Client Alert

November 2, 2015

Following the Wisdom of the Crowd?

A Look at the SEC's Final Crowdfunding Rules

In this alert, we provide a detailed overview of the final rules, Regulation Crowdfunding, which will be applicable to crowdfunding offerings conducted in reliance on Section 4(a)(6) of the Securities Act of 1933 as amended (the "Securities Act"), which was added by Title III of the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"), as well as to those intermediaries participating in such offerings. We do not address the proposed FINRA framework applicable to funding portals, which will be covered in a separate alert. All rule references, unless otherwise noted, refer to rules under Regulation Crowdfunding.

We will supplement this alert with a more detailed practical analysis comparing the various new offering exemptions available to issuers as a result of the JOBS Act.

PART ONE: GENERAL REQUIREMENTS

Limit on Capital Raised

Consistent with the statutory limitations, Rule 100(a) provides that an issuer may sell up to $1 million in any 12-month period to investors in an offering made pursuant to the exemption. Of course, an issuer may consider conducting other exempt offerings in close proximity with its crowdfunded offering. In calculating the amounts sold for purposes of the threshold, amounts sold by a predecessor or by an entity under common control with the issuer will be aggregated with the amounts sold by the issuer.

Individual Investment Limits

In the final rules, the Securities and Exchange Commission (the "SEC") has modified the investor limits from those included in its proposed rules. The final rules make clear that the individual investor limit is an aggregate limit, which applies to all investments made by the individual over a 12-month period in crowdfunded offerings and not to a specific offering.

An investor will be limited to investing:

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

As we discuss below, the issuer can rely on the intermediary's calculation of the investment limit; provided that the issuer does not have knowledge that the investor has exceeded, or would exceed, the investment limits as a result of participating in the issuer's offering.

Offering through an Intermediary

An issuer would only be able to engage in an offering through a registered broker-dealer or through a funding portal, and an issuer can only use one intermediary for a particular offering or concurrent offerings made in reliance on the exemption.

The offering must be conducted online only through the intermediary's platform, so that the "crowd" has access to information and there is a forum for an exchange of information among potential offering participants.

A "platform" is defined as "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."

Eligible Issuers

The ability to engage in crowdfunding is not available to all issuers. By statute, the following issuers cannot rely on crowdfunding transactions under Section 4(a)(6):

- issuers not organized under the laws of a state or territory of the United States or the District of Columbia;
- issuers already subject to Securities Exchange Act of 1934, as amended (the "Exchange Act") reporting requirements;
- investment companies as defined in the Investment Company Act of 1940 (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; and
- any issuer that the Commission, by rule or regulation, determines appropriate.

The final rules also exclude:

- issuers disqualified from relying on Section 4(a)(6), or "bad actors;" and
- issuers that have sold securities in reliance on Section 4(a)(6) and have failed, to the extent required, to make required ongoing reports required by Regulation Crowdfunding during the two-year period immediately preceding the filing of the required new offering statement; and

- any issuer that is a development stage company that has no specific business plan or purpose, or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies.

PART TWO: ISSUER REQUIREMENTS

Disclosure Requirements

The statute sets out a number of required disclosures in any Section 4(a)(6) offering. An issuer that elects to engage in a crowdfunding offering must comply with disclosure requirements, including: an initial disclosure about the offering on Form C, amendments to Form C to report material changes (Form C-A), periodic updates on the offering on Form C-U and ongoing annual filings until a filing obligation is terminated. The annual filing must be made on Form C-AR and a termination notice on Form C-TR.

Form C

The Form C would be filed with SEC and the intermediary would post the filing or provide a link to the filing for investors. The Form C must include disclosures relating to the issuer's business, officers, directors and control persons, use of proceeds, capital structure and financial results, as discussed below in more detail. In many respects, the Form C requirements resemble those for Form 1-A used in connection with Regulation A offerings. The final Form C also includes an optional Q&A format that issuers may elect to use to provide certain disclosures.

