

Regulation Crowdfunding: Worth the Wait?

You've been waiting more than four years since Congress passed the JOBS Act to use equity crowdfunding to raise capital for your company. On May 16, 2016, the SEC's final crowdfunding rules under the Securities Act of 1933 finally go into effect ("Regulation Crowdfunding"). You're now ready to take advantage of the new rules and raise funds from a much larger pool of investors. But not so fast: there are important limitations to Regulation Crowdfunding that you'll want to consider carefully.

You're likely attracted to the structure of Regulation Crowdfunding because it provides your business with the ability to raise capital from a much larger group of people than could previously invest in your business. Namely, Regulation Crowdfunding allows issuers to raise up to \$1 million from both accredited and non-accredited investors in a given 12-month period, as opposed to traditional SEC registration exemptions which, absent extensive, cost-prohibitive disclosures, only allow for fundraising from wealthy, sophisticated investors who meet the financial qualifications of accredited investors.

In the United States, all offers and sales of securities must either be registered pursuant to the Securities Act, or qualify for an exemption. Section 4(a)(6) of the Securities Act imposes the following limitations and requirements for offerings to qualify for the Regulation Crowdfunding offering exemption:

- The amount raised cannot exceed \$1 million in 12 months.
- If the annual income or net worth of the individual investor is less than \$100,000, that investor may invest up to \$2,000, or 5% of his or her annual income or net worth, whichever is greater.
- If the annual income and net worth of the individual investor is at least \$100,000, that investor may invest up to an amount equal to 10% of his or her annual income or net worth, whichever is lower (not to exceed \$100,000).
- The offering may only be conducted through SEC-approved intermediaries known as "funding portals." These third parties are managed by registered broker-dealers and facilitate investments between the issuer and investors. Issuers may only use a single funding portal for any given crowdfunding transaction.
- Before any investing begins, the issuer must file the new Form C with the SEC.

Additionally, and particularly burdensome (i.e., expensive!), are the sliding scale financial disclosure requirements issuers must include in their public filing with the SEC: financial statements certified by an officer of the issuer if the total issuance is less than \$100,000; independent CPA-reviewed financial statements if the total issuance is between \$100,000 and \$500,000; and independent CPA-audited financial statements if the total issuance is between \$500,000 and \$1 million (first time issuers in this largest total issuance category may submit reviewed financial statements if audited statements are not available). Finally, Regulation Crowdfunding provides a comprehensive list of corporate information that must also be disclosed.

While it's clear that your company will have access to a larger group of potential investors with Regulation Crowdfunding, careful consideration should be made before diving in. The regulatory and disclosure obligations are undeniably more onerous than more traditional exemptions (such as the very limited disclosure requirements under Rule 506(b) of Regulation D, which is the exemption used in most private placements). Additionally, given the nature of crowdfunding, it is likely that an issuer funded via a crowdfunded campaign will have a large number of small investors. This could make structuring downstream venture capital financings more onerous (and perhaps less desirable). The regulatory obligations and other limitations, including dollar amounts that can be raised, truly raise the question of Regulation Crowdfunding's economic viability. In other words, it could cost a lot to raise a little!

Offerings made under a more traditional Regulation D exemption, like Rule 506(b), might still make more sense for your early-stage company than Regulation Crowdfunding. True, you generally won't be able to tap into the pool of non-accredited investors, but you'll be able to avoid the additional disclosure requirements, and you

generally won't have a dollar amount limitation on the amount that you raise.

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