



The New "Crowdfunding" Exemption from Securities Registration

April 5, 2012

Part of the Jumpstart Our Business Startups Act (the "JOBS Act") passed by Congress and signed into law by the President on April 5, 2012, exempts "crowdfunding" from the registration requirements for securities offerings under the Securities Act of 1933 (the "Securities Act"). Crowdfunding refers to private companies raising relatively small amounts of money from a potentially large number of investors often via the internet, as we discussed in our Lathrop Gage Alert dated October 6, 2011.

Eligible Companies

The crowdfunding exemption is limited to issuers that are private companies – i.e., not subject to the reporting requirements of the Securities Exchange Act of 1934 (the "Exchange Act") – and organized under the laws of a U.S. State or territory or the District of Columbia. However, investment companies, other specifically excluded companies, and companies subject to "bad actor" disqualifications may not issue securities under the crowdfunding exemption.

Offerings Limited to \$1 Million

For an issuance of securities to be exempt from registration under the crowdfunding exemption:

- The aggregate amount of securities sold to **all** investors by the issuer, including any amount sold in reliance on the crowdfunding exemption during the 12-month period preceding the date of the issuance, **may not exceed \$1 million**; and
- The aggregate amount of securities sold to **any** investor by the issuer, including any amount sold in reliance on the crowdfunding exemption during the 12-month period preceding the date of the issuance, may not exceed:
 - The greater of **\$2,000 or 5%** of the investor's annual income or net worth, if the investor's annual income or net worth is less than **\$100,000**; or
 - **10%** of the investor's annual income or net worth, not to exceed a maximum aggregate amount of **\$100,000** sold to the investor, if the investor's annual income or net worth is at least **\$100,000**.

Crowdfunding Requires Using a Registered Intermediary



An issuance of securities under the crowdfunding exemption must be conducted through an “intermediary,” which must:

- Register with the Securities and Exchange Commission (the “SEC”) either as a broker or as a “funding portal,” and also register with any applicable self-regulatory organization;
- Take steps to ensure that investors understand their risks, including the risk of loss of their entire investment, the risk of illiquidity, and the general level of risk applicable to investments in small businesses;
- Take measures (to be specified in SEC rulemaking) to prevent fraud, including background and regulatory checks on the issuer’s officers, directors, and 20% equity holders;
- Take measures (to be specified in SEC rulemaking) to ensure that investors do not purchase more than the maximum amount of securities during any 12-month period; and
- Not pay promoters, finders, or lead generators; Protect investor information; Avoid conflicts of interest; And meet any other requirements to be specified in SEC rulemaking.

Issuer Disclosures

An issuer of securities under the crowdfunding exemption must file with the SEC, and provide to its investors, potential investors, and intermediary, the following information:

- Identifying information about itself and its directors, officers, and 20% equity holders;
- A description of its business and anticipated business plan;
- A description of the financial condition of the issuer, including – for offerings that, together with all other offerings of the issuer under the crowdfunding exemption within the preceding 12-month period, have in the aggregate target offering amounts of:
 - **\$100,000 or less** – the issuer’s most recently filed annual income tax returns, if any, and financial statements certified by the issuer’s principal executive officer;
 - **Over \$100,000 up to \$500,000** – financial statements reviewed by an independent public accountant; or
 - **More than \$500,000** – audited financial statements;
- The stated purpose of the offering and intended use of the proceeds;
- The target offering amount, the deadline for reaching it, and regular progress updates;
- The price of the securities to the public or the method of determining the price (and, prior to the sale, the final price in writing to each investor, who may rescind the purchase); and
- A description of the ownership and capital structure of the issuer.

Transfer Restrictions



Securities issued under the crowdfunding exemption may not be transferred by the purchaser during the one-year period beginning on the date of purchase, except:

- To the issuer; To an accredited investor; In a registered offering; or
- To a family member (or the equivalent) of the purchaser, or in connection with the death or divorce of the purchaser or other similar circumstance.

The statutory crowdfunding exemption is not self-executing, so it will become effective once the SEC issues final rules, which are due within 270 days after the enactment date. To discuss this alert or any securities law matter, please contact your Lathrop Gage attorney or any of the attorneys listed on this alert.