Basic issuer information would be required, including: the entity name, the form of entity, the jurisdiction of formation, formation date, address, website, number of employees, the issuer's website on which an investor can find the issuer's annual report and the date by which such report will be made available, whether the issuer or any predecessor previously failed to comply with the ongoing reporting requirements of Regulation Crowdfunding. In addition, the form must disclose certain basic information about the intermediary, including: the intermediary's SEC file number and FINRA CRD number and fees being paid to the intermediary, expressed either as a dollar amount or as a percentage of the offering amount, and a description of the intermediary's financial interests in the transaction and in the issuer.

In addition, the form will require, among other things, a discussion of:

- **Use of Proceeds**: a specific use or range of possible uses for the offering proceeds, as well as the factors impacting the selection by the issuer of each such use;
- **The Targeted Offering Size**: as discussed further below, the issuer must disclose the maximum offering size and the subscription process;
- **Offering Price**: a description of the price to the public of the securities and a description of how the offered securities were valued;
- **Business**: the form must include a business description, for which no particular format is prescribed;
- **Directors and officers**: each individual's name, positions held with the issuer and duration in those positions and business experience during the last three years;

- **Beneficial Ownership and Capital Structure**: for principal stockholders, the issuer would be required to identify each shareholder who owns 20% or more of the issuer's outstanding voting equity securities (calculated as of the most recent practicable date), as well as provide a description of capital stock, including any special voting rights or investor rights;
- **Indebtedness**;
- **Related party transactions**: a description of transactions that involve amounts in excess of 5% of the amount raised by the issuer in crowdfunded offerings in the trailing 12-month period including in the proposed deal;
- **Exempt offerings**: a description of all exempt offerings undertaken during the preceding three years;
- **Risk factors**: a discussion of risks associated with an investment in the securities and with participation in a crowdfunded offering;
- **Transfer restrictions**; and
- **Management's Discussion and Analysis**: a discussion that covers each period for which financial statements of the issuer are provided, as well as a discussion of material changes or trends known to management.

Financial Statement Requirements

In a change from the proposed rules, the final rules provide some accommodations with respect to financial statement requirements depending upon the target offering size and for first-time issuers.

Based on target offering size, the requirements are as follows:

- **$100,000 or less**: the amount of total income, taxable income and total tax or equivalent line items, as reported on the federal tax forms filed by the issuer for the most recently completed year (if any), certified by the principal executive officer of the issuer, and the financial statements of the issuer, also certified by the principal executive officer. If financial statements of the issuer are available that have either been reviewed or audited by a public accountant independent of the issuer, then, these financial statements must be provided instead of the materials described in the preceding sentence.

- **More than $100,000 and less than $500,000**: financial statements of the issuer reviewed by a public accountant independent of the issuer. If financial statements of the issuer are available that have been audited by a public accountant independent of the issuer, the issuer must provide those instead of the reviewed statements.

- **More than $500,000**: financial statements of the issuer audited by a public accountant independent of the issuer; provided, however, that for issuers that are first-time issuers, offerings that have a target offering amount of more than $500,000 but not more than $1 million, financial statements of the issuer reviewed by a public accountant independent of the issuer. If audited statements are available, those must be provided instead.

Financial statements must be prepared in accordance with U.S. GAAP. Audited financial statements must be conducted in accordance either with American Institute of Certified Public Accountants ("AICPA") standards (referred to as U.S. GAAS) or Public Company Accounting Oversight Board

("PCAOB") standards. These requirements are similar to those applicable for Tier 1 offerings made under Regulation A. A signed audit report must accompany audited financial statements.

During the first 120 days of the issuer's fiscal year, an issuer may conduct an offering in reliance on Section 4(a)(6) using financial statements for the fiscal year prior to the most recently completed fiscal year if the financial statements for the most recently completed fiscal year are not otherwise available.

Amendments to Form C

An issuer would be required to amend its Form C disclosures using Form C/A for any updates or material changes. The materiality determination is left up to the issuer based on the customary guidance that the SEC considers a material change to be a change that would affect an investor's investment decision. The issuer must identify on Form C/A whether the amendment is filed to disclose a material change. Investor reconfirmations must be obtained following the occurrence of a material change.

Progress Update

An issuer also is required to file progress updates with the SEC on a Form C-U. Updates are required five days after any of the following milestones: commitments for 50% of the deal are received, commitments for the full deal are received, subscriptions in excess of the initial offering amount will be accepted, or the issuer closes the offering.

