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SEC FINALIZES REGULATION CROWDFUNDING

The United States Securities and Exchange Commission has issued final rules on Regulation Crowdfunding. Our summary is set forth below. The final rules and forms are effective 180 days after publication in the Federal Register, except provisions related to Form Funding Portal and the amendments to Form ID are effective January 29, 2016.

Crowdfunding Exemption

Limitation on Capital Raised

The exemption from registration provided by Section 4(a)(6) is available to a U.S. issuer provided that the aggregate amount sold to all investors by the issuer in reliance on the exemption provided under Section 4(a)(6) during the 12-month period preceding the date of such transaction, is not more than $1,000,000. Capital raised through means other than the crowdfunding exemption is not counted towards the $1,000,000 maximum.

The SEC believes that an offering made in reliance on Section 4(a)(6) should not be integrated with another exempt offering made by the issuer, provided that each offering complies with the requirements of the applicable exemption that is being relied upon for the particular offering. An issuer could complete an offering made in reliance on Section 4(a)(6) that occurs simultaneously with, or is preceded or followed by, another exempt offering. An issuer conducting a concurrent exempt offering for which general solicitation is not permitted, however, would need to be satisfied that purchasers in that offering were not solicited by means of the offering made in reliance on Section 4(a)(6). Similarly, any concurrent exempt offering for which general solicitation is permitted could not include an advertisement of the terms of an offering made in reliance on Section 4(a)(6) that would not be permitted under Section 4(a)(6) and the final rules.

The amount of securities sold in reliance on Section 4(a)(6) by entities controlled by or under common control with the issuer must be aggregated with the amount sold by the issuer in the current offering to determine the amount sold in reliance on Section 4(a)(6) during the preceding 12-month period. In determining whether an entity is "controlled by or under common control with" the issuer, an issuer must consider whether it possess, directly or indirectly, the power to direct or cause the direction of the management and policies of the entity, whether through the ownership of voting securities, by contract or otherwise, consistent with the definition of "control" in Securities Act Rule 405.

Additionally, the amount of securities sold in reliance on Section 4(a)(6) also includes securities sold by a predecessor of the issuer in reliance on Section 4(a)(6) during the preceding 12-month period.

Investment Limitation

Under Section 4(a)(6)(B), the aggregate amount sold to any investor by an issuer, including any amount sold in reliance on the exemption during the 12-month period preceding the date of such transaction, cannot exceed:

- if either annual income or net worth is less than $100,000, the greater of $2,000 or 5 percent of the lesser of the investor's annual income or net worth; or
- if both annual income and net worth are $100,000 or more, 10 percent of the lesser of the investor's annual income or net worth, not to exceed an amount sold of $100,000.

Additionally, during the 12-month period, the aggregate amount of securities sold to an investor through all crowdfunding offerings may not exceed $100,000. Issuers are allowed to rely on efforts that an intermediary is required to undertake in order to determine that the aggregate amount of securities purchased by an investor does not cause the investor to exceed the investment limits as a result of purchasing securities in the issuer's offering, provided that the issuer does not have knowledge that the investor had exceeded, or would exceed, the investor limits as a result of purchasing securities in the issuer's offering.

The rules require a natural person's annual income and net worth to be calculated in accordance with the SEC's rules for determining accredited investor status. An investor's annual income and net worth may be calculated jointly with the income and net worth of the investor's spouse. However, when such a joint calculation is used, the aggregate investment of the spouses may not exceed the limit that would apply to an individual investor at that income and net worth level.

Transactions Conducted Through an Intermediary

Under Section 4(a)(6)(C), a transaction in reliance on Section 4(a)(6) must be "conducted through a broker or funding portal that complies with the requirements of [S]ection 4A(a)." Additionally, for any transaction conducted in reliance on Section 4(a)(6), an issuer must use only one intermediary (that complies with the requirements of Section 4A(a) and the related requirements in Regulation Crowdfunding) and the transaction must be conducted exclusively on the intermediary's platform. The rules require an issuer to use only one intermediary because:

- The SEC believes a central tenet of the concept of crowdfunding is presenting members of the crowd with an idea or business so members of the crowd can share information and evaluate the idea or business. Allowing an issuer to conduct a single offering or simultaneous offerings in reliance on Section 4(a)(6) through more than one intermediary would diminish the ability of the members of the crowd to effectively share information, because, essentially, there would be multiple "crowds."
- Due to differing practices among intermediaries, were multiple intermediaries to conduct a single offering or simultaneous offerings, this could result in significant differences among such offerings and the information available to the crowds.
- Allowing an issuer to conduct an offering using more than one intermediary would make it more difficult for intermediaries to determine whether an issuer is exceeding the $1 million aggregate offering limit.

Although the statute does not expressly require it, the SEC believes that in enacting Section 4(a)(6)(C), Congress contemplated that crowdfunding transactions made in reliance on Section 4(a)(6) and activities associated with these transactions would occur over the Internet or other similar electronic medium that is accessible to the public. The SEC believes that an "online-only" requirement enables the public to access offering information and share information

publicly in a way that will allow members of the crowd to decide whether or not to participate in the offering and fund the business or idea. The rules require that an intermediary, in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6), effect such transactions exclusively through an intermediary's platform.

