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## SEC Adopts Final Equity Crowdfunding Rules

On October 30, 2015, the Securities and Exchange Commission (the “SEC”) voted to approve final rules on crowdfunding, marking the adoption of the last major provision of the 2012 Jumpstart Our Business Startups Act (the “JOBS Act”). The new rules for issuers and investors will become effective in the Spring of 2016. With its new Regulation Crowdfunding, the SEC will open the door for start-up companies to use the Internet to access a potentially huge pool of investors and will provide ordinary investors with the opportunity to participate in early stage investing. The SEC sought to balance investor protection with facilitating capital raising by including specific disclosure requirements and imposing limits on the dollar amounts that companies may raise and that investors may invest.

All Regulation Crowdfunding offerings must be effected online through an intermediary registered with the SEC. The intermediary must be a broker-dealer or “funding portal.” The new rules also provide the regulatory framework for these intermediaries, however, our focus here is on the new rules for issuers and investors. The requirements are summarized below.

### ISSUERS

**Eligibility**— Regulation Crowdfunding provides an exemption from the registration requirements of Section 5 of the Securities Act of 1933 (the “Securities Act”) for those issuers that qualify and comply with its requirements. Only certain issuers may take advantage of the new crowdfunding

rules. Ineligible companies include non-U.S. companies, companies that already file reports under the Securities Exchange Act of 1934 (the “Exchange Act”), certain investment companies, companies that are disqualified under Regulation Crowdfunding’s “bad actor” disqualification rules, companies that have failed to comply with the annual reporting requirements under Regulation Crowdfunding for two years, and certain companies that have no business plan or have indicated their business plan is to engage in a merger or acquisition with an unidentified company.

**Offering Limits**— The ceiling on the aggregate amount an issuer may sell under the exemption is currently set at \$1 million in any 12-month period. The SEC further clarified that the \$1 million cap only limits offerings under Regulation Crowdfunding, quieting concerns about whether capital raised under other exemptions would be included. Offerings under Regulation Crowdfunding will not be integrated with other exempt offerings, provided such other offerings comply with the applicable exemption requirements.

**Offerings Through One Intermediary; Restrictions on Advertising**— The SEC mandated that each issuer may only use one intermediary for each offering, confining the offering only to that intermediary’s online-only platform. The issuer is also limited to using an advertising notice that can only include: the existence of the offering, the name and link to the intermediary where

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the offering is being conducted, the offering terms and general information about the issuer.

**Disclosure Requirements** – Issuers conducting crowdfunding offerings will be required to file a disclosure statement with the SEC to provide specified information to investors and potential investors and the relevant broker-dealer or funding portal. The SEC created new Form C, which issuers will prepare and file to provide the required disclosures. The disclosure requirements will include, among other things:

- Information about the officers, directors and owners of 20% or more of the issuer's shares;
- Information relating to the issuer's business and anticipated business plan;
- Information about the issuer's intended use of proceeds from the offering;
- The terms of the offering: including price, nature and amount of the securities offered;
- Discussion of the issuer's financial condition and capital structure; and
- Financial statements, which will vary depending on the size of the offering.

**Financial Statements** – All issuers must include a complete set of their financial statements prepared in accordance with U.S. GAAP -- balance sheets, statements of comprehensive income, statements of cash flows, statements of changes in stockholders' equity and notes to the financial statements. These financial statements are required to cover the shorter of the two most recently completed fiscal years or the period since the issuer's inception. The following rules apply to the

financial statements included in a Form C filing:

- **For offerings of \$100,000 or less** – Financial statements must be certified by the principal executive officer of the issuer to be true and complete in all material respects. In addition, issuers in these offerings must disclose the amount of total income, taxable income and total tax, or the equivalent line items from the applicable form, exactly as reflected in its filed federal income tax returns, and have the principal executive officer certify that those amounts reflect accurately the information in the issuer's federal income tax returns. If an issuer has not yet filed a tax return and is not required to file a tax return before the end of the offering period, then the tax return information does not need to be provided. In the event that financial statements of the issuer are available that have either been reviewed or audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead, and need not include the information reported on the federal income tax returns or the certification of the principal executive officer.
- **Offerings of more than \$100,000 but not more than \$500,000** – Issuers must file and provide reviewed financial statements when offering more than \$100,000 but not more than \$500,000, however, if financial statements of the issuer are available that have been audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead.