Annual Report

An issuer that completes a crowdfunded offering must file with the SEC and post on its website an annual report on Form C-AR along with financial statements of the issuer certified by its principal executive officer within 120 days of the end of the issuer's fiscal year. The annual report is required to contain the same information required in the offering statement, described above.

Termination of Reporting

An issuer must file with the SEC a Form C-TR to terminate its reporting obligation within five days of the date on which it becomes eligible to do so.

An issuer can terminate its ongoing reporting requirements upon the earliest to occur of the following:

- the issuer is required to file reports under the Exchange Act;
- the issuer has filed at least one annual report and has fewer than 300 holders of record;
- the issuer has filed at least three annual reports and has total assets that do not exceed $10 million;
- the issuer or another party purchases or repurchases all of the securities issued pursuant to Section 4(a)(6), including any payment in full of debt securities or any complete redemption of redeemable securities; or
- the issuer liquidates or dissolves in accordance with state law.

Offering Amount and Offering Mechanics

In connection with a proposed offering, the rules contemplate that the issuer would include in its disclosures a discussion of the target or maximum amount to be raised, and a discussion of the subscription or offering process. The description of the subscription process must disclose that investors can cancel their investment up to 48 hours prior to the deadline identified in the offering materials, but if an investor does not cancel the investment, then the investor's funds will be released to the issuer upon closing.

The intermediary will notify investors when the target offering amount has been met, and if the target offering amount is not met, then no securities will be sold and all funds will be returned to investors. If the target offering amount is met prior to the deadline identified in the offering materials, the issuer must provide five days' advance notice before closing the offering early. If an investor does not reconfirm the investment commitment after a material change is made to the offering and disclosed on Form C-A, the investment will be cancelled, and the issuer must return the funds to the investor.

Types of Securities Offered

The final rules do not limit the types of securities that may be offered in reliance on Section 4(a)(6). The release notes that an issuer may offer debt securities and discusses the exemption from the requirement to qualify an indenture under the Trust Indenture Act of 1939 (the "Trust Indenture Act") for any offering exempted by Section 4 of the Securities Act from the provisions of Section 5 of the Securities Act; however, the final rules do not include a specific exemption from Trust Indenture Act requirements for crowdfunded offerings.

Status of Securities

Securities sold in a crowdfunded offering pursuant to the exemption would be subject to transfer restrictions. Pursuant to Rule 501, securities issued in a crowdfunded offering could not be transferred by a purchaser for one year from the date of purchase, except for transfers to: the issuer; an accredited investor; a family member of the purchaser or in estate type transfers; and third parties in an SEC-registered offering.

The statute exempts securities sold in Section 4(a)(6) offerings from the Exchange Act "holder of record" count for the purposes of determining if registration of a class of equity securities is required under Section 12(g). An issuer will be required to establish a means for tracking its shareholders. This may require an early-stage company to engage the services of a transfer agent or other similar service provider in order to monitor its security holders.

Integration

An offering made pursuant to the Section 4(a)(6) exemption will not be integrated with another exempt offering that precedes the crowdfunded offering or that takes place concurrently or subsequently. The issuer must ensure that it has satisfied all of the conditions for the exemption that it is claiming for each such offering. If the issuer is conducting a Rule 506(c) offering (using general solicitation), it must ensure that the Rule 506(c) offerees were not solicited by means of the communications used for the crowdfunded offering.

Restrictions on Advertising and Promotion

The final rules limit the ability of the issuer, as well as the ability of others acting on the issuer's behalf, to advertise. Pursuant to Rule 204, an issuer is permitted to advertise a Section 4(a)(6)-exempt offering by releasing an offering notice that contains only the following information:

- a statement that the issuer is conducting an offering;
- the name of the intermediary and a link to the intermediary's offering page;
- the amount of securities offered;
- the nature of the securities;
- the price of the securities;
- the closing date for the offering; and
- the name, address, phone number and website of the issuer;
- the email address of a representative of the issuer; and
- a brief factual description of the issuer's business.

The adopting release notes that this notice is intended to be similar to tombstone ads permitted under Securities Act Rule 134. The issuer would be able to communicate with potential crowdfunding investors if the communications occur through the platform; however, it should be clear to potential investors which platform communications are being made by the issuer or on the issuer's behalf.