The SEC defines the term "platform" to mean "a program or application accessible via the Internet or other similar electronic communication medium through which a registered broker or a registered funding portal acts as an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6))".

Exclusion of Certain Issuers from Eligibility under Section 4(a)(6)

These following issuers are excluded from relying on the crowdfunding exemption:

- issuers not organized under the laws of a state or territory of the United States or the District of Columbia;
- issuers that are subject to Exchange Act reporting requirements;
- investment companies as defined in the Investment Company Act or companies that are excluded from the definition of investment company under Section 3(b) or 3(c) of the Investment Company Act;
- any issuer that has sold securities in reliance on Section 4(a)(6) if the issuer has not filed with the Commission and provided to investors, to the extent required, the ongoing annual reports required by Regulation Crowdfunding during the two years immediately preceding the filing of the required new offering statement;
- issuers subject to the "bad boy" disqualifiers in Section 302(d) of the JOBS Act; and
- any issuer that has no specific business plan or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies.

Issuer Requirements

Offering Statement Disclosure Requirements

The final rules under Regulation Crowdfunding create new Form C that issuers will use to file the required disclosures and related information with the SEC. Form C itself will be filed in the standard format of eXtensible Markup Language (XML), but the SEC is not mandating any specific media format for any and all attachments or exhibits to the offering statement.

Issuer Information; Officer and Directors; and Certain 20% Beneficial Owners

The SEC has adopted the issuer, officer and director, and 20% beneficial owners disclosure requirements largely as proposed. Issuers must identify these persons "as of the most recent practicable date, but no earlier than 120 days prior to the date the offering statement or report is filed." As opposed to Regulation A required disclosures, Regulation Crowdfunding disclosures related to the business experience of directors and officers must only cover the previous three, rather than five, years. Additionally, issuers offering securities under the Regulation Crowdfunding regime must disclose their website address. The SEC believes that given the

Internet-based nature of Crowdfunding, all issuers will have websites or will be able to create them at a small cost. *Business Plan and Use of Proceeds*

The SEC did not modify Rule 201(d) with regard to the requirements that the issuer disclose information about its business and business plan. The final requirement, therefore, is very flexible and issuers will be allowed to tailor their disclosures according to their particular business and stage of development.

As adopted in the final rules, the use of proceeds disclosure will require issuers to provide a reasonably detailed description of the purpose of the offering, such that investors will be able to understand how the proceeds will be used by the issuer. According to the SEC, instead of providing formulaic requirements, the key for this disclosure is for issuers to provide the appropriate level of detail to potential investors so they will be able to make an informed decision.

Target Offering Amount and Deadline

The final disclosure rule related to the target offering amount is unmodified from the proposed rule. Under this rule, issuers will be required to disclose both the target offering amount as well as the total amount it will be willing to accept. Therefore, for example, if an issuer sets a target amount of $100,000 but is willing to accept up to $1,000,000, the issuer must disclose both amounts in its offering statement.

Additional Disclosures

Rule 201 contains a lengthy list of additional factual and business information that must be disclosed by the issuer to the SEC and the intermediary, including information on such topics as identities of intermediaries, intermediary compensation, legends, employee statistics, risk factors, indebtedness, and related-party transactions. For the most part, the disclosure requirements detailed in the proposed rules have been adopted with minimal modifications. The most noteworthy modifications from the proposed rules are summarized below.

- An added Rule 10b-5 type requirement to "disclose any material information necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."
- Modification of the required disclosure of the compensation to be paid to the intermediary so that it may be disclosed either as a dollar amount, percentage of the offering amount or as a good faith estimate if the exact amount is not available at the time of the filing.
- An added requirement to disclose the location on an issuer's website where prospective investors will be able to access the issuer's annual report (including the date on which the report will be available).
- An added requirement to disclose whether the issuer or any of its predecessors had previously failed to comply with ongoing reporting requirements of Regulation Crowdfunding.

Discussion of Financial Condition and Financial Disclosures

The SEC has only made a few technical clarifications to the proposed rules regarding the discussion of financial condition and financial disclosures. The SEC notes that the discussion should focus, to the extent material, on the issuer's operational history as well as its liquidity and capital resources. Additionally, issuers should explain their access to other sources of capital, such as lines of credit, to the extent these disclosures do not overlap with the discussion of business or business plan.

The SEC has modified the requirements on financial disclosures in the final rules. The disclosure requirements are based on the amount of securities offered and sold. The following list of requirements has been reproduced from the final rules release:

- For issuers offering $100,000 or less: disclosure of the amount of total income, taxable income and total tax as reflected in the issuer's federal income tax returns certified by the principal executive officer to reflect accurately the information in the issuer's federal income tax returns (in lieu of filing a copy of the tax returns), and financial statements certified by the principal executive officer to be true and complete in all material respects. If, however, 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.
- Issuers offering more than $100,000 but not more than $500,000: financial statements reviewed by a public accountant that is independent of the issuer. If, however, 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 and need not include the reviewed financial statements.
- Issuers offering more than $500,000: For issuers offering more than $500,000 but not more than $1 million of securities in reliance on Regulation Crowdfunding for the first time: financial statements reviewed by a public accountant that is independent of the issuer. If, however, 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 and need not include the reviewed financial statements.
- For issuers that have previously sold securities in reliance on Regulation Crowdfunding: financial statements audited by a public accountant that is independent of the issuer.

