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SEC Issues Guidance on Crowdfunding

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The SEC's "Regulation Crowdfunding" (Regulation CF) permits most private companies to raise up to $1 million during any 12-month period through Internet-based crowdfunding offerings. Earlier this year, the SEC issued several Compliance and Disclosure Interpretations (C&DIs) that provide additional guidance on the subject.

A Quick Recap

The advantage of crowdfunding is that it allows a company to reach a virtually unlimited audience of investors who may participate regardless of whether their income or net worth qualifies them as "accredited investors." To protect less sophisticated investors, Regulation CF imposes several requirements. Among other things, a company that wishes to take advantage of crowdfunding must:

- Conduct the offering through an SEC-registered intermediary — either a broker-dealer or a "funding portal,"
- Comply with limits on the amount of securities that may be sold to a particular investor (based on income and net worth levels), and
- Meet certain reporting and disclosure requirements.
- The regulation also places limits on advertising. Under Rule 204(b), a company may not advertise the terms of a crowdfunding offering except in a limited notice (sometimes called a tombstone ad) that contains no more than the following information:
- A statement that the company is conducting an offering pursuant to Section 4(a)(6) of the Securities Act, together with the name of the intermediary and a link to the intermediary's platform,
- The terms of the offering — that is, the nature of the securities, the amount offered, the price and the offering period closing date, and
- Factual information about the company: its name, contact information and a brief description of its business.

Despite these strict limits on advertising outside the intermediary's platform, companies may communicate with investors and potential investors about the terms of an offering through channels provided on the intermediary's platform, so long as the company and its representatives identify themselves properly.

New Guidance

The C&DIs issued in 2016 clarify several aspects of the regulation. For example:

Information disseminated prior to an offering. Before a company commences a crowdfunding offering by filing Form C, the only restriction on company communications is that it may not disseminate information constituting an "offer of securities." The C&DIs remind readers, however, that the SEC interprets the term "offer" broadly to include any statements that "have the effect of conditioning the public mind or arousing public interest in" the company.

Advertisements during an offering. The C&DIs detail that advertisements during a crowdfunding offering are limited to the information described in Rule 204(b) only if they include the terms of the offering. Advertisements that don't include the offering's terms need not comply with Rule 204(b), although they're still subject to the general prohibition against public offers of securities. These requirements apply to third parties engaged to promote an offering to the same extent that they apply to the company.

Third-party publications. The restrictions on advertising extend to third-party publications, such as articles in the media, if they include the offering's terms and the company has been directly or indirectly involved in their preparation (through an interview, for example). As the SEC observes, it will be difficult for companies to comply with the limits imposed by Rule 204(b) under these circumstances.

Disclosure requirements. The C&DIs provide details on the balance sheets and other financial statements that recently formed companies should furnish. For example, if a company conducts a crowdfunding offering during the period beginning with the company's inception and ending 120 days after the company's first annual balance sheet date, it may provide a balance sheet as of its inception date.

Investment limits. The investment limits apply to both natural persons and entities. For an entity, the limits are based on revenue and net assets as of its most recent fiscal year end.

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Crowdfunding can be a cost-effective way for companies to raise equity capital without a full-fledged public offering. If you're considering this strategy, familiarize yourself with Regulation CF's requirements and limitations. And keep in mind that C&DIs, while they provide insight into the SEC staff's views, don't rise to the level of rules, regulations or even official SEC statements.

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