

# PUBLICATION

---

## **JOBS Act: The Crowdfunding Exemption from Registration and New Exchange Act Thresholds for Registration**

**May 23, 2012**

**(Part IV of IV)**

On April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act (JOBS Act). The intended purpose of the JOBS Act is to spur job creation by small companies and start-ups by relaxing the regulatory burdens of raising capital. This is the final alert in a four-part series of alerts related to the JOBS Act.

In this alert, we focus on Title III of the JOBS Act, which deals with a new registration exemption under the Securities Act of 1933, as amended (the Securities Act), for "crowdfunded" offerings, and Titles V and VI of the JOBS Act, which deal with the shareholder registration thresholds under the Securities Exchange Act of 1934, as amended (the Exchange Act).

### **Crowdfunding Exemption from Registration**

Crowdfunding enables small or startup businesses that may not have access to traditional methods of capital fundraising to raise capital via the Internet and social media, typically from small dollar investors. The JOBS Act amends the Securities Act by adding a new Section 4(6), which provides a registration exemption for crowdfunding transactions as long as certain requirements are met. Securities issued pursuant to the crowdfunding exemption will be restricted securities subject to a one-year holding period. These securities will also be considered "covered securities," and thus will not be required to be registered with any state securities commission.

### ***Issuer Requirements***

Issuers who intend to use the crowdfunding exemption from registration must meet the following requirements:

- The issuer must be a U.S. company;
- The issuer must not be a reporting company or an investment company; and
- The dollar amount of securities sold via crowdfunding must be less than \$1 million in a 12 month period.

### ***Investor Requirements***

Crowdfunded offerings will also be subject to the following restrictions on the amount they may accept from any individual investor:

- Investors with an annual income or net worth below \$100,000 may only invest, in the aggregate, the greater of \$2,000 or 5% of such investor's annual income or net worth; and
- Investors with an annual income or net worth greater than \$100,000 may only invest 10% of such investor's annual income or net worth, with a maximum aggregate investment amount capped at \$100,000.

## ***Information and Disclosure Requirements***

Issuers offering stock pursuant to the crowdfunding exemption will be required to file certain information with the SEC and provide the same information to potential investors and intermediaries. These requirements include the following:

- Issuers must make an initial filing with the SEC that contains basic information related to the issuer, the issuer's business, its financial information, and certain information related to the offering; and
- At least once per year, issuers must file with the SEC and provide to investors financial statements and reports of results of operations, as the SEC deems appropriate.

## ***Restrictions on Issuers***

Issuers of crowdfunded offerings are prohibited from advertising the terms of the offering, except for notices directing investors to the funding portal or broker. Issuers are also prohibited from compensating any third party promoters without disclosing such compensation to investors. Furthermore, issuers of crowdfunded offerings will be subject to liability under Section 12(b) of the Securities Act and may potentially be liable for untrue statements of material facts or omissions of material facts required to be stated to make a statement not misleading.

## ***Intermediaries***

New Section 4A(a) of the Securities Act requires that crowdfunding transactions be conducted through a broker or "funding portal." In turn, brokers and funding portals must register with the SEC and any applicable self-regulatory organization.

A "funding portal," as defined by the JOBS Act, is any person acting as an intermediary in a transaction involving the offer or sale of crowdfunded securities for the account of others. However, funding portals are restricted from offering investment advice or recommendations; soliciting purchases, sales or offers to buy the securities offered or displayed on its website or portal; compensating employees, agents or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal; holding, managing, possessing or otherwise handling investor funds or securities; or engaging in such other activities as the SEC determines appropriate.

Intermediaries of crowdfunding transactions have significant responsibilities under the JOBS Act, including providing certain disclosures and undertaking certain actions to prevent fraud and to ensure investor and issuer compliance.

## ***Impact of Title III***

Entrepreneurs and early stage startups that are unable to undertake traditional methods of capital financing may choose to take advantage of the new crowdfunding exemption to raise small amounts of capital from an expansive group of investors through a seemingly user-friendly access point, the Internet. However, the extensive reporting requirements and restrictions will make crowdfunding an expensive and time-consuming enterprise for both issuers and intermediaries. The SEC has 270 days from the date of enactment of the JOBS Act in which to promulgate rules to effectuate the crowdfunding provisions. In the interim, the SEC has issued a [notice](#) reminding issuers that, until the SEC issues its crowdfunding rules, there is no exemption from registration for offers or sales of securities purporting to rely on the crowdfunding exemption. Therefore, issuers must wait for the final rules implementing Title III in order to conduct a crowdfunding offering. We will send alert updates as the final rules are released.

## **New Thresholds for Exchange Act Registration and Shares Held of Record**

Prior to the enactment of the JOBS Act, the threshold for registration requirements under Section 12(g) of the Exchange Act was limited to issuers with total assets greater than \$10 million and a class of equity securities held of record by 500 or more holders. Title V of the JOBS Act amends Section 12(g) of the Exchange Act to increase the second half of this threshold, such that issuers are not required to register under Section 12(g) of the Exchange Act until they meet the existing \$10 million asset threshold and have a class of equity securities held of record by 2,000 or more holders or 500 non-accredited investors (as such term is defined by the SEC).

The JOBS Act also amends the definition of "held of record" to exclude securities held by employees pursuant to an employee compensation plan issued in a transaction exempt from registration under the Securities Act, as well as securities acquired in an exempt crowdfunding transaction. The term "held of record" continues to disregard beneficial holders who hold securities through nominees.

### ***Effects on Pending Registration Obligations***

Because the amendments to Section 12(g) of the Exchange Act are immediately effective, issuers in the registration process who met the pre-JOBS Act registration thresholds but do not meet the post-JOBS Act registration thresholds found themselves in a state of limbo. In April, the SEC [clarified](#) the registration obligations of these issuers. Issuers with a pending registration statement at the time of enactment of the JOBS Act who do not meet the new registration thresholds may withdraw any filed Exchange Act registration statement, provided that the registration statement is not yet effective.

If you have questions about the JOBS Act and how it can impact your business, please contact your Baker Donelson attorney.