In order for a public accountant to be "independent" from the issuer, one of two conditions must be satisfied: (a) the public accountant complies with the SEC's independence rules set forth in Rule 2-01 of Regulation S-X, or (2) the public accountant complies with the independence standards of AICPA. Finally, it should be noted that the final rules confirm that no issuers is exempt from the financial statement requirements under any circumstances.

Progress Updates

The major change from the proposed crowdfunding rules related to progress statements is that, under the final rules, issuers may satisfy the progress updating requirements by "relying on the

relevant intermediary to make publically available on the intermediary's platform frequent updates about the issuer's progress toward meeting the target offering amount." When the issuer decides to close the offering, they will still be required to file Form C-U with the SEC, as contemplated in the proposed rules.

On-Going Reporting Requirements

Under the final rules, issuers will be required to file annual reports with the commission within 120 days of the end of the fiscal year covered in the report. The rules also require issuers to post these annual reports on their websites. As opposed to the high level of public accountant involvement in preparing financial statements in connection with the offering statement, the SEC has relaxed the level of involvement for financial statements included with the annual reports. The final rules only require the issuer's principal executive officer to certify that the financial statements are true and complete in all material respects. Apart from the diminished requirements for annual report financial statements, however, all other information contained in the offering statement must be included in the crowdfunding issuer's annual reports.

With regard to the final rules on termination of the on-going reporting requirement, the SEC adopted as proposed the three circumstances as previously drafted and added two additional circumstances that will trigger the end of the on-going reporting obligation. The circumstances that will end the on-going reporting requirement are: (a) when the issuer is required to file Exchange Act reports; (b) when the issuer has filed at least one annual report and has fewer than 300 holders of record; (c) when the issuer has filed at least three annual reports and has total assets that do not exceed $10 million; (d) when the issuer or another party purchases or repurchases all of the securities issued pursuant to the crowdfunded offering, including repayment in full of all debt securities; or (e) the issuer liquidates or dissolves in accordance with state law.

Form C and Filing Requirements

The final rules related to Form C and the related filing requirements largely parrot the proposed rules. The SEC, however, did make a few changes worth noting. First, as alluded to above, all exhibits required or permissible under the rules will be allowed to take the portable document format ("PDF") as official filings. Second, the proposed Form C-A to be used for amendments to the offering statement has been changed in name to Form C/A in order to remain consistent with the SEC's other form-naming conventions. Third, a new Form C-AR/A will be available for issuers when amending annual reports. Fourth, the XML-based portion of Form C will require issuers to check applicable boxes indicating the state jurisdiction in which it plans to offer securities, with the justification that including such information will aid state authorities who still maintain antifraud authority over crowdfunding offerings. Fifth, an optional Q&A section has been added to Form C that will afford issuers the option to include information not required to be included in the XML format all in one place.

Prohibition on Advertising Terms of the Offering

The final crowdfunding rules related to the prohibition on advertising the offering terms will look familiar to those who read the proposed rules carefully. Crowdfunding advertising notices may only include the following information:

- A statement that the issuer is conducting an offering, the name of the intermediary through which the offering is being conducted and a link directing the investor to the intermediary's platform;
- the terms of the offering; and
- factual information about the legal identity and business location of the issuer, limited to the name of the issuer of the security, the address, phone number and website of the issuer, the e-mail address of a representative of the issuer and a brief description of the business of the issuer.

The "terms of the offering" only include: (a) the amount of securities offered; (b) the nature of the securities; (c) the price of the securities; and (d) the closing date of the offering period. Although these are substantially similar to "tombstone ads" under Securities Act Rule 134, the permitted crowdfunding notices will require a statement (for example, a hyperlink) directing the investor to the intermediary's online platform.

Although the content of information an issuer may disseminate in a notice is admittedly limited, the SEC will not regulate the medium through which the notice is transmitted. Therefore, in the view of the SEC, "the final rules will allow issuers to leverage social media to attract investors, while at the same time protecting investors by limiting the ability of issuers to advertise the terms of the offering without directing them to the required disclosure."

Additionally, the final rules permit the issuer to communicate directly with investors about the terms of the offering through the channels provided on the intermediary's platform, as long as the issuer clearly identifies itself. The SEC believes that one of the keys to crowdfunding is the ability of crowd members to communicate with each other in order to determine which ideas or companies are worth funding. According the SEC, the issuer should be given an opportunity to respond to questions about the terms of the offering as well as communicate directly with investors through the communication channels available on the intermediary's website. All of the rules related to the prohibition on advertising the terms of the offering apply to any person acting on behalf of the issuer.

Compensation of Persons Promoting the Offering

The final rules about the compensation of persons promoting the offering were finalized as proposed with one clarification that broadens the term "acting on behalf of the issuer" to include all persons compensated by issuers for *any* reason (i.e. employees) regardless of whether the compensation is related to promoting the offering. Under the final rules, an issuer or a person acting on the issuer's behalf can compensate someone for promoting the offering, but only if the promotional activities takes place through the communication channels provided by an intermediary, and only if the issuer "takes reasonable steps" to ensure that the promoter clearly discloses the receipt of such compensation along with any communication regarding the offering.

