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PERSPECTIVE

Securities crowdfunding rules go live

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The Securities and Exchange Commission recently adopted rules to permit securities crowdfunding under the JOBS Act of 2012. The final rules, referred to as "Regulation Crowdfunding," took effect on Monday.

Navigating the new requirements of Regulation Crowdfunding will be challenging for investors and companies alike, and each must weigh if this new form of financing is worthwhile. Below are four key questions for entrepreneurs to consider as they explore whether to use this new form of financing.

Is my company eligible to use Regulation Crowdfunding?

Yes, with some noteworthy exceptions. Your company must be a U.S. company, and it cannot be one that already reports under the Securities Exchange Act of 1934. Certain types of investment companies, shell companies and companies that have failed to comply with the annual reporting requirements of Regulation Crowdfunding are also disqualified. Lastly, if your company or any of the key individuals involved with your company is a "bad actor," (they have a relevant criminal conviction, regulatory or court order or other disqualifying event), your company is disqualified.

Will there be substantial costs?

The legal, accounting and administrative requirements are likely to be costly. You will be required to file with the SEC before starting a Regulation Crowdfunding offering. The filing form requires extensive information which will be publicly available including, but not limited to, the names of your company's directors and officers, its anticipated business plan, and a discussion of its financial condition, including a description of the company's existing debt and risk factors that could make an investment in the company risky. The company will need to file annual financial statements prepared in accordance with US GAAP, which may need to be audited.

The company also will be required to publicly file, on an annual basis, reports covering most of the original information requiring disclosure above, updated in all respects as applicable, by no later than 120 days after the end of each fiscal year. For the most part, a company will be required to continue to publicly file annual reports each year until it becomes public, repurchases all securities issued pursuant to the crowdfunding exemption, or liquidates or dissolves.

In addition, the company will be required to publicly file progress reports and other reports disclosing material changes, additions or updates to information that it provides to investors for any offering that has not yet been completed or terminated.

Navigating the new requirements of Regulation Crowdfunding will be challenging for investors and companies alike, and each must weigh if this new form of financing is worthwhile.

How much will I be able to raise?

Generally, qualifying companies may raise up to $1 million in a 12-month period. However, there are limitations placed on individual investors.

An individual with an annual income or net worth less than $100,000 may invest the greater of $2,000 or 5 percent of the lesser of their annual income or net worth in all Regulation Crowdfunding offerings in a year. An individual with an annual income or net worth equal to or more than $100,000 may invest 10 percent of the lesser of their annual income or net worth, subject to a maximum aggregate investment of $100,000. These limitations mean that, if Regulation Crowdfunding is utilized, a company's administrative costs are likely to increase as a result of having to negotiate with many potential investors and communicate on an ongoing basis with a larger pool of stockholders.

Offerings must be held open for a minimum of 21 days during which investment commitments may be accepted. Potential investors are permitted to cancel their investment commitments until 48 hours prior to the deadline specified by the company for any reason.

Will I be able to advertise my offering?

Advertising is limited. All Regulation Crowdfunding transactions must take place on an internet platform, exclusively through an SEC-registered "intermediary." A company may only conduct a crowdfunded offering through one intermediary's platform at a time.

Any advertisement or public announcements regarding a crowdfunded offering, whether made by the company or by someone acting on behalf of the company, must be limited to the following:

* A statement that the company is conducting an offering, the name of the intermediary through which the offering is being conducted and a link to its platform;

* The terms of the offering (limited to amount of securities offered, nature of securities, price and closing date); and

* Contact information for the company and a brief description of the business of the company.

If a company hires a promoter to promote an offering, the company must ensure the promoter clearly discloses the receipt of compensation in each promotional communication. If the promoter's communications occur outside of the intermediary's platform, they will be subject to the same content restriction that companies face.

Entrepreneurs will have to weigh the substantial costs against the potential benefits to determine if crowdfunding is right for them. When Congress adopted the JOBS Act in April 2012, many budding entrepreneurs rejoiced at the prospect of easier and quicker access to capital to help turn their ideas into money-making ventures. These entrepreneurs envisioned joining their tech-savvy competitors and colleagues in the new world of crowdfunding, where startups vie for average investors' dollars through website offerings unencumbered by the strict rules and regulations that govern other types of financings. In an economic environment in which traditional paths to capital for entrepreneurs, such as small business loans, can be difficult to access, crowdfunding appeared to offer an attractive alternative.

Despite its theoretical promise, the balance between facilitating broader and meaningful access to the capital markets for smaller companies and providing adequate protections for a large group of new and potentially unsophisticated investors has proved to be a hard one to strike. While Regulation Crowdfunding seeks to liberalize the ways in which a company can raise money and open the door to a wide variety of investors, the burdens of reporting requirements and the limitations on advertising may make Regulation Crowdfunding a less attractive option.

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