



Regulation Crowdfunding Outline

December 5, 2013

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The following is an outline of proposed Regulation Crowdfunding (Reg CF), promulgated under Title III of the Jumpstart Our Business Startups (JOBS) Act of 2012. Reg CF is currently in a public comment period that runs through February 3, 2014. [Click here to submit a comment to the SEC.](#)

THE EXEMPTION

The JOBS Act and Reg CF create a new securities exemption pursuant to new Section 4(a)(6) of the Securities Act. The exemption contains the following conditions:

- An issuer (together with its affiliates) is limited to raising \$1M in a rolling 12 month period using Reg CF
- An individual investor is limited in the amount it can invest in a year based on its net worth or income

Greater of Net Worth or Income	Individual Investment Limit
<\$100,000	Greater of (i) \$2,000 or (ii) 5% of greater of net worth or income
\$100,000+	10% of greater of net worth or income

- An issuer can rely on the funding portal to determine individual investor limits
- Crowdfunding Offering through a single platform, which must be an internet website or similar electronic medium
- The following issuers cannot use Reg CF:
 - Disqualified Entities (i.e. bad actors)
 - Investment companies (i.e. no crowdfunds or holding companies)
 - Public companies
 - Merger special purpose vehicles
 - Crowdfunded issuers who previously failed to file required annual reports
 - Foreign issuers

ISSUERS

Disclosure Requirements. Issuers must file with the Commission (via Edgar) and provide to the portal and its investors, the following information:

- Identifying Information, including
 - a. Name, entity, address, website
 - b. Director and officers, including 3 year professional background of each
 - c. 20% shareholders
 - d. Number of employees
- Description of business and anticipated business plan
- Material Risk Factors
- Transaction Details:
 - a. Target Offering Amount and Deadline
 - Failure to hit target by deadline will cancel offering and return funds to investor
 - b. Maximum Offering Amount and allocation of oversubscriptions

- c. Intended Use of Proceeds
 - Adequate info to understand how they will be used)
 - “General corporate purposes” is probably not sufficient
 - Describe how any oversubscription would be used
 - Range of uses requires factors in decision process
- d. Process to complete transaction or cancel investment
 - Investor may cancel until 48 hours prior to deadline
 - Funding Portal will notify investors when target is hit
 - May close early if provides 5 days’ notice of new deadline
 - If do not cancel 48 hours prior to deadline, funds released to issuer in exchange for securities
- e. Material Change in Offering
 - Investor must reconfirm investment or subscription will be cancelled
- f. Price or method of determining price (final price to be disclosed)
- g. Description of ownership and capital structure of issuer
 - Terms of securities offered
 - Other classes of securities
 - Voting rights and limitations on voting rights
 - Differences between offered securities and each other class of security
 - How rights may be limited, diluted or qualified by rights of other classes
- h. Description of exercise of rights by principal shareholders could affect crowdfunders (i.e. anti-dilution, pre-emptive rights, pay-to-play)
- i. Description of how securities are being valued with examples
- j. Minority ownership risks, including
 - Dilution
 - Repurchases
 - Related parties transactions / sale of company
- k. Description of transfer restrictions
- l. CRD # of Intermediary
- m. Compensation Paid to intermediary, including referral or any other fees
- n. Material terms of any indebtedness of issuer (amount, interest rate, maturity date and any other material terms)
- o. Exempt offerings conducted in last 3 years
 - Date of offering
 - Exemption relied upon
 - Type of securities
 - Amount of securities sold and use of proceeds
- p. Description of insider transactions.
 - Exceeding 5% of offering amount since beginning of last full fiscal year
 - Between company and director, officer, promoter, 20% shareholder
- q. Description of Financial Condition of Issuer
 - Historical results of operations and whether indicative of future results
 - If no prior operating history, financial milestone and operational, liquidity and other challenges
 - Include impact of proceeds of offering on liquidity and necessity of funds for viability of business
 - Other sources of capital (i.e. lines of credit)
- r. Financial Statements
 - =<\$100,000 total, tax returns and financial statements of issuer, certified by officers as being true and complete in all material respects
 - >\$100,000 - \$500,000, financial statements reviewed by independent public accountant, using the Statements on Standards for Accounting and Review Services issued by Accounting and Review Services Committee of the American Institute of CPAs
 - >\$500,000, audited financial statements by a public accountant, using AICPA or PCAOB standards

- Threshold is based on aggregate amount previous sold in last 12 months + maximum offering amount of current transaction.
 - Includes balance sheet, income statement, statement of cash flows and changes in owner's equity and notes to financial statements prepared according to GAAP for last 2 fiscal years.
 - Copy of accounting reports must be provided in disclosure
 - Must include discussion of material changes to financial condition since financial statements
 - Any disqualifying events that occurred prior to effective date of rule (must make an inquiry about disqualifying events, i.e. bad actor questionnaires!)
- s. Updates regarding the progress of the issuer in meeting the target offering amounts