Other Issuer Requirements

Oversubscriptions

Regardless of the structure of the offering, all crowdfunding issuers must describe how securities in oversubscribed offerings will be allocated. The SEC will not, on the other hand, limit the

amount of nor prescribe how to allocate oversubscriptions. All that is required of issuers is to abide by the annual $1 million limit and disclose in the offering statement how much it will be willing to accept, the allocation, and intended purpose of, amounts raised in oversubscriptions.

Offering Price; Types of Securities Offered; and Valuation

Consistent with the proposed rules, the final rules about offering price will not require listing a fixed price or prohibit dynamic pricing. Additionally, the final rules do not limit the type of securities offered and do not require any specific method for valuing the securities.

Intermediaries and Requirements

Section 4(a)(6)(C) of the Securities Act requires that a crowdfunded offering must be conducted through a registered broker-dealer or funding portal registered with the SEC pursuant to Section 4A(a)(1) of the Securities Act and Rule 400 of Regulation Crowdfunding (each an "intermediary"). A crowdfunding intermediary must also be a member of a national securities association that is registered with the SEC under Section 15A of the Exchange Act – currently the only such association in existence is FINRA. Regulation Crowdfunding does not impose any licensing, testing, or qualification requirements with respect to associated persons of funding portals, instead relying on FINRA or another registered national securities association to provide for such requirements if it deems them necessary.

Restriction on Financial Interests

Section 4A(a)(11) of the Securities Act requires intermediaries to prohibit their directors, officers, partners, or persons occupying similar roles from having any "financial interest" (basically an equity interest) in an issuer, and Rule 300(b) implements this prohibition. Although the proposed rules prohibited intermediaries from having any financial interest in an issuer, as well, final Rule 300(b) allows an intermediary to receive a financial interest in an issuer using its services provided that: (i) the financial interest is received as compensation for services in connection with the crowdfunded offering on the intermediary's platform, and (ii) the financial interest consists only of the same securities offered to investors in the offering. Note that if an intermediary will receive a financial interest as compensation for its services, the intermediary will need to disclose this arrangement to investors at the time of account opening under Rule 302(d) and upon confirmations of investments under Rule 303(f).

Measures to Reduce the Risk of Fraud

Regulation Crowdfunding requires intermediaries to take certain steps to reduce the risk of fraud. A number of these measures require the intermediary to have a "reasonable basis" for believing certain information. In this context, having a reasonable basis does not require any particular prescribed level of due diligence by the intermediary, and the intermediary is permitted to "reasonably rely" on the representations of an issuer or an investor, provided that the intermediary does not have knowledge to the contrary or knowledge of facts and circumstances that would cause a reasonable person to doubt the credibility of the representations.

An intermediary must have a reasonable basis to believe that a crowdfunding issuer is in compliance with Section 4(a)(6) of the Securities Act and Regulation Crowdfunding. An intermediary has a responsibility to assess whether it can reasonably rely on the representations,

and should consider, for example, whether the representation given by the issuer is detailed enough to indicate that the issuer is aware of its obligations.

An intermediary must have a reasonable basis to believe that the issuer has established a system for keeping accurate records relating to the holders of securities offered through the intermediary. In a change from the proposed rule, the intermediary will be deemed to have satisfied its "reasonable basis" belief obligation if the issuer engages the services of a transfer agent registered under Section 17A of the Exchange Act.

An intermediary is required to deny access to its platform if it has a reasonable basis to believe that an issuer or any officer, director, or 20% owner is subject to a disqualification under Rule 503 of Regulation Crowdfunding (the bad boy disqualifications). In addition, an intermediary is require to conduct background and securities enforcement regulatory history checks on each issuer and its officers, directors, and 20% owners.

An intermediary must deny access to an issuer when the intermediary (i) has a reasonable basis for believing that the issuer or the offering presents the potential for fraud or raises other investor protection concerns, (ii) reasonably believes it is unable to adequately or effectively assess the risk of fraud of the issuer or the offering, or (iii) becomes aware (after the issuer has already been granted access to the platform) of information that causes the intermediary to reasonably believe the issuer or the offering presents the potential for fraud or raises other investor protection concerns.

An intermediary does not need to make public or report the fact that it has denied access to an issuer.

Account Opening and Educational Materials

An investor seeking to purchase securities through an intermediary must comply with the intermediary's account opening procedures and agrees to accept electronic delivery of documents and communications with the intermediary. At the time of account opening, the intermediary is required to inform investors that any person who uses the intermediary's platform to promote an offering and either does so for past or prospective compensation, or is a founder or employee of the issuer, must clearly disclose such compensation or relationship in all communications on the platform. The intermediary must also disclose, at the time of account opening, the manner in which the intermediary will be compensated in connection with offerings on its platform.

