities are made available to the public at large (i.e., the “crowd”) through internet-based platforms.

To allow for these new offerings, the JOBS Act included new Sections 4(a)(6) and 4A of the Securities Act of 1933, as amended (the “Securities Act”), which exempt qualifying crowdfunding offerings from the registration requirements of Section 5 of the Securities Act. Reg. C provides additional rules relating to such crowdfunding transactions.

### Overview of Final Rules

Reg. C allows qualifying private issuers to raise up to \$1 million in a 12-month period through crowdfunding offerings conducted exclusively via online intermediaries. The rules include certain restrictions and disclosure requirements for issuers and intermediaries, and investors are subject to tiered caps on the amount they can contribute during any 12-month period.

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<sup>1</sup> Crowdfunding, Release Nos. 33-9974 and 34-76324, available at: <https://www.sec.gov/rules/final/2015/33-9974.pdf> (October 2015).

<sup>2</sup> Pub. L. No. 112-106, 126 Stat. 306 (2012); for more information on the JOBS Act, see our April 2012 [Client Alert](#).

<sup>3</sup> Crowdfunding Disclosure, Release Nos. 33-9470 and 34-70741, available at <http://www.sec.gov/rules/proposed/2013/33-9470.pdf> (October 2013); for more information on the initially proposed crowdfunding rules, see our [Client Alert](#) from October 2013.



## Issuer Eligibility

Reg. C is available for use only by private companies, and Issuers subject to the reporting obligations of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), do not qualify to conduct offerings in reliance on the new rules. In addition, certain private issuers are excluded from participation, including foreign issuers, certain investment companies (as defined in the Investment Company Act of 1940) and issuers that have been disqualified under Reg. C or that have previously failed to comply with Reg. C’s ongoing reporting obligations in connection with past crowdfunding offerings. Issuers must also have a specific business plan (other than a plan to engage in a merger or acquisition with an unidentified company or companies) in order to qualify to conduct crowdfunding offerings under the new rules.

## Advertisements

Any advertisements or notices regarding a crowdfunding offering outside the context of the intermediary through which the offering is conducted must be limited to a statement that the issuer is conducting a crowdfunding offering pursuant to Section 4(a)(6) of the Securities Act, the name of the intermediary through which the offering is being conducted and a link directing the potential investor to the intermediary’s platform, along with the terms of the offering and basic factual information about the issuer and its business.

## Issuer Disclosure Obligations

As part of a crowdfunding offering, issuers must disclose on Form C (among other information):

- basic company information (e.g., name, legal status, address, website, biographical information for the issuer’s officers and directors, identification of significant shareholders, number of employees, material risk factors, etc.);
- a business description, business plan and a summary of the intended use of proceeds;
- the target offering amount, deadline and offering price, and a summary of the company’s ownership and capital structure (including the terms of the securities being offered); and
- a discussion of the issuer’s financial condition and related party transactions.

Issuers must update this information on Form C/A in the event of any material changes, additions or updates to information previously provided. In some cases, such updates will trigger an obligation of investors to reconfirm their investment commitment within five business days or have their commitments cancelled. Reg. C also obligates issuers to provide certain offering progress updates on Form C-U.



In addition, issuers must provide financial disclosures in connection with offerings under Reg. C. For issuers (other than first-time crowdfunding issuers) offering more than \$500,000 under Reg. C (calculated together with all amounts offered under Reg. C in the last 12 months), the financial statements must have been audited by an independent public accounting firm. For issuers offering more than \$100,000 but not more than \$500,000 under Reg. C (calculated together with all amounts offered under Reg. C in the last 12 months), and for issuers offering more than \$500,000 as part of their first-ever crowdfunding offering, these financial statements must be reviewed by an independent public accounting firm (unless audited financials are otherwise available, in which event they must be provided). The financial statements must be prepared in accordance with generally accepted accounting principles in the United States (GAAP) and must cover the shorter of the two most recently completed fiscal years or the period since the issuer's inception. Issuers offering \$100,000 or less must provide only the amount of total income, taxable income and total tax as reflected in the issuer's federal income tax return for the most recently completed year, certified by the issuer's principal executive officer (unless audited or reviewed financials are otherwise available, in which event they must be provided).