The final rules do not limit an issuer from being able to continue to engage in regular business communications so long as it does not disclose information about the offering, except as permitted in an offering notice. However, the final rules do not contain an express safe harbor for regularly released business information.

Promoter Compensation

Rule 205 prohibits an issuer from compensating, or committing to compensate, directly or indirectly, a person for advertising or promoting a Section 4(a)(6) offering through the intermediary's platform, unless the issuer takes reasonable steps to ensure that the person clearly discloses the receipt (past and prospective) of compensation each time that such person makes a promotional communication. A founder or employee of the issuer that engages in promotional activities on the issuer's behalf through the intermediary's platform would be required to disclose in each posting that s/he is engaging in those activities on the issuer's behalf.

The release discusses a number of "reasonable steps" that an issuer can take in order to ensure that promoters disclose the receipt of communication, including, but not limited to, obtaining representations from the promoter and monitoring communications.

PART THREE: INTERMEDIARIES

Title III of the JOBS Act provides that a crowdfunded offering must be made through an intermediary that is either a registered broker-dealer or a funding portal. The intermediary is intended to function as a gatekeeper and, in this role, protect investors from fraud. The SEC's final rules establish a regulatory framework for these intermediaries. As discussed below, in the case of funding portals, the regulatory framework is a scaled back version of the framework applicable to broker-dealers.

We discuss the final rules in the sequence of an offering and then provide an overview of the registration, compliance and other requirements applicable to intermediaries.

Conducting a Crowdfunded Offering

Single Intermediary

As discussed above, the final rules require that an offering be made only through one intermediary.

Financial Interests in Issuer

Rule 300 prohibits directors, officers or partners (or others having a similar status or performing a similar function) of an intermediary from having any financial interest in an issuer using its services and prohibits such persons from receiving a financial interest in an issuer as compensation for the service provided to or for the benefit of the issuer in connection with the offering. An intermediary cannot have a financial interest in an issuer that is using the intermediary's platform, unless:

- The intermediary receives the financial interest from the issuer as offering compensation; and
- The financial interest consists of securities of the same class and having the same terms as those sold in the offering.

A "financial interest" in an issuer means a direct or indirect ownership of, or economic interest in, any class of the issuer's securities.

Measures to Reduce Risk of Fraud

Under Rule 301, an intermediary must have a reasonable basis for believing that the issuer is in compliance with relevant regulations and has established means to keep accurate records of holders of the securities it offers. An intermediary could reasonably rely on the issuer's representations, absent knowledge or other information that would suggest that the representations are not true.

An intermediary must deny access to an issuer if it has a reasonable belief that the issuer or its offering would present a potential for fraud. An intermediary would be required to deny access to its platform to an issuer if the intermediary has a reasonable belief that the issuer, or any of its directors, officers or 20% beneficial owners is subject to a disqualification under Rule 503. An intermediary must conduct a background and securities enforcement regulatory history check on each issuer whose securities are to be offered by the intermediary, as well as on each of its officers, directors (or any person occupying a similar status or performing a similar function) and 20% beneficial owners.

Account Opening

Under Rule 302, no intermediary or associated person may accept an investment commitment until the investor opens an account with the intermediary and the intermediary obtains consent to electronic delivery of materials. An intermediary is required to certain information to each investor, including educational materials, by electronic message with links to information posted on the intermediary's website.

Educational Materials

Rule 302 requires that in connection with establishing an account, an intermediary deliver educational materials in plain English. Any revised materials must be made available to all investors before accepting any additional investment commitments or effecting any further crowdfunded transactions. The materials must discuss:

- the process for the offering;
- the types of securities sold through the platform and the associated risks;
- the restrictions on resale;
- the offering statement;
- the investment limitations;
- the limitations on an investor's right to cancel an investment commitment and the circumstances under which an issuer may cancel the commitment;
- the need to consider the appropriateness for the investor of an investment in a crowdfunded offering;
- that following the completion of the offering there may or may not be a continuing relationship between the issuer and the intermediary; and
- that under certain circumstances the issuer may cease its ongoing reporting.

An intermediary also would be required to inform investors that disclosure is required regarding any past or prospective compensation paid to a promoter. An intermediary also must disclose the compensation it will receive in connection with crowdfunded offerings.