An intermediary is required to provide investors with certain educational material regarding its platform and crowdfunded equity offerings in general. As long as the educational materials meet minimum standards prescribed by the SEC and are in plain language, the intermediary has discretion over the form, content, and presentation of the educational materials. The educational materials must be accurate, requiring periodic update by the intermediary. When a material update is made to the educational materials, the intermediary may not accept any further investment commitments until the revised materials have been distributed to all investors. An intermediary is required to obtain a representation from each investor that the investor has reviewed the most recent version of the educational materials. The minimum content requirements for the educational materials are:

- the process for the offer, purchase and issuance of securities through the intermediary;
- the risks associated with investing in securities offered and sold in reliance on Section 4(a)(6);
- the types of securities that may be offered on the intermediary's platform and the risks associated with each type of security, including the risk of having limited voting power as a result of dilution;
- the restrictions on the resale of securities offered and sold in reliance on Section 4(a)(6);
- the types of information that an issuer is required to provide in annual reports, the frequency of the delivery of that information, and the possibility that the issuer's obligation to file annual reports may terminate in the future;
- the limitations on the amounts investors may invest, as set forth in Section 4(a)(6)(B);
- the circumstances in which the issuer may cancel an investment commitment;
- the limitations on an investor's right to cancel an investment commitment;
- the need for the investor to consider whether investing in a security offered and sold in reliance on Section 4(a)(6) is appropriate for him or her;
- that following completion of an offering, there may or may not be any ongoing relationship between the issuer and intermediary; and
- that in some cases an issuer may cease publishing annual reports and, as a result, the investor may not continually have current financial information about the issuer.

Transaction Requirements

Intermediaries have a number of obligations relating to issuer information, investor qualification, investor communication, funds management, and investor notices.

Issuer Information

Rule 303(a) of Regulation Crowdfunding requires an intermediary to publicly display on its website any information required to be provided by issuers under Rules 201 and 203(a) of Regulation Crowdfunding (a long list of information about the issuer and its insiders, and SEC Form C: Offering Statement). The information must be made available in a format that can be easily printed, downloaded, and saved, it must be available for at least 21 days prior to selling any securities in the offering, and it must remain available until the offering is completed or cancelled.

Investor Qualification

Intermediaries have responsibility for ensuring that investors do not exceed the maximum aggregate investment limitations for crowdfunded offerings in a 12 month period. Rule 303(b)(1) requires that, before accepting each investment commitment, the intermediary must have a reasonable basis to believe the investor has not exceeded the applicable limitations in Section 4(a)(6)(B) of the Securities Act. The intermediary will be permitted to reasonably rely

on investor representations as to annual income, net worth, and the amount of other crowdfunding investments in the last 12 months, as well as on information received from centralized data depository of crowdfunding investor information (in the event one is created in the future).

Acknowledgement of Risk

Rule 303(b)(2) requires an intermediary to obtain, before each investment commitment, a representation from the investor that the investor (i) has reviewed the educational materials described above, and (ii) understands that the entire investment may be lost and is in a financial condition to bear such loss. An intermediary is also required, prior to accepting each investment commitment, to obtain answers from the investor to questions demonstrating an understanding that there are limitations on the right to cancel the investment, that the securities are subject to restrictions on transfer, and that the investor should not invest in any crowdfunded offering unless the investor can afford the entire loss of the investment. The form of the questionnaire and acknowledgement are within the discretion of the intermediary.

Communication Channels

Rule 303(c) requires intermediaries to provide communication channels to permit discussions among investors and between investors and the issuer about offerings on the platform. The discussion channel itself and all comments must be publicly available, but only those persons with an account with the intermediary can be permitted to post comments. The intermediary must require that commenters disclose whether they are compensated promoters of the offering or founders or employees of the issuer in any comments.

Investor Communications and Notices

Rule 303(d) requires an intermediary to provide a notification (by email or other electronic media) to an investor after the investor's investment commitment has been received. The notice must contain the dollar amount of the investment, the price of the securities, the name of the issuer, and the date and time by which the investor can cancel the investment commitment.

In connection with the completion of an investor's purchase of securities through an intermediary's platform the intermediary must provide the investor with a notice containing information about the purchase, such as the date, type of security, purchase price, specified terms of the security, number of securities sold by the issuer, and the source, form, and amount of compensation earned by the intermediary in connection with the transaction. An intermediary that is a registered broker-dealer is exempt from its obligations under Rule 10b-10 with respect to a transaction for which it complies with this required notification.

If an offering fails to close (for example, because an offering minimum was not achieved), an intermediary must, within five business days, provide investors with notification that the offering has terminated, direct the qualified third party holding investor funds to return those funds to the investors.

Maintenance and Transmission of Funds

The handling of investor funds by broker-dealers, including a broker-dealer acting as an intermediary in a crowdfunded offering, is governed by Exchange Act Rule 15c2-4. For funding

portals, though, Regulation Crowdfunding establishes separate requirements in Rule 303(e)(2), which requires the funding portal to manage an escrow arrangement with a qualified third party (which includes banks, certain credit unions, and registered broker-dealers that hold funds for customer, broker, or dealer accounts) and to direct the disbursement of funds to the issuer only when (i) the offering target amount has been satisfied, (ii) the cancellation period for all investment commitments has expired, and (iii) at least 21 days have passed since the public posting of offering materials.

