POLSINELLI

in the news

Corporate Finance
and Securities

December 2013

Update: SEC Releases Long-Awaited Proposed Crowdfunding Rules

In this Issue:

On October 23, 2013, the SEC voted unanimously to publish for public comment rules that would permit startups and small businesses to publicly raise capital by offering and selling unregistered securities through crowdfunding. The proposed crowdfunding rules represent a significant shift in how companies are permitted to raise capital. The cost of complying with current federal and state securities laws has effectively made the use of crowdfunding unavailable to start-ups and small business when seeking investors.

The proposed rules are intended to provide certain companies with greater access to capital by creating an exemption from registration for securities offered and sold through crowdfunding. The new crowdfunding exemption would allow these companies to raise capital from an unlimited number of investors without registering the offering with the SEC or any state. In addition, the proposed rules provide a framework for regulation of on-line intermediaries that issuers must use when conducting crowdfunding exempt offerings, including a new type of authorized intermediary known as a “funding portal.” Under the proposed rules, a funding portal will be exempt from broker-dealer registration and will have less demanding licensing and oversight standards compared to those of a registered broker-dealer.

Requirements and Obligations Governing Crowdfunding Offerings

The proposed rules would implement that part of the Jumpstart Our Business Startups (JOBS) Act that addresses crowdfunding by providing an exemption from securities registration. Under the proposed rules, securities offerings made in reliance on the crowdfunding exemption would be subject to various requirements and limitations, including:

- *Maximum Offering Amount:* The aggregate amount that could be raised by an issuer in reliance on the crowdfunding exemption in any 12-month period cannot exceed $1 million. There is no limitation on the number of persons that may invest in a given crowdfunding offering.

- *Investment Limitations per Investor:* Investors would be limited in the aggregate amount they may invest in a 12-month period in the securities of an issuer relying on the crowdfunding exemption. In the case of investors with an annual income or net worth of $100,000 or more, the limit is 10% of their annual income or net worth, not to exceed $100,000. For investors with both annual income and net worth of less than $100,000, the limit is $2,000 or 5% of their annual income or net worth, whichever is greater. In an effort to reduce the burden on issuers and intermediaries, the proposed rules do not mandate that they take specific steps to verify the income levels and net worth of investors.

- *Disclosure; Financial Statements:* An issuer would be required to file a disclosure document with the SEC at least 21 days prior to the first sale being effected and provide this information to the intermediary and investors. The required disclosure would include a description of the company's business, the material factors that make an investment in the issuer speculative or risky and the use of the proceeds from the offering, how the valuation of the securities being offered was determined, the target offering amount, the deadline to reach the target amount and whether the company will accept capital in excess of the target amount, as well as information about the company's officers and directors, and the financial condition of the company.

  The proposed rules provide for tiered financial disclosure based on the aggregate target offering amount of an issuer within the preceding 12-month period. Issuers offering $100,000 or less would be required to file with the SEC and disclose to potential investors and the relevant intermediary its tax returns for the most recently completed year and its financial statements that have been certified by its officers. Issuers offering more than $100,000, but not more than $500,000, would be required to file with the SEC and disclose its financial statements that have been reviewed by a public accountant that is independent of the issuer. Finally, issuers offering more than $500,000 would be required to file with the SEC and disclose audited financial statements.

- *Public Solicitation Prohibited:* Unlike private placements conducted in reliance on recently adopted Rule 506(c) of Regulation D, the crowdfunding exemption does not allow advertising in connection with an offering, except solely to provide notices directing investors to the appropriate on-line intermediary.

- *On-Going Disclosure Requirements:* A company that offers and sells securities in reliance on the crowdfunding exemption must file annual reports with the SEC (and must post the reports on its website) containing specific disclosure information, including a discussion of its results of operations and its financial statements. This obligation begins no later than 120 days after the end of the fiscal year covered by the report and is on-going and can only be terminated in certain limited circumstances.

