

US “Regulation Crowdfunding”

Emerging Trends in
Crowdfunding Regulation and Transactions

IBA Annual Conference, Sydney October 2017



Who we are

MacDonald Weiss is a New York City-based law firm that provides the business-law related services that growing companies need. We have a special focus on advising non-US companies entering the US in search of markets or capital. Formed by senior lawyers with decades of experience in the large international law firms, we offer top-tier legal services on terms that young companies can handle.

Our clients include start-ups and emerging growth companies, investors, SMEs, multinationals, venture capital firms, private equity firms and family offices, and non-US investment funds.

Our industry sector expertise includes software, fin-tech and equity crowdfunding, gaming, IT and big data, education technology, healthcare technology, e-commerce, mobile telecommunications, TV and online media services, on-line retail, fashion, food, wine and spirits, and financial services.

What we do

Startup and growing company services

- Corporate structuring and governance
- Incentive compensation plans
- Cross border expansion and “flips”

Capital Formation

- VC and angel investments and IPOs
- Corporate finance, debt and equity private placements
- Securities law compliance
- VC and PE Fund Formation

Business Development and Investment

- M&A - US Domestic and Cross Border
- Joint ventures and strategic alliances

Tax structuring and compliance

Contracts and commercial law

- Software and technology licensing
- Data privacy
- US general counsel services
- Product Distribution

What is Regulation Crowdfunding?

Section 4(a)(6) of the Securities Act of 1933

Regulation Crowdfunding – Key Elements

- **Amount of offering:** up to \$1 million in a 12-month period through crowdfunding
- **By?** Issuers that are **US entities** and that are not reporting companies under the Securities Act, not funds, and not subject to disqualification (not “bad actor”, not a prior Reg CF issuer that has failed to provide ongoing disclosure, and not a development company with no business plan)
- **Who can invest?** Accredited and non-accredited investors
- **Is there a dollar cap on amount investors may invest? Yes.** An investor is subject to an investment limit on amounts invested in any 12-month period through crowdfunding equal to:
 - 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
 - 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.
- **Is the type of security limited? No.** Debt or equity, and adopting release notes that debt securities are exempt from the requirements to qualify an indenture under the Trust Indenture Act if exempt from registration under Section 4 of the 33 Act.
- **Is an intermediary required? Yes.** A **broker-dealer or a funding portal** must be used, and the issuer can use only one intermediary for an offering
- **Manner of offering:** the offering must be conducted only through the portal.

Regulation Crowdfunding – Issuer Requirements

Offering disclosure requirements: initial disclosure about the issuer and the offering on Form C (Form C requirements resemble the Form 1-A requirements for a Regulation A offering) including a discussion of:

- | | |
|---|--|
| <ul style="list-style-type: none">• Use of Proceeds• Targeted Offering Size• Offering Price• Description of the business• Identify directors and officers• Beneficial Ownership and Capital Structure, ID owners of 20% or more of the equity• Indebtedness | <ul style="list-style-type: none">• Related party transactions of a certain size;• Description all exempt offerings in the prior 3 years;• Risk factors;• Transfer restrictions; and• Management’s Discussion and Analysis• Information about the intermediary/portal |
|---|--|

Reg CF – Financial Statement Requirements

- Prepared in accordance with U.S. GAAP.
- Audited financial statements in accordance either with AICPA standards or PCAOB standards.
- Requirements depend on the target offering size as follows:
 - **\$100,000 or less:** 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. If not, issuer must disclose 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.
 - **More than \$100,000 and less than \$500,000:** If financial statements have been audited by a public accountant independent of the issuer, the issuer must provide the audited statements. If not, it must provide financial statements reviewed by a public accountant independent of the issuer.
 - **More than \$500,000:** If audited statements are available, they must be provided. If not, Issuer must provide 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.

Reg CF – Advertising, Post-Offering reporting

- **Advertising:** an issuer's ability to advertise or promote the offering is limited to certain offering notices (basic offering details) and certain communications with potential investors made exclusively through the platform
- **Intermediary restrictions and requirements:** the intermediary is subject to providing investor educational materials
- **Reporting following the offering:** until an issuer terminates its reporting obligations, it is required to file amendments for material changes (C/A), periodic updates (C-U) and annual filings (C-AR). The issuer may terminate its reporting obligations when:
 - 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.