Investor Rescission Rights

Investors who have committed to purchase securities in a crowdfunded offering have the unconditional right to rescind that commitment until 48 hours prior to the announced offering closing date. If an issuer proposes to close an offering early (for example, because the target offering amount has been achieved early), all investors must be given at least five business days' notice of the new offering closing date, and the rescission right will apply until 48 hours prior to the new offering closing date.

If there is a material change to the terms of an offering, all investors who have committed to purchase securities in the offering must be provided with a notification indicating the change and stating that, unless the investor re-affirms the intent to invest, the investment commitment will be deemed rescinded.

Payments to Third Parties

Under Rule 305(a), an intermediary cannot compensate any person for providing it with "personally identifiable information" of an investor. Personally identifiable information is broadly defined to include any information that "can be used to distinguish or trace an individual's identity, either alone or when combined with other personal or identifying information that is linked or linkable to a specific individual." In other words, an intermediary can't pay for investor leads or referrals. An intermediary can pay a fixed fee for the service of directing persons to the intermediary's platform (such as through general advertising or hyperlinks).

Additional Funding Portal Requirements

Registration Requirement

Securities Act Section 4A(a)(1) requires that an intermediary facilitating a transaction made in reliance on Securities Act Section 4(a)(6) register with the Commission as a broker or a funding portal. The statute does not, however, prescribe the manner in which a funding portal would register with the Commission. Registration will be made through the EDGAR system. The registration requirements for funding portals are generally consistent with those imposed on broker-dealers, while not as extensive in every aspect.

Form Funding Portal

A funding portal will register with the SEC by filing Form Funding Portal. Form Funding Portal is generally modeled on Form BD, used for the registration of broker-dealers. Before a funding portal will be able to access EDGAR and electronically file Form Funding Portal, it will have to obtain EDGAR access codes and a central index key, or CIK, by creating and submitting a Form

ID with the Commission for authorization to access EDGAR. When a funding portal's registration becomes effective, the information on Form Funding Portal will be made available to the public through EDGAR, with the exception of certain personally identifiable information or other information with significant potential for misuse.

The final rule permits a funding portal to operate multiple website addresses under a single funding portal registration. Funding portals cannot license or sell their registrations as registrations are not transferrable among entities.

Fidelity Bond

In a departure from the proposed rules, the SEC decided not to adopt a requirement that funding portals post a fidelity bond.

Exemption from Broker-Dealer Registration

Exchange Act Section 3(h)(1), which was added by Section 304(a) of the JOBS Act, directs the Commission by rule to exempt, conditionally or unconditionally, a registered funding portal from the requirement to register as a broker or dealer under Exchange Act Section 15(a), subject to certain limitations.

The exemption adopted by the SEC is set forth in Rule 401. The exemption applies only to funding portals that are registered with the SEC.

Safe Harbor for Certain Activities

Selecting Entities

A funding portal cannot give investment advice or make recommendations. Selecting which entities may use the portal's platform could be considered a recommendation. The final rule makes it clear that a funding portal may exercise its discretion, subject to the prohibition in the statute on providing investment advice or recommendations, to limit the offerings and issuers that it allows on its platform under the safe harbor, as long as it complies with all other provisions of Regulation Crowdfunding. A funding portal cannot advertise, make statements or otherwise represent that the offerings listed on its platform are safer or better investments than those listed on other platforms.

Highlighting Particular Issuers

Rule 402(b)(2) allows a funding portal to highlight particular issuers or offerings of securities made in reliance on Section 4(a)(6) on its platform based on objective criteria where the criteria are reasonably designed to highlight a broad selection of issuers offering securities through the funding portal's platform, are applied consistently to all issuers and offerings and are clearly displayed on the funding portal's platform. The objective criteria may include, for example: the type of securities being offered (e.g., common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the number or amount of investment commitments made; the progress in meeting the target offering amount or, if applicable, the maximum offering amount; and the minimum or maximum investment amount.

Search Functions

The final rule permits a funding portal to provide search functions or other tools on its platform that users could use to search, sort or categorize available offerings according to objective criteria. The final rule also permits search functions that, for example, will allow an investor to sort through offerings based on a combination of different criteria, such as by the percentage of the target offering amount that has been met, geographic proximity to the investor and number of days remaining before the closing date of an offering. However, the final rule makes clear that the search criteria may not include the advisability of investing in the issuer or its offering, or an assessment of any characteristic of the issuer, its business plan, its management or risks associated with an investment.

Communication Channels

Rule 402(b)(4) addresses the terms under which a funding portal can provide communication channels by which investors can communicate with one another and with representatives of the issuer through the funding portal's platform about offerings conducted through the platform. The safe harbor specifies that a funding portal (including its associated persons, such as its employees) may not participate in these communications, other than to establish guidelines about communication and to remove abusive or potentially fraudulent communications. Under Rule 402(b)(4), a funding portal must make communication channels available to the general public and restrict the posting of comments on those channels to those who have accounts on the funding portal's platform. In addition, the funding portal must require each person posting comments to disclose clearly with each posting in the channel whether he or she is a founder or an employee of an issuer engaging in promotional activities on behalf of the issuer, or is otherwise compensated or will receive any compensation for promoting an issuer.