Not all companies will be eligible to use the crowdfunding exemption. Companies will not be eligible if they (i) are not domiciled in the United States, (ii) are already reporting under the Securities Exchange Act of 1934 (the "Exchange Act"), (iii) have no specified business plan, or (iv) have indicated that their business plan is to merge with or acquire an unidentified company. In addition, the exemption is not available to registered investment companies or private investment companies, such as hedge funds or private equity funds.

Regulation of Crowdfunding Portals

Under the proposed rules, an exempt crowdfunding offering would be required to take place exclusively through an SEC-registered intermediary, either an SEC-registered broker-dealer or a new SEC-regulated entity, known as a "funding portal." A funding portal is an intermediary for exempt crowdfunding offerings that does not (i) offer investment advice or recommendations; (ii) solicit purchases, sales, or offers to buy securities offered or displayed on its website or portal; (iii) compensate employees, agents, or other persons for such solicitation, or based on the sale of securities displayed or referenced on its website or portal; or (iv) hold, manage, possess, or otherwise handle investor funds or securities. Funding portals would not be subject to registration as a broker-dealer, but be subject to an alternative regulatory regime with oversight by the SEC and the broker-dealer self-regulatory organization FINRA, which released its own set of "Funding Portal Rules" concurrently with the SEC's proposed rules.

The proposed rules impose various requirements on crowdfunding intermediaries, including obligations to provide investors with educational materials and to provide communications channels to permit discussions about offerings on their platforms. A company's crowdfunding intermediary would be barred from any ownership of the company's securities.

Additional Notable Provisions of the Proposed Rules

The proposed rules would exempt securities sold in a crowdfunding transaction from the registration requirements of Section 12(g) of the Exchange Act, meaning that those shareholders would be exempt from the calculation of shareholders of record to determine when a company is required to publicly register a class of its securities. Additionally, the proposed rules would make securities purchased through the crowdfunding exemption "covered securities" under Section 18 of the Securities Act of 1933 and would therefore be exempt from substantially all state securities laws dealing with registration or qualification of securities offerings. Funding portals will also be exempt from most state laws.

Next Steps

The SEC has provided a 90 day period to submit comments on the proposed crowdfunding rules. If adopted,

the rules will likely not be effective until the late spring or summer of 2014. Until the SEC adopts final rules implementing this JOBS Act exemption, and such rules become effective, the SEC's proposed crowdfunding exemption is not available to issuers or intermediaries.

The full 585-page release on the proposed rules covers a number of other issues. The release can be found on the SEC's website at www.sec.gov. FINRA's release can be found on its website at www.finra.org.

For More Information

To learn more about the SEC's proposed crowdfunding exemption rules and how your business may take advantage of these proposed rules or existing federal and state exemptions, please contact a member of Polsinelli' s Corporate Finance and Securities practice group or the contributing authors of this alert:

- Peter F. Waltz | Author | 303.583.8254 | pwaltz@polsinelli.com
- Evan M. Gilbert | Author | 602.650.2084 | egilbert@polsinelli.com
- William M. Schutte | 816.360.4115 | wschutte@polsinelli.com

William W. Mahood III,
Practice Area Chair
Kansas City
816.360.4350
wmahood@polsinelli.com

Donald Figliulo
Practice Area Vice Chair
Chicago
312.463.6311
dfigliulo@polsinelli.com