Reg CF – Transfer Restrictions

- **Transfer Restrictions** – Securities will be **freely tradable after one year** from the date of purchase. During the first year resales are restricted to
 - the issuer
 - an accredited investor
 - a sale as part of a registered offering, or
 - to a family member or in connection with certain life events such as death, divorce.
- There are no venture exchanges or other secondary sales market place in the US.

Reg CF – No risk of triggering Periodic Disclosure Requirements under the 1934 Act

Securities sold under Reg CF are exempt from the “holder of record” tally that could trigger requirements to file periodic reports meeting the standards of a US public company.

Issuer must **establish a means for tracking record holders**, which includes engaging services of a transfer agent.

Record holder tally rule:

- Issuer (US or foreign) must register with the SEC within 120 days after the end of its fiscal year when:
- It has total assets in excess of \$10 million, and
- Either 2,000 or more US holders of record or 500 US holders who are not accredited investors.

No integration issues with other types of exempt offerings (prior, concurrent or subsequent).

Reg CF – Intermediary Platform Requirements

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.”

Reg CF Intermediary as Investor in an Issuer

- Directors, officers or partners of the intermediary may not have a financial interest in the issuer.
- An intermediary may have a financial interest in an issuer on the platform if
 - 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.

Reg CF Intermediary Responsibility to reduce the Risk of Fraud

- 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 may 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**, or that the issuer, or any of issuer's officers or directors is disqualified as a "bad actor"
- **Background check requirement** - 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.

Reg CF Intermediary - Account and Information Delivery Requirements

- Investor must create an account with the intermediary.
- Investor must agree to electronic delivery of materials.
- Intermediary must deliver educational materials to investors.
 - 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.

Reg CF – Intermediary as Baby Sitter

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.
- Demonstrates that it understands that there are restrictions on its 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.

Reg CF – Intermediary Must Verify that Investor is in Compliance with Limitations

- 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.
- Intermediary may rely upon the representation of the investor.

Reg CF – Rights of Investors to Cancel

- Investors have an unconditional right to cancel an investment commitment for any reason until 48 hours prior to the deadline set in issuer's offering materials.
- Deadline can be shortened if an issuer reaches the target offering amount prior to the deadline identified in its offering materials, it closes the offering and sets a new deadline as long as the offering had been open for a minimum of 21 days.
 - Intermediary notifies investors of the new deadline at least 5 business days prior to the new offering dead line, and
 - Investors have opportunity to reconsider investment and cancel their commitment up to 48 hours prior to new deadline, and
 - At time of new deadline, issuer has continued to meet or exceed the target offering amount.
- Intermediary must send investors information about a material change to the terms of the offering or the issuer's information, with notice that the commitment will be automatically cancelled if not reconfirmed within 5 business days of receipt of the notice, followed up by a refund if reconfirmation is not received.

Reg CF – Intermediary Management of Failed Offering

- If an issuer does not complete an offering because the **target is not reached** or the **issuer decides to terminate the offering**, within 5 business days the intermediary 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 future commitments** – block investors from making investment commitments with respect to that offering on its platform.

Reg CF – Intermediary Prohibited Actions

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
- Hold, manage, possess or otherwise handle investor funds or securities

Reg CF – Intermediary Permitted Activities

- **Provide communications channel** for potential investors to communicate about the merits of an offering.
- **Highlight Issuers and Offerings based on objective criteria**, such as the type of security, geographic region, industry, etc. The funding portal cannot receive special or additional compensation for highlighting one or more issuers or offerings on its platform.
- **Advise Issuers** about the structure or content of its proposed offering and prepare offering documentation.
- **Pay for Referrals:** a funding portal may pay for referrals, subject to various limitations.
- **Have Compensation Arrangements with Registered Broker-Dealers:** 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.
- **Advertise its services** as well as offerings that are available through its platform, subject to compliance with various requirements.
- **Limit Offerings** on its platforms (i.e., 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.

Reg CF – Intermediary Registration

An intermediary must be

- **a broker-dealer** registered 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 be a **member of a national securities association** registered under Section 15A of the Exchange Act, which is FINRA.

Streamlined registration process, easier than for a broker-dealer (“Form Funding Portal”), which is 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.

No fidelity bond is required.

A portal may operate multiple website addresses.

Reg CF - Foreign Issuers and Foreign Portals

Can a non-US company rely on Regulation Crowdfunding? No.