Ongoing Reporting Requirements

- Annual Reports. Must file on EDGAR and post to their website an annual report containing an updated version of all of the information required above (except for the transaction terms).
- File on new Form C, Offering Statement and Amendments
 - File with SEC, Portal prior to commencement of offering
 - File Amendments to Offering Statement
 - Progress Updates, five business days after reaches each of 50% and 100% of target offering
 - Final Form C-U to disclose total securities

Advertising

- No advertising directly or indirectly the terms of the offering except notices directing to platform
- Notices may be disseminated broadly through general solicitation in all media channels.
- Notice may contain:
 - Statement that issuer is conducting an offering
 - Terms of the Offering
 - Includes amount of securities offered, nature of the securities, the price of the securities and closing date of offering period.
 - Factual information about the legal identity and location of issuer
 - Name, address, phone number and website, the email address of a rep and brief description of the business of issuers
- Issuer may communicate about terms of the offering through platform provided communication channels (i.e. chatroom, FAQ, webcast) – must identify themselves as issuer

Promoter Compensation (for Issuers)

- Issuer can pay to promote an offering through the intermediary channels, but must clearly disclose receipt of communication together with any communication
- Founder or employee must identify themselves as such
- No off-platform promotion of issuer other than distribution of notices

INTERMEDIARIES

All crowdfunding offerings must take place through an intermediary, which can either be a registered broker-dealer, or a new entity, “funding portal.”

Intermediaries

- Must be registered with the Commission as a broker or as a funding portal
- Be a member of FINRA
- Intermediary or its director, officer, partner, etc. may not have a financial interest in an issuer
 - Portal shareholder/members may not be able to participate on platform
 - No carried interest for portal

Measures to Reduce Risk of Fraud

- Platform must have reasonable basis for believing issuer complies with regs
 - May rely on representations of issuer unless reason to believe otherwise
- Platform must have reasonable basis to believe issuer has means to keep accurate records of holders of securities it would offer
 - May rely on issuer representation
- Platform MUST deny access to issuer if
 - Reasonable basis to believe there is a disqualified party
 - Presents the potential for fraud or otherwise raises concerns regarding investor protection
 - It believes that it is unable to adequately or effectively assess the risk of fraud of the issuer or its potential offering
 - It becomes aware of information after granted access, must promptly remove from platform and cancel offering.

Account Opening

- Investor must open an account and consent to electronic delivery
- All information must be provided electronically via email, a link to platform or website or notice of information located on platform or website
- Educational Materials – at account opening
 - Plain language
 - Process for offer, purchase and issuance of securities through intermediary and risks associated
 - Types of securities offered, risks associated with each type of security including limited voting power resulting from dilution
 - Restrictions on resale
 - Information required from issuer
 - Investment limits
 - Right to cancel investment
 - May or may not be relationship with intermediary following closing
 - Educational materials must be available, any updates require sending an update to all investors prior to accepting additional transactions
- Promoters. Must inform investors that promoters must be disclosed in communications
- Must disclose compensation paid to platform

Requirements with respect to Transactions

- Platform must make all info available to SEC and Investors
- Must be allowed to save, store or download info
- Must be publicly available on platform for 21 Days before securities sold
- Must remain until closed or cancelled
- No login may be required to access information (i.e. must be public)

Investor Qualification

- Platform must have reasonable basis for believing investor satisfies individual maximum investment across platforms
 - May rely on investor representations with respects to annual income, net worth and amount of other investments
- Obtain from Investor:
 - Rep that has reviewed educational materials, understands entire investment may be lost and is in financial condition to bear the loss
 - Questionnaire completed demonstrating understanding that
 - Restrictions on investors ability to cancel investment and obtain a return of investment

- Difficult to resell securities
- Investing involves risks, should not invest unless you can afford to lose entire investment

Communications

- Platform must provide communication channels whereby persons can communicate about offerings with each other
- Funding Portals may not participate other than to establish guidelines and moderate
- Public access to communications channels to view only (no login walls)
- Posting allowed only by those who have opened an account
- Posters must disclose whether founder, employee or otherwise compensated

Notice of Investment Commitment

Platform promptly give or send notification of investment commitment, including

- Dollar amount of investment commitment
- Price of securities, if known
- Name of issuer
- Date and time by which investor may cancel