Zachary A. Abeles
St. Louis
314.889.7035
zabeles@polsinelli.com

Charles R. Berry
Phoenix
602.650.2030
cberry@polsinelli.com

Steven A. Bierly
Chicago
312.463.6346
sbierly@polsinelli.com

Ruben K. Chaquimia
St. Louis
314.622.6636
rchaquimia@polsinelli.com

Evan M. Gilbert
Phoenix
602.650.2084
egilbert@polsinelli.com

Phillip P. Guttilla
Phoenix
602.650.2327
pguttila@polsinelli.com

Larry K. Harris
St. Louis
314.889.7063
lharris@polsinelli.com

Tara J. Hawley
Kansas City
816.572.4687
thawley@polsinelli.com

Darren R. Hensley
Denver
303.583.8236
dhensley@polsinelli.com

Scott M. Herpich
Kansas City
816.360.4150
sherpich@polsinelli.com

Andrew T. Hoyne
St. Louis
314.552.6876
ahoyne@polsinelli.com

Sharon R. Nowakowski
Chicago
312.463.6313
snowakowski@polsinelli.com

Michael F. Patterson
Phoenix
602.650.2038
mfpatterson@polsinelli.com

Clifford R. Pearl
Denver
303.583.8246
cpearl@polsinelli.com

Jay E. Pietig
Kansas City
816.360.4183
jpietig@polsinelli.com

William E. Quick
Kansas City
816.360.4335
wquick@polsinelli.com

William M. Schutte
Kansas City
816.360.4115
wschutte@polsinelli.com

David A. Shipley
Dallas
214.661.5550
dshipley@polsinelli.com

Peter F. Waltz
Denver
303.583.8254
pwaltz@polsinelli.com

Tyler L. Weigel
Kansas City
816.572.4870
tweigel@polsinelli.com

Eric S. Wu
Kansas City
816.572.4580
ewu@polsinelli.com

About Corporate Finance & Securities

Polsinelli's Corporate Finance and Securities attorneys combine significant transactional capabilities and regulatory knowledge with experience across a range of industries to help our publicly traded and private company clients plan and execute capital-raising and M&A transactions, address complex disclosure and regulatory issues, and establish appropriate governance policies and practices. Our experience representing a variety of capital markets participants in a full range of financial transactions, including public and private issuers, underwriters and placement agents, allows us to deliver practical solutions to our clients.

Our significant experience and knowledge base allow us to quickly and efficiently address our clients' needs. Several of our attorneys have held positions at the SEC and state regulatory bodies, which gives us additional insight into the procedural and regulatory processes. We work closely with clients in a number of industries, including health care and life sciences, telecommunications, banking and financial services, manufacturing and energy. We learn and understand their businesses and strategic objectives to efficiently deliver timely, pragmatic advice that is tailored to their particular circumstances and satisfies their business and legal needs.

Polsinelli's attorneys have experience with a broad range of debt and equity capital markets transactions, including:

- Registered Public Offerings
- Private Placements
- Mergers, Acquisitions and Divestitures
- Going Private

Polsinelli is a trusted advisor to numerous public companies on all aspects of capital-raising transactions, SEC and FINRA compliance, New York Stock Exchange and NASDAQ listing standards, Sarbanes-Oxley, Dodd-Frank, and executive compensation disclosures.

About Polsinelli

real challenges. real answers.[SM]

Serving corporations, institutions, entrepreneurs, and individuals, our attorneys build enduring relationships by providing legal counsel informed by business insight to help clients achieve their objectives. This commitment to understanding our clients' businesses has helped us become the fastest growing law firm in the U.S. for the past five years, according to the leading legal business and law firm publication, The American Lawyer. Our more than 680 attorneys in 17 cities work with clients nationally to address the challenges of their roles in health care, financial services, real estate, life sciences and technology, energy and business litigation.

The firm can be found online at www.polsinelli.com. Polsinelli PC. In California, Polsinelli LLP.

About this Publication

If you know of anyone who you believe would like to receive our e-mail updates, or if you would like to be removed from our e-distribution list, please contact Kim Auther via e-mail at KAuther@polsinelli.com.

Polsinelli provides this material for informational purposes only. The material provided herein is general and is not intended to be legal advice. Nothing herein should be relied upon or used without consulting a lawyer to consider your specific circumstances, possible changes to applicable laws, rules and regulations and other legal issues. Receipt of this material does not establish an attorney-client relationship.

Polsinelli is very proud of the results we obtain for our clients, but you should know that past results do not guarantee future results; that every case is different and must be judged on its own merits; and that the choice of a lawyer is an important decision and should not be based solely upon advertisements.

Polsinelli PC. In California, Polsinelli LLP.