- **Offerings of more than \$500,000** – Issuers that have previously sold securities in reliance on Regulation Crowdfunding that are offering more than \$500,000 are required to provide audited financial statements. First-time issuers who are offering more than \$500,000 are permitted to provide reviewed rather than audited financial statements, unless audited financial statements are otherwise available.

**Updates** – Regulation Crowdfunding also includes specific rules detailing the filing requirements for updates, amendments and ongoing reporting, including that an issuer amend its disclosure for any material change in the offer terms or disclosure previously provided to investors and that it provide annual reports within 120 days of the end of each fiscal year by posting these to its website. The annual report must disclose information about the company and its financial condition, as required in connection with the offer and sale of the securities. With regard to the financial statements to be included in an annual report, the financial statements must be certified by the principal executive officer of the issuer to be true and complete in all material respects, however, issuers that have available financial statements that have been reviewed or audited by an independent certified public accountant, because they prepare them for other purposes, must provide them and will not be required to have the principal executive officer certification. Issuers will be able to terminate their ongoing reporting obligations under certain circumstances, including after the issuer has filed at least one annual report and has fewer than 300 holders of record or the issuer has filed at

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least three annual reports and has total assets that do not exceed \$10 million.

*Exemption from Exchange Act Reporting* – Regulation Crowdfunding provides an exemption from the record holder count under section 12(g) of the Exchange Act for certain issuers of securities under the new rules. Generally, an issuer will be subject to the periodic reporting requirements under the Exchange Act if it has more than \$10,000,000 in total assets and a class of equity securities held of record by either: (i) 2,000 persons, or (ii) 500 persons who are not accredited investors. Under the new exemption, an issuer of securities pursuant to an offering under Regulation Crowdfunding will be exempted from the record holder count provided that the issuer is current in its ongoing annual reports required pursuant to Regulation Crowdfunding, has total assets as of the end of its last fiscal year of \$25 million or less and has engaged the services of an Exchange Act-registered transfer agent. Once an issuer has more than \$25 million in assets and exceeds the record holder limit threshold, provided it timely files its ongoing reports, the issuer will have a two-year transition period before it will be required to commence periodic reporting.

*Scope of Liability* – Issuers will be subject to antifraud rules in connection with their disclosures. An issuer could be liable to an investor if the issuer makes an untrue statement of a material fact or omits to state a material fact required to be stated or necessary in order to make the statements, in light of the circumstances they were made, not misleading. Accordingly, issuers should carefully draft their disclosures and vet all potential issues with counsel.

### INVESTORS

*Cap on Investments* – Regulation Crowdfunding imposes limits on the aggregate amount an investor may invest in all offerings relying on the crowdfunding exemption within a 12-month period across all issuers. The limits vary based on the investor's annual income and net worth.

An Investor whose annual income or net worth is less than \$100,000 may invest up to the greater of either:

- \$2,000 or
- 5% the lesser of their annual income or net worth.

An Investor whose annual income and net worth are both greater than \$100,000 may invest up to 10% of their:

- annual income or
  - net worth;
- whichever is less, subject to a total investment of \$100,000 during any 12-month period, regardless of an investor's annual income or net worth.

The SEC has not changed the rules for calculating an investor's annual income or net worth. They will be determined in accordance with the rules used to calculate an accredited investor's income or net worth, as set forth in Rule 501. One concern for start-ups and other small companies contemplating use of the crowdfunding exemption might be the administrative costs associated with verifying an investor's income or net worth. Those costs could be prohibitive to issuers attempting to conduct a small funding round. In recognition of this issue, the SEC adopted rules allowing

issuers to rely on an intermediary's due diligence on investors. An issuer of securities that violated the investor's individual investment limits in reliance on an intermediary would avoid liability if the issuer did not know of such violation.

*Holding Period* – An investor who purchases securities issued in a crowdfunding transaction may not sell such securities for a period of one year, unless sold:

- To the issuer of the securities;
- To an accredited investor;
- As part of an offering registered with the SEC; or
- To a member of the family of the purchaser or the equivalent, to a trust controlled by the purchaser, to a trust created for the benefit of a member of the family of the purchaser or the equivalent, or in connection with the death or divorce of the purchaser.

*The foregoing is only a summary of a complicated set of rules and we encourage you to discuss your questions and concerns with us. We look forward to hearing from you and to seeing the extent to which intermediaries will provide their platforms to facilitate equity crowdfunding and issuers and investors will embrace the new crowdfunding rules.*