Issuer Information

Under Rule 303, an intermediary must make available to the SEC and potential investors not later than 21 days prior to the first day on which securities are sold to any investor any information provided by the issuer under Rules 201 and 203(a).

The information must be made publicly available on the intermediary's platform, in a manner that reasonably permits a person accessing the platform to save, download or store the information; this information be made publicly available on the intermediary's platform for a minimum of 21 days before any securities are sold in the offering, during which time the intermediary may accept investment commitments; and this information, including any additional information provided by the issuer, remain publicly available on the intermediary's platform until the offer and sale is completed or cancelled. An intermediary cannot require any person to establish an account with the intermediary in order to receive this information.

Investor Qualifications

Securities Act Section 4A(a)(8) imposes an obligation on intermediaries to make sure no investor exceeds the statutory investment limitations.

The final rules implement this requirement by providing that, before permitting an investor to make an investment commitment on its platform, an intermediary must have a reasonable basis to believe that the investor satisfies the investment limitations discussed above.

The final rules allow reasonable reliance on an investor's representation to this effect.

Investor's Acknowledgment of Risks

Securities Act Section 4A(a)(4) requires an intermediary to ensure that each investor reviews the educational materials, positively affirms that the investor understands that he or she is risking the loss of the entire investment and that the investor could bear such a loss, and answer questions demonstrating an understanding of the level of risk involved in startups. As discussed above, educational materials must be provided at account opening.

Rule 303 requires that an intermediary, each time before accepting an investment commitment, obtain from the investor a representation that the investor has reviewed the intermediary's educational materials, understands that the entire investment may be lost and can bear the risk of loss. The intermediary also must ensure each time before accepting an investment commitment that each investor answers questions demonstrating the investor's understanding that there are restrictions on the investor's ability to cancel an investment commitment and obtain a return of his or her investment, that it may be difficult for the investor to resell the securities and that the investor should not invest any funds in a crowdfunding offering unless s/he can afford to lose the entire amount of his or her investment.

Communication Channels

Rule 303 requires an intermediary to provide, on its platform, channels through which investors can communicate with one another and with representatives of the issuer about offerings made available on the intermediary's platform, subject to certain conditions.

This is intended to provide a centralized and transparent means for members of the public to share their views and to communicate with the issuer. The intermediary cannot participate in the communications. It can set rules regarding the postings or remove postings that use offensive language.

Communications should be available for public viewing, but the intermediary would only be able to permit those persons who have opened accounts with it to post comments. With each post, a person must disclose whether such person is a promoter or affiliate of the issuer and whether it has been or will be compensated. The intermediary must keep records of these communications.

Notice of Investment Commitment

An intermediary, upon receipt of an investment commitment from an investor, must promptly give or send to the investor a notification disclosing: the dollar amount of the commitment, the price of the securities (if known), the name of the issuer and the date and time by which the investor may cancel the investment commitment. Notification would be required to be provided by email or other electronic media and to be documented in accordance with applicable recordkeeping rules.

Maintenance and Transmission of Funds

Securities Act Section 4A(a)(7) requires that an intermediary "ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount."

An intermediary that is a registered broker must comply with established requirements in Exchange Act Rule 15c2-4 for the maintenance and transmission of investor funds. Investor funds must be held in escrow until the specified contingency occurs (*i.e.*, the targeted amount or the minimum amount is raised), and then the funds would be promptly transmitted to a bank, which has agreed in writing to hold such funds in escrow for the investors and to transmit or return such funds directly to the issuer or to investors, as the case may be. Proceeds are to be transmitted to the issuer only if the target offering amount is met or exceeded.

Because a funding portal cannot receive or handle any funds, it would be required to direct investors to transmit money or other consideration directly to a qualified third party (a registered broker-dealer, a bank, or a credit union) that serves as an escrow agent. A funding portal must promptly direct transmission of funds from the qualified third party to the issuer when the aggregate amount of investment commitments from all investors is equal to or greater than the target amount of the offering and the cancellation period for each investor has expired, but no earlier than 21 days after the date on which the intermediary makes publicly available on its platform the information required to be provided about the issuer and the offering. A funding portal must direct the return of funds to an investor when an investment commitment has been cancelled or the offering is terminated or cancelled.

