

Equity Crowdfunding Now a Reality

On May 16, 2016, the long-awaited equity crowdfunding rules authorized under the JOBS Act of 2012 came into effect. Unlike non-equity crowdfunding, which became popular during the past decade and rewards supporters with goods or services instead of profits, equity crowdfunding allows businesses to publicly solicit an unlimited number of non-accredited investors for small investments in exchange for an equity stake in the company.

Who Can Invest?

Anyone! Unlike most other exemptions from registration, who can invest is not restricted. However, *how much* an investor can give to crowdfunded companies is limited. An investor with an annual income or net worth less than \$100,000 can invest up to \$2,000 or five percent of the lesser of his or her annual income or net worth during any twelve-month period, whichever is greater. Investors with an annual income or net worth greater than \$100,000 may invest up to ten percent of their annual income or net worth during any twelve-month period, whichever is less. No single investor can invest more than an aggregate amount of \$100,000 in crowdfunding offerings during any 12-month period.

Can my Company Take Advantage of Equity Crowdfunding?

Most companies, especially startups and mid-sized companies, qualify to raise capital under Regulation Crowdfunding. However, certain companies are not eligible, including:

- companies outside of the United States;
- companies that already are reporting companies under the Securities Exchange Act of 1934;
- investment companies as defined in the Investment Company Act of 1940;
- companies that are disqualified under Regulation Crowdfunding's bad actor rules;
- companies that have failed to comply with the annual reporting requirements under Regulation Crowdfunding during the two years immediately preceding the filing of the offering statement; and
- companies that have no specific business plan or have indicated their business plan is to engage in a merger or acquisition with an unidentified company or companies.

When Is a Company Disqualified from Equity Crowdfunding?

Similar to the disqualifications provisions under Regulation A and Rules 505 and 506 of Regulation D, an issuer is disqualified from taking advantage of Regulation Crowdfunding if a "covered person" is a "bad actor". A "covered person" includes the issuer and its predecessors and affiliates, principals of the issuer, beneficial owners of 20% or more of the issuer's outstanding voting equity securities, any promoter connected with the issuer, compensated solicitors of investors, and principals of any such solicitor. Generally, a person or entity becomes a "bad actor" if they have been convicted of a crime or are subject to a state securities regulators or SEC injunction or order involving the purchase or sale of securities, or violations of other specified laws. Exceptions and waivers from disqualification are also available to issuers.



How Can My Company Solicit Investors?

Regulation Crowdfunding does not allow for general solicitation of investors as Rule 506(c) of Regulation D does. Solicitation of investors in a crowdfunding offering must be through an intermediary, which must either be the online platform of a broker-dealer or a funding portal that is registered with the SEC or FINRA. Any general advertising of the offering must direct the potential investor to the intermediary's website and may contain no more than the following information:

- a statement that the issuer is conducting an 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;
- the terms of the offering, including the amount of securities offered, the nature of the securities, the price of the securities, and the closing date of the offering period;
- the name of the issuer;
- the address, phone number, and website of the issuer;
- the e-mail address of a representative of the issuer; and
- a brief description of the business of the issuer.

Additionally, any communications with potential investors must be made via the intermediary's communication channels.

What Information Must be Disclosed?

Like most private offering exemptions, Regulation Crowdfunding requires the disclosure of certain information about the company to potential investors. This information must be disclosed on the issuer's Form C and includes a description of the company's business plan, risk factors in the investment, the company's financial condition, the deadline for the company to raise its target amount and whether the company will accept investments above that amount, and the names of directors, officers, and the beneficial owners of 20% or more of the company's outstanding voting equity securities.

Issuers may also need to make additional financial disclosures, depending on the amount it plans to raise. If \$100,000 or less is being raised, the company's financial statements must be certified by the principal executive officer of the company. If more than \$100,000 but \$500,000 or less, then the financial statement must be reviewed by an independent public accountant. If the company plans to raise more than \$500,000, then first time crowdfunding companies must have their financial statements reviewed by an independent public accountant. Companies raising over \$500,000 that have previously raised capital under Regulation Crowdfunding must provide audited financial statements.

After the offering has begun, issuers must file progress updates after reaching 50% and 100% of their goal, as well as make a final filing disclosing the total amount of securities that were sold. Thereafter, the issuer must file annual reports with information similar to that which is required



to be disclosed in the Form C, except that financial statements do not need to be reviewed or audited. These annual reports must be filed until:

- the issuer is required to file reports under Exchange Act Sections 13(a) or 15(d);
- the issuer has filed at least one annual report and has fewer than 300 holders of record;
- the issuer has filed at least three annual reports and has total assets that do not exceed \$10 million;
- the issuer or another party purchases or repurchases all of the securities issued pursuant to Regulation Crowdfunding, including any payment in full of debt securities or any complete redemption of redeemable securities; or
- the issuer liquidates or dissolves in accordance with state law.

Should my Company Raise Funds under the Regulation Crowdfunding Exemption?

While it is too early to say whether Regulation Crowdfunding will be a boon or a burden for companies raising capital, as with non-equity crowdfunding it may prove very beneficial for startups and mid-sized companies with a following that is passionate about the company’s products or services. When deciding whether to raise funds under Regulation Crowdfunding or the more established Regulation D, companies should consider how much they plan to raise during the next two years, what potential investors they have access to, and the amount of compliance they are willing to perform.

Below is a table comparing the major differences between Regulation D and Regulation Crowdfunding:

	Regulation D	Regulation Crowdfunding
Number of unaccredited investors allowed	Rule 504: Unlimited Rule 505 & 506(b): Up to 35 Rule 506(c): None	Unlimited
Total amount that can be raised in a one year period	Rule 504: \$1 million Rule 505: \$5 million Rule 506: Unlimited	\$1 million
Total amount that each investor can give	Unlimited	Investors with a net worth or annual income of less than \$100,000 are limited to greater of \$2,000 or 5% of their net worth or income. Investors with a net worth or annual income of \$100,000 or greater may invest up to 10% of the lesser of their net worth or income.

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		No single investor can invest more than \$100,000 in crowdfunded offerings during any 12-month period, regardless of income or net worth.
General solicitation	Not allowed, except under Rule 506(c), provided that issuer verifies that all investors are accredited	Not allowed, except through a registered broker-dealer or funding portal
SEC filings	Form D	Form C plus progress updates and annual reports
Criminal background check	None	Required for company directors, executives, and 20% beneficial owners
Financial disclosures	Rule 504: not required Rule 505: required for non-accredited investors Rule 506: required for non-accredited investors	Required. Financial statements must be reviewed by an independent accountant if the company is seeking to raise more than \$100,000 and must be audited if the company is raising more than \$500,000 and has used Regulation Crowdfunding before.
Intermediary requirements	Must be through a registered broker-dealer	Must be through a registered broker-dealer or funding portal
State "Blue Sky" Laws	Applicable for offerings under Rule 504 and 505. Not applicable for Rule 506 offerings, although states may require a notice filing.	Not applicable, although states may require a notice filing.