Maintenance and Transmission of Funds

- Broker-dealers must comply with BD rules
- Funding portals must direct investors to transmit funds to qualified third party that has agreed in writing to hold the funds for the benefit of, and to promptly transmit or return the funds to, the entitled persons.
- A qualified third party means a bank that has agreed in writing either to hold the funds in escrow for the persons who have the beneficial interests therein and to transmit or return such funds directly to the persons entitled thereto when so directed by the funding portal, or to maintain a bank account for the exclusive benefit of investors and the issuer.
- Funding Portal shall promptly direct the qualified third party to:
 - Transmit funds to issuer when aggregate investment commitments exceeds or is greater than the target and the cancellation period has elapsed (unless 21 day period has not elapsed)
 - Return funds to an investor when an investment commitment has been cancelled (including failure to obtain reconfirmation)
 - Return funds to investors when an issuer does not complete offering
- Confirmation of Transaction
 - Deliver notification of date of transaction, type of security, identity, price and number of securities purchased, number of securities sold by issuer and prices at which securities sold
 - If debt, interest rate and yield
 - If callable security, first date on which it may be called
 - Source and amount of remuneration received by platform, including from persons other than issuer
 - Exempt from BD confirmation requirements

Completion of Offerings, Cancellations and Reconfirmations

- Investor may cancel an investment commitment for any reason until 48 hours prior to deadline – not thereafter
- Early Completion – may close earlier so long as
 - 21 days have elapsed;
 - give investors 5 business days, notice of new closing date;
 - allow investors to cancel prior to 48 hours before new closing date;
 - notify investors whether they will continue to accept investments during final 48 hours; and
 - At time of new deadline, issuer continues to exceed target
- Material Changes to terms or disclosure

- Send notice to committed investors that investment will be cancelled unless reconfirmed within 5 business days
- Failure to reconfirm will cancel investments
- Upon cancellation, must send notice to investor of cancellation and reason and refund amounts
- If material changes occur within five business days of max number of days for an offering, must be extended for a period of five business days for an investor to reconfirm investment
- Return of Funds if Offering Not Completed
 - If an issuer does not complete an offering, platform must within 5 business days send notice of cancellation and refund amounts
 - Prevent investors from making investment commitments on that offering

Payments to Third Parties

- Cannot pay for Personally Identifiable Information of any investor (i.e. no buying lists)
- Can pay for directing issuers and investors to platform, cannot be transaction based compensation unless it's a BD
- PIN means info that can be used to distinguish or trace individuals identity

Funding Portal Regulation

- Must register with Commission via Form Funding Portal
- Must become member of FINRA or another national securities organization
- \$100k Fidelity Bond Required
- Foreign Portals Allowed
 - Information Sharing Arrangement with competent regulator in foreign jurisdiction
 - Written power of attorney appointing an agent in US who may be served with process
 - Opinion of Counsel
 - Access to Books and Records
 - Must submit to onsite examination

Exemption (Broker-Dealer)

- Funding Portals in compliance with above are exempt from federal broker-dealer regulation
- Still is "required to be registered" for purposes of the Act

Conditional Safer Harbors

- Statutory Restrictions
 - May not offer investment advice or recommendations, solicit purchases, sales or offers
 - May not compensate for solicitation based on sales
 - May not hold manage or possess or otherwise handle investor funds or securities
- May Limit Access by Objective Criteria
 - Criteria designed to result in broad selection, applied consistently, clearly displayed
 - May include type of securities, geographic location, industry or business segment
 - May not deny access based on advisability of investing in the issuer
- May Highlight Offerings by Objective Criteria
 - Designed to highlight broad selection of issuers, applied consistently, clearly displayed
 - Types of securities, geographic location, industry and business segment, investment commitments, progress in meeting the issuers target, maximum offering, min or max investment amount
 - May not highlight based on advisability
 - No special compensation for highlighting
- May provide search functions to sort by objective criteria
 - Objective criteria may not include, advisability of offering, assessment of characteristic of issuer, business plan, key management or risks of investment
- May provide communication channels by which investors can communicate with one another
 - Portal may not participate in discussions – other than establishing guidelines

- Permits public viewing
 - Restricts posting of comments to account holders
 - Require disclosure of poster interests (i.e. founder, employee, promoter, paid)
- May advise issuer about the structure or content of the issuers offering, including assisting the issuer in preparing offering documentation.
- May compensate a third party for referring a person to the funding portal, so long as not providing PIN and compensation is not transaction based (other than to a BD)
- May pay or offer to pay any compensation to a registered broker for services in connection with sale of offering, provided that
 - Pursuant to written agreement
 - Permitted under Regulation Crowdfunding
 - Doesn't violate FINRA rules
- May receive any compensation from a registered BD for services provided
 - Written Agreement
 - Permitted under Reg CF
 - Complies with FINRA rules
- Advertise the existence of the funding portal and identity of issuers or offerings on portal on basis of objective criteria
- Deny access to its platform or cancel offering, portal believes may present potential for fraud
- Accept, on behalf of an issuer, an investment commitment for securities offered by that issuer on funding portals platform
- Direct investors where to transmit funds or remit payment in connection with purchase of securities
- Direct a qualified third party to release proceeds to issuer or return proceeds to investors in the event an investment commitment or offering is cancelled