Confirmation of Transaction

At or before the completion of a transaction, the intermediary is required to give or send each investor a notification, like a confirmation, disclosing the transaction date; the type of security; the price and number of securities purchased; the number of securities sold by the issuer in the transaction; the price at which the securities were sold; certain specified terms of the security (for example, if it is a debt or callable security); and the source and amount of any remuneration received or to be received by the intermediary in connection with the transaction, whether from the issuer or other persons. This notification must be by email or other electronic media and subject to recordkeeping rules.

Completion of Offerings, Cancellations and Reconfirmations

Investors have an unconditional right to cancel an investment commitment for any reason until 48 hours prior to the deadline identified in the issuer's offering materials. Thereafter, an investor cannot cancel any investment commitments made within the final 48 hours (except in the event of a material change to the offering, as discussed below).

If an issuer reaches the target offering amount prior to the deadline identified in its offering materials, it may close the offering once the target offering amount is reached, provided that the offering will have remained open for a minimum of 21 days; the intermediary provides notice about the new offering deadline at least five business days prior to the new offering deadline; investors are given the opportunity to reconsider their investment decision and to cancel their investment commitment until

48 hours prior to the new offering deadline; and at the time of the new offering deadline, the issuer continues to meet or exceed the target offering amount.

If there is a material change to the terms of the offering, or the information provided by the issuer regarding the offering, the intermediary must give or send to any potential investors who have made investment commitments notice of the material change, stating that the investor's investment commitment will be cancelled unless the investor reconfirms his or her commitment within five business days of receipt of the notice. If the investor fails to reconfirm his or her investment within those five business days, the intermediary, within five business days thereafter, must provide or send the investor a notification disclosing that the investment commitment was cancelled, the reason for the cancellation and the refund amount that the investor should expect to receive, and direct the refund of investor funds.

Finally, if an issuer does not complete an offering because the target is not reached or the issuer decides to terminate the offering the intermediary within five business days must give or send to each investor who made an investment commitment a notification disclosing the cancellation of the offering, the reason for the cancellation, the refund amount that the investor should expect to receive, direct the refund of investor funds and prevent investors from making investment commitments with respect to that offering on its platform.

Intermediary Registration and Other Requirements

Registration and SRO Membership

An intermediary must be registered as a broker-dealer with the SEC under Section 15(b) of the Exchange Act or a funding portal registered with the SEC in accordance with the requirements of Rule 400 and also a member of a national securities association registered under Section 15A of the Exchange Act, which is FINRA.

Additional Requirements on Funding Portals

The SEC has established a streamlined registration process under which a funding portal would register with the SEC by filing a form, Form Funding Portal, with information consistent with, but less extensive than, the information required for broker-dealers on Form BD.

A funding portal would register by completing a Form Funding Portal, which includes information concerning the funding portal's principal place of business, its legal organization and its disciplinary history, if any; business activities, including the types of compensation the funding portal has received and disclosure of its disciplinary history, if any; FINRA membership with any other registered national securities association; and the funding portal's website address(es) or other means of access.

A funding portal's registration would become effective the later of (1) 30 calendar days after the date that the registration is received by the SEC; or (2) the date the funding portal is approved for membership in FINRA.

In order to promote transparency, all such Forms Funding Portal will be available publicly.

A funding portal must file an amendment to the Form Funding Portal within 30 days of any of the information in the original form becoming inaccurate for any reason. The final rules require a funding portal to promptly file a withdrawal of registration on Form Funding Portal upon ceasing to operate as a funding portal. The withdrawal would be effective on the later of 30 days after receipt by the SEC after the funding portal is no longer operational within such longer period of time as to which the funding portal consents or within such period of time as to which the SEC, by order, may determine as necessary or appropriate in the public interest or for the protection of investors.

A funding portal can operate multiple website addresses under a single funding portal registration provided that the funding portal discloses on the Form Funding Portal all the website and names under which it does business.

Non-U.S. Funding Portals

Entities domiciled or organized outside of the United States ("nonresident funding portals") are able to act as funding portals; however, they are subject to additional requirements.