Advising the Issuer

Rule 402(b)(5) permits a funding portal to advise an issuer about the structure or content of the issuer's offering, including assisting the issuer in preparing offering documentation. A funding portal can, for example, provide pre-drafted templates or forms for an issuer to use in its offering that will help it comply with its proposed disclosure obligations. Other examples of permissible assistance can include advice about the types of securities the issuer can offer, the terms of those securities and the procedures and regulations associated with crowdfunding.

Paying for Referrals

Rule 402(b)(6) permits a funding portal to compensate a third party for referring a person to the funding portal if the third party does not provide the funding portal with personally identifiable information about any investor and the compensation, other than that paid to a registered broker or dealer, is not based, directly or indirectly, on the purchase or sale of a security in reliance on Section 4(a)(6) of the Securities Act offered on or through the funding portal's platform.

Compensation Arrangements With Registered Broker-Dealers

Subject to certain limitations, Rule 402(b)(7) specifies that a funding portal may pay or offer to pay compensation to a registered broker or dealer for services, including for referring a person to the funding portal, in connection with the offer or sale of securities by the funding portal in reliance on Section 4(a)(6) of the Securities Act.

In addition, Rule 402(b)(8) permits a funding portal to provide services to, and receive compensation from, a registered broker-dealer in connection with the funding portal's offer or sale of securities in reliance on Section 4(a)(6), subject to certain limitations.

Advertising

Rule 402(b)(9) permits a funding portal to advertise its existence and identify one or more issuers or offerings available on the portal on the basis of objective criteria, as long as:

- the criteria are reasonably designed to identify a broad selection of issuers offering securities through the funding portal's platform and are applied consistently to all potential issuers and offerings;
- the criteria may include, among other things, the type of securities being offered (for example, common stock, preferred stock or debt securities); the geographic location of the issuer; the industry or business segment of the issuer; the expressed interest by investors, as measured by number or amount of investment commitments made, progress in meeting the issuer's target offering amount or, if applicable, the maximum offering amount; and the minimum or maximum investment amount; and
- the funding portal does not receive special or additional compensation for identifying the issuer or offering in this manner.

Denying Access to the Platform

Rule 402(b)(10) permits a funding portal to deny access to its platform to, or cancel an offering of, an issuer that the funding portal believes may present the potential for fraud or otherwise raises investor protection concerns. The Rule is consistent with Rule 301(c)(2), which requires an intermediary to deny access if it has a reasonable basis for believing that the issuer or the offering presents the potential for fraud or otherwise raises concerns about investor protection.

Accepting Investor Commitments

Rule 402(b)(11) permits a funding portal to accept, on behalf of an issuer, an investment commitment for securities offered in reliance on Section 4(a)(6) of the Securities Act by that issuer on the funding portal's platform. The safe harbor does not permit funding portals to handle customer funds.

Directing Transmission of Funds

Proposed Rule 402(b)(12) permits a funding portal to direct investors where to transmit funds or remit payment in connection with the purchase of securities offered and sold in reliance on Section 4(a)(6) of the Securities Act.

402(b)(13) permits a funding portal to direct a qualified third party, as required by Rule 303(e), to release proceeds to an issuer upon completion of a crowdfunding offering or to return proceeds to investors in the event an investment commitment or an offering is cancelled.

Posting News

The final rules do not include a safe harbor that permits a funding portal to post news, such as market news and news about a particular issuer or industry, on its platform. The SEC believes

the permissibility of posting news should be a facts and circumstances determination. When posting news, funding portals will need to ensure that they do not violate the prohibition on giving investment advice and recommendations. For example, if a funding portal selectively determines which news articles to post or posts only flattering or positive news, then the funding portal is more likely to be giving impermissible investment advice or recommendations.

Compliance

Policies and Procedures

Rule 403(a) requires a funding portal to implement written policies and procedures reasonably designed to achieve compliance with the federal securities laws and the rules and regulations thereunder relating to its business as a funding portal.

A funding portal may rely on the representations of others when meeting certain requirements under Regulation Crowdfunding, unless the funding portal has reason to question the reliability of those representations. The SEC believes that when a funding portal relies on the representations of others to form a reasonable basis, the funding portal should have policies and procedures regarding under what circumstances it can reasonably rely on such representations and when additional investigative steps may be appropriate. The SEC also believes that a funding portal's policies and procedures should cover not only permitted activities, but also address prohibited activities. For example, a funding portal should have policies and procedures on the criteria used to limit, highlight and advertise issuers and offerings.

Privacy

Rule 403 subjects funding portals to the same privacy rules as those applicable to brokers. Regulation S-P governs the treatment of nonpublic personal information by brokers, among others. Regulation S-AM allows a consumer, in certain limited situations, to block affiliates of covered persons (i.e., brokers, dealers, investment companies and both investment advisers and transfer agents registered with the Commission) from soliciting the consumer based on eligibility information. Regulation S-ID generally requires brokers to develop and implement a written identity theft prevention program that is designed to detect, prevent and mitigate identity theft in connection with certain existing accounts or the opening of new accounts.

Inspections and Examinations

Under Rule 403(c) of Regulation Crowdfunding, a funding portal is required to permit the examination and inspection of all of its business and business operations that relate to its activities as a funding portal, such as its premises, systems, platforms and records, by the SEC's representatives and by representatives of the registered national securities association of which it is a member.