Crowdfunding issuers will also have an ongoing obligation to file and make available on their website an annual report no later than 120 days after the end of the fiscal year covered by the report. This ongoing reporting obligation would terminate in five circumstances: (1) when the issuer has filed at least one annual report and has fewer than 300 shareholders; (2) when the issuer has filed at least three annual reports and has total assets that do not exceed \$10 million; (3) when the issuer becomes obligated to file reports under Exchange Act Sections 13(a) or 15(d); (4) if the issuer or another party purchases or repurchases all the securities issued in the crowdfunding offering; or (5) if the issuer liquidates or dissolves in accordance with state law.

### Individual Investment Limits

Investors may not purchase securities in crowdfunding transactions in any 12-month period in excess of the following amounts:

- the greater of \$2,000 or 5% of the lesser of the investor's annual income or net worth if either annual income or net worth is less than \$100,000; or
- 10% of the lesser of the investor's annual income or net worth, not to exceed an amount sold of \$100,000, if both annual income or net worth are \$100,000 or more.

Reg. C allows spouses to calculate their net worth and annual income jointly, but if such a joint calculation is used, then the aggregate investments of the spouses in Reg. C offerings may not exceed the limit that would apply to an individual investor at that income or net worth level. Issuers may rely on the efforts of an intermediary to ensure that amounts in excess of these limits are not sold to an investor.



## Resales

Investors are prohibited from reselling or transferring securities purchased in a Reg. C offering for a period of at least one year after issuance, except that transfers are permitted to the issuer, to accredited investors, as part of a registered offering or to an investor's family members, qualifying trust or incidental to the investor's death or divorce.

## Intermediaries

A crowdfunding offering must be conducted entirely through a single intermediary that is either registered with the SEC as a broker under Exchange Act Section 15(b) or a funding portal pursuant to Section 4A(a)(1) of the Securities Act and Rule 400 of Reg. C. Funding portals seeking to so register must do so on a new Form Funding Portal. In addition, crowdfunding intermediaries must register with the Financial Industry Regulatory Authority ("FINRA") or any other self-regulatory organization. (Currently FINRA is the only self-regulatory organization.)

Directors, officers or partners of an intermediary are prohibited from having any financial interest in issuers using the intermediary's services and from receiving a financial interest in an issuer as compensation for such services. However, Reg. C allows an intermediary itself to receive a financial interest in an issuer using its platform as compensation for the services being provided by the intermediary in connection with the offering, so long as the financial interest consists of securities of the same class and terms as are being offered by the issuer in the relevant crowdfunding offering.

Reg. C includes a number of additional rules and regulations applicable to intermediaries, including requirements that intermediaries take efforts to reduce the risk of fraud, provide certain basic educational information to investors, assist issuers in facilitating investor disclosures as part of the offering, facilitate crowd-based discussions and commentary, and assist with the confirmation, processing and facilitation of investments, among others.

## **Action Items; Contact**

Reg. C is expected to be effective in early May 2016 (180 days after it is published in the Federal Register), except for the Form Funding Portal and amendments to Form ID, which will be effective January 29, 2016. While waiting for the rules to become effective, qualifying companies may wish to analyze the desirability of conducting a crowdfunding offering.

## **Contact Information**

If you have questions about the final rules discussed in this alert or other securities-related matters, please contact [Matt Triplett](mailto:Matt.Triplett@wcsr.com), the principal drafter of this client alert, at 336.747.6618 or [MTriplett@wcsr.com](mailto:MTriplett@wcsr.com), or you may contact the Womble Carlyle attorney with whom you usually work or one of our [Corporate and Securities](#) attorneys.



# Client ALERT

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