There must be an information sharing arrangement in place between the SEC and the competent regulator in the jurisdiction under the laws of which the nonresident funding portal is organized or where it has its principal place of business. In addition, a nonresident funding portal would be required to have an agent for service of process in the United States, as well as an opinion of counsel addressing the ability of the applicant to provide the SEC and the national securities association of which it is a member with prompt access to its books and records and to submit to onsite inspection and examination by the SEC and the national securities association. The nonresident funding portal also would be required to consent that service of any civil action brought by, or notice of any proceeding before, the SEC or any national securities association of which it is a member, in connection with the funding portal's investment-related business, may be given by registered or certified mail to the nonresident funding portal's contact person at the main address or mailing address indicated on the form.

Fidelity Bond

The proposed rules would have required a fidelity bond, however the final rules do not require a fidelity bond.

Exemptions from Broker-Dealer Registration and Safe Harbors

But for the exemption from registration for funding portals that Congress directed in the JOBS Act, a funding portal would be required to register as a broker under the Exchange Act.

The SEC's final rules exempt an intermediary that is registered as a funding portal from the requirement to register as a broker-dealer under the Exchange Act, although a funding portal would remain subject to the full range of the SEC's examination and enforcement authority.

A funding portal cannot:

- Offer investment advice or recommendations;

- Solicit purchases, sales or offers to buy the securities displayed on its platform;
- Compensate employees, agents or other persons for such solicitations based on the sale of securities displayed or referenced on its platform; or
- Hold, manage, possess or otherwise handle investor funds or securities.

In addition, the final rules set out certain "permitted activities" of a funding portal.

Providing Communication Channels: as noted above, a funding portal should provide a channel for potential investors to communicate about the merits of an offering.

Highlighting Issuers and Offerings: a funding portal may highlight a particular offering made through its platform based on objective criteria, such as the type of security, geographic region, industry, etc. Criteria must be objective and cannot be based on investment advice or implicitly endorse an issuer or an offering. The funding portal cannot receive special or additional compensation for highlighting one or more issuers or offerings on its platform.

Advising Issuers: a funding portal may advise an issuer on the structure or content of its proposed offering and prepare offering documentation.

Paying for Referrals: a funding portal may pay for referrals, subject to various limitations.

Compensation Arrangements with Registered Broker-Dealers: a funding portal may enter into arrangements with a broker-dealer pursuant to which they could compensate one another provided such arrangements are not prohibited by the national securities association of which the funding portal is a member.

Advertising: a funding portal could advertise its services as well as offerings that are available through its platform, subject to compliance with various requirements.

***Limiting Offerings*:** a funding portal can limit the offerings on its platforms (for example, by limiting the offerings to issuers in certain industries, geographies, etc.) without being deemed to be providing investment advice. The criteria would be required to be reasonably designed to result in a broad selection of issuers offering securities through the funding portal's platform and be applied consistently to all potential issuers and offerings. Criteria must be displayed on the funding portal's site.

Compliance Policies and Procedures

A funding portal is required to implement written policies and procedures designed to achieve compliance with applicable regulations.

A funding portal will be required to comply with the same privacy rules (Regulation S-P, Regulation S-AM, and Regulation S-ID) applicable to broker-dealers.

A funding portal is subject to the SEC's examination and inspection authority. Also, a funding portal is subject to recordkeeping requirements in order to ensure that there is an audit trail for all crowdfunding transactions and communications.

Disqualification ("Bad Actor") Provisions

Rule 503 sets out bad actor disqualification provisions. The Section 4(a)(6) exemption will not be available for a sale of securities if the issuer, a predecessor of the issuer, an affiliated issuer, any director, officer, general partner or managing member of the issuer, a beneficial owner of 20% or more of the issuer's outstanding voting equity securities, any promoter or solicitor, or any general partner, director, officer or managing member of any such solicitor is subject to a "statutory disqualification."

Conclusion

With the much anticipated crowdfunding rules now adopted, it will be interesting to observe the extent to which the rules will prove useful for issuers and intermediaries in raising small amounts of capital. While the SEC sought to add more flexibility in the final rule within the confines of the statutory directive from Title III of the JOBS Act, the exemption contemplates procedural and informational requirements that will require the significant dedication of resources by the smaller issuers that would likely find the exemption most useful, as well as their intermediaries. We will continue to monitor developments as market practices emerge for issuers and intermediaries.

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