Records to be Created and Maintained by Funding Portals

Rule 404(a) requires funding portals to make and preserve certain records for five years, with the records retained in a readily accessible place for at least the first two years.

Miscellaneous Provisions

Insignificant Deviations from Regulation Crowdfunding

Rule 502 of Regulation Crowdfunding provides issuers a safe harbor for insignificant deviations from a term, condition or requirement of Regulation Crowdfunding. To qualify for the safe harbor, the issuer relying on the exemption has to show that:

- the failure to comply with a term, condition or requirement was insignificant with respect to the offering as a whole;
- the issuer made a good faith and reasonable attempt to comply with all applicable terms, conditions and requirements of Regulation Crowdfunding; and
- the issuer did not know of the failure to comply, where the failure to comply with a term, condition or requirement was the result of the failure of the intermediary to comply with the requirements of Section 4A(a) and the related rules, or such failure by the intermediary occurred solely in offerings other than the issuer's offering.

Restrictions on Resales

Rule 501 provides that securities issued in a transaction pursuant to Section 4(a)(6) may not be transferred by any purchaser of such securities during the one-year period following the purchase of securities unless such securities are transferred:

- to the issuer of the securities;
- to an accredited investor;
- as part of an offering registered with the Commission; 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 or other similar circumstance.

Information Available to States

Under Section 4A(d), the SEC must make available, or cause to be made available by the relevant intermediary, the information required under Section 4A(b). Accordingly, the rules require issuers to file on EDGAR the information required by Section 4A(b) and the related rules. Information filed on EDGAR is publicly available and would, therefore, be available to each state, territory and the District of Columbia.

Exemption from Section 12(g)

Rule 12g-6 provides that securities issued pursuant to an offering made under Section 4(a)(6) are exempted from the record holder count under Section 12(g), provided that the issuer is current in

its ongoing annual reports required pursuant to Rule 202 of Regulation Crowdfunding, has total assets as of the end of its last fiscal year not in excess of $25 million, and has engaged the services of a transfer agent registered with the Commission pursuant to Section 17A of the Exchange Act.

Section 12(g) registration will be required only if, on the last day of the fiscal year the company has total assets in excess of the $25 million total asset threshold, or the class of equity securities is held by more than 2,000 persons or 500 persons who are not accredited investors. In such circumstances, an issuer that exceeds the thresholds in Section 12(g) and has total assets of $25 million or more will be required to begin reporting under the Exchange Act the fiscal year immediately following the end of the two-year transition period. An issuer entering Exchange Act reporting will be considered an "emerging growth company" to the extent the issuer otherwise qualifies for such status.

An issuer seeking to exclude a person from the record holder count has the responsibility for demonstrating that the securities held by the person were initially issued in an offering made under Section 4(a)(6).

Scope of Statutory Liability

Securities Act Section 4A(c) provides that an issuer will be liable to a purchaser of its securities in a transaction exempted by Section 4(a)(6) if the issuer, in the offer or sale of the securities, 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 under which they were made, not misleading, provided that the purchaser did not know of the untruth or omission, and the issuer does not sustain the burden of proof that such issuer did not know, and in the exercise of reasonable care could not have known, of the untruth or omission.

Section 4A(c)(3) defines, for purposes of the liability provisions of Section 4A, an issuer as including "any person who offers or sells the security in such offering." The SEC specifically declined to exempt funding portals (or any intermediaries) from the statutory liability provision of Section 4A(c) or to interpret this provision as categorically excluding such intermediaries. The SEC believes that the determination of "issuer" liability for an intermediary under Section 4A(c) will turn on the facts and circumstances of the particular matter in question. The SEC believes that there are appropriate steps that intermediaries might take in exercising reasonable care in light of this liability provision. These steps may include establishing policies and procedures that are reasonably designed to achieve compliance with the requirements of Regulation Crowdfunding, and conducting a review of the issuer's offering documents, before posting them to the platform, to evaluate whether they contain materially false or misleading information.

Disqualification Provisions

The final rules provide for issuer "bad actor" disqualification provisions that are closely aligned with similar provisions in Rules 262 and 506. The final rules also establish "bad actor" disqualification provisions under which an intermediary would not be eligible to effect or participate in transactions conducted pursuant to Securities Act Section 4(a)(6).

Secondary Market Trading

Exchange Act Rule 15c2-11 governs broker-dealers' publication of quotations for certain over-the-counter securities in a quotation medium other than a national securities exchange. The rule prohibits broker-dealers from publishing quotations (or submitting quotations for publication) in a "quotation medium" for covered over-the-counter securities without first reviewing basic information about the issuer, subject to certain exceptions. A broker-dealer also must have a reasonable basis for believing that the issuer information is accurate in all material respects and that it was obtained from a reliable source. Regulation Crowdfunding does not affect the obligations of a broker-dealer under Exchange Rule 15c2-11 to have a reasonable basis under the circumstances for believing that the information required by Rule 15c2-11 is accurate in all material respects, and that the sources of the information are reliable, prior to publishing any quotation, absent an exception, for a covered security in any quotation medium.

Should you have any questions regarding the foregoing please contact the attorneys set forth below or your usual contact at Stinson Leonard Street LLP. This summary does not constitute legal advice.

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