

SECURITIES REGULATION AND COMPLIANCE ALERT

SEC ADOPTS CROWDFUNDING RULES

On October 30, 2015, the SEC adopted rules permitting companies to sell stock, debt instruments, and other securities through crowdfunding. These long-awaited rules, originally proposed over two years ago, have the potential to reduce the cost and increase the availability of investment capital for early-stage and emerging growth companies. Due to the conditions and obligations the SEC has imposed, however, the process of raising investment funds through crowdfunding will not be as simple as other types of crowdfunding activities.

The SEC's 686 page adopting release containing the crowdfunding rules can be found at: <http://www.sec.gov/rules/final/2015/33-9974.pdf>

Investment Crowdfunding Not Permissible Until at least May 2016

Raising investment capital through crowdfunding must be done in compliance with the SEC's new Regulation Crowdfunding. Using other means of selling securities through crowdfunding will likely violate securities laws and other SEC rules, which generally prohibit public solicitation of investments unless the company has gone through the long and expensive process of registering its securities with the SEC. The new SEC rules are not effective until six months after publication in the Federal Register. Therefore, selling securities through crowdfunding will not be permissible until May 2016.

In addition, investment crowdfunding will only be permitted on facilities set up by a registered broker-dealer or a crowdfunding portal. Crowdfunding portals must register with the SEC. Forms for portal registration are not expected to be available until January, and we don't know how long the registration process will take. It is possible that registered portals and broker-dealer crowdfunding facilities will not come on-line until later than May 2016.

Limitation on Amounts Raised

A company may raise up to \$1 million in regulated crowdfunding transactions in a 12-month period.

Obligations of Companies Seeking to Raise Funds Through Crowdfunding

While the new regulations will remove the requirement that a company register its securities with the SEC prior to publicly soliciting investment funds through crowdfunding, companies will not be free from interaction with the SEC.

- Prior to listing on a crowdfunding portal or facility, a company will need to file certain information with the SEC, and the portal or broker-dealer, on new Form C. This information will include:
 - Information about the pricing, timing, and size of the offering, including how the offered securities are being valued
 - Discussion of the company's business, financial condition and resources, and the planned use of the investment proceeds
 - The terms of the securities offered and all other securities of the company

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- Identities of, and other information about, the company's officers and directors as well as any holder of 20 percent or more of the company's equity
 - Risk factors associated with an investment in the company
 - Financial statements prepared in accordance with Generally Accepted Accounting principles. If the company is raising less than \$100,000, the financial statements need only be certified by an officer of the company; if the company is raising more than \$100,000 but less than \$500,000, the financial statements must be reviewed by an independent public accountant. If the company is raising \$500,000 or more, the financial statements must be reviewed if it is the first time the company is raising funds; after the first time a company raises funds, financial statements for an offering of \$500,000 or more must be audited
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- The company must give periodic progress reports on its offering and make a filing with the SEC to report the total funds raised ultimately raised.
 - If the company raises any investment funds through crowdfunding, it must file an annual report with the SEC, and post the annual report on the company's website, within 120 days after its fiscal year end.

Other Requirements, Restrictions, and Provisions

- A company may only conduct crowdfunding activities on one portal or broker-dealer facility at a time.
- Investors are limited in the aggregate amounts they may invest in all crowdfunding offerings in any year. The absolute limit is \$100,000 per year, but individuals whose net income and net worth is below \$100,000 are subject to a limit of the greater of \$2,000 or 5 percent of their net worth.
- Companies that file reports with the SEC under the Securities Exchange Act of 1934 (most publicly traded companies), foreign companies, shell or blank check companies and companies that have not complied with certain SEC rules are not eligible to use crowdfunding.
- Companies generally will not need to comply with any state rules if they comply with the SEC's crowdfunding rules (but states can still enforce anti-fraud rules).

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