Compliance

- Must implement policies reasonably designed to achieve compliance
- Anti-money laundering compliance
- Must comply with BD level privacy
- Permit examinations

Books and Records

- Preserve records for five years, first 2 in easily accessible place
- Records related to an investor who purchases or attempts to purchase securities through the portal
- Records related to issuers who offer and sell or attempt to offer and sell securities through the funding portal and the control persons of such issuers
- Records of all communications occurring on or through platform
- All records related to promoters
- All records required to demonstrate compliance
- All notices provided by funding portals
- All written agreement entered into by funding portal
- All daily, monthly, quarterly summaries of transactions effected through portal, including
 - Successful issuers & amounts distributed
 - Transaction volume
 - Number of transactions
 - Number of securities involved
 - Total amounts raised by and distributed to issuers
 - Total dollars amounts raised across issuers
- A log reflecting progress of each issuers towards target
- Organizational documents of funding portal
- Must be maintained and preserved in original form as they were created

- Third parties may maintain records, but will not relieve duty of portal. Must file agreement with FINRA
- Subject to examination, random, periodic
- Financial Reporting of Foreign Currency

Restrictions on Resale

- Securities issued pursuant to a crowdfunding exemption may not be transferred for 1 year after purchase except to the issuer, an accredited investor, in a registered offering or for estate planning purposes.

Insignificant Deviations

- Failure to comply with a term of Reg CF will not lose exemption if issuer shows:
 - Failure to comply with insignificant with respect to offering as a whole
 - Issuer made a good faith and reasonable attempt to comply with all applicable terms; and
 - Did not know of such failure where the failure was result of portal and was not related to issuers offering
 - SEC can still bring enforcement action (i.e. this only valuable for private actions)

Disqualification

- No exemption if issuer, predecessor, affiliated issuer, director, officer, general partner or managing member of the issuer; any beneficial owner of 20% or more, any promoter connected with the issuer in any capacity at time of sale, any person paid to solicit or any affiliate of solicitor (“Covered Person”):
 - Has committed a felony or misdemeanor in connection securities, making false filing with commission, arising out of securities business
 - Is subject to decree re securities
 - Is subject to final order of a state securities commission, etc.
- Reasonable care exemption if issuer did not know and, in the exercise of reasonable care, could not have known that a disqualification existed because of the presence or participation of another covered person
 - Must do bad actor questionnaire/diligence

Form C Requirements

- Must file Form C prior to offering and include material required in 201
- Screenshots may be included
- Include standard legends
- Must disclose in offering statement that it will file a report on EDGAR annually and post the report on its website
- Annual report no later than 120 days after end of fiscal year
- Must be signed by issuer, its principal executive officer, its principal financial officer, its controller and at least a majority of the board of directors

LIABILITY

Issuer Liability

- Issuers, including their directors and officers, are liable to purchasers of securities for untrue or materially misleading statements in their offering documents.
- Does not apply if purchaser knew of the untruth or omission
- Issuers bear the burden of proof to show that they did not know, and in the exercise of reasonable care could not have known, of the untruth or omission.
- Personal liability could attach to directors and officers of issuer

Portal Liability

- Issuer is broadly defined to include “any person who offers or sells the security in such offering,” which would capture
 - Funding portal

- Funding portal's directors and officers and any employees involved in the offering
- Intermediary must use reasonable care in reviewing offering document, including establishing a reasonable policy to avoid misstatements and untruths.
- Personal liability could attach to directors, officers and employees of funding portal

Damages

- Limited to amount paid by purchaser plus interest
- Purchaser may no longer hold security in order to bring suit
- Will be subject to the provisions of Securities Act Sections 12(b) and 13, as though the liability were created under Securities Act Section 12(a)(2).

STATE LAW

Under the JOBS Act and Reg CF, the individual states are pre-empted from requiring state registration of crowdfunding securities, subject to the following:

- States can still enforce for fraud or deceit by issuers, brokers or funding portals
- May impose fees in the home state of the issuer or where more than the half purchaser are located
- Home state may regulate, but not impose different or additional rules
- No information must be provided to state, but access to EDGAR

About SeedInvest

SeedInvest is a technology company that powers private funding platforms for angel groups, venture capital funds, private equity funds, incubators and accelerators, investment banks and industry organizations. With no software customization, coding or detailed setup required, groups can create their own private investment platform where they can privately invite and manage their members, verify accredited investor status, invite and manage potential issuers, propose investment transactions, facilitate discussion and due diligence, electronically sign transaction documents, fund investments into an escrow account and close such investment transactions. Groups can also seamlessly syndicate deals to other groups on or off the SeedInvest network.



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