Issuers must be domiciled in the United States. A foreign private issuer must use a US operating entity.

Can a non-US crowdfunding platform operate a platform in the United States?

Yes. But subject to additional requirements.

- An **information sharing arrangement** is 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.
- It **designates an agent for service of process in the United States**, and provides 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.
- It **consents 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 its investment-related business, may be **main address** or mailing address indicated on the form.

Regulation Crowdfunding Performance Statistics

First 16 Months After Effective Date

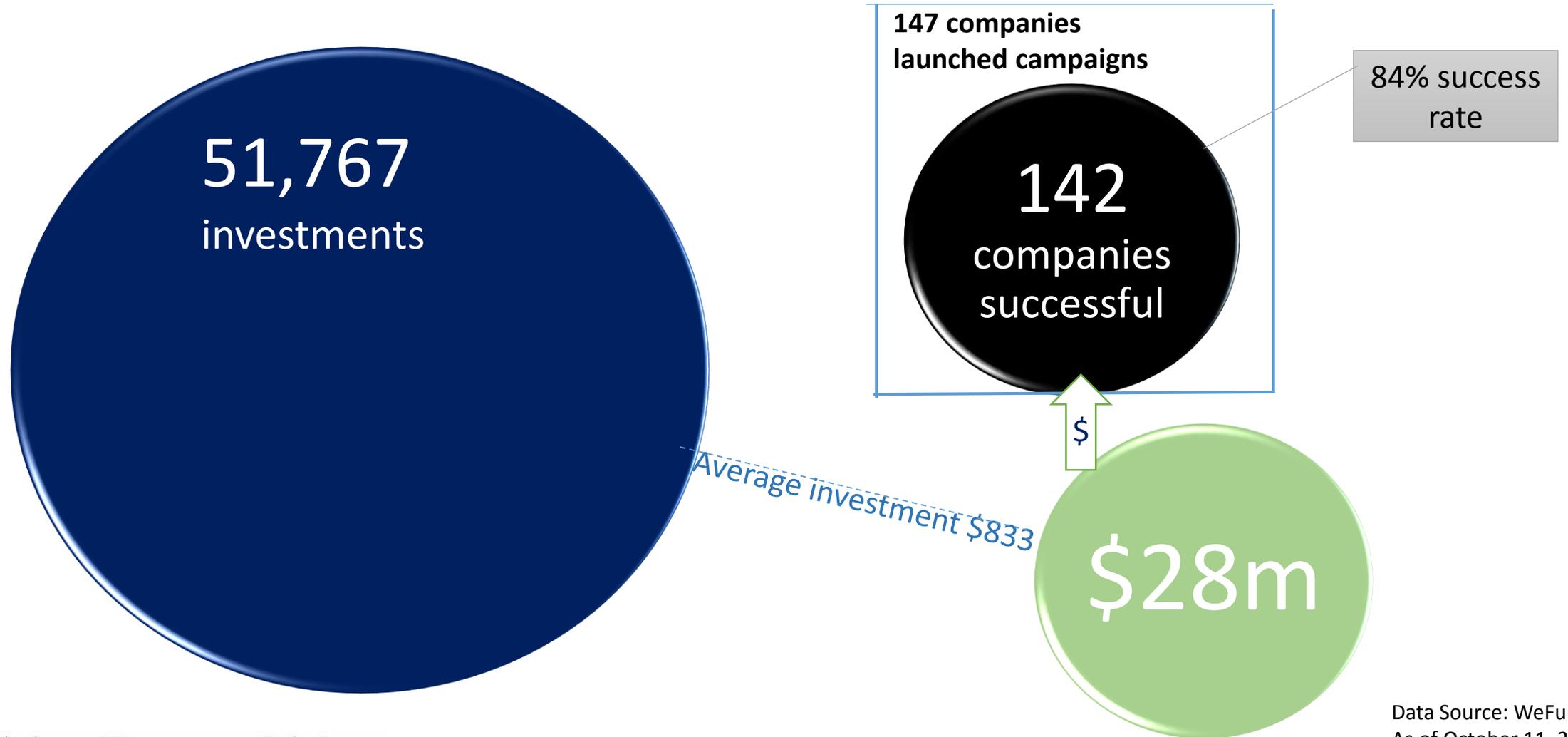
(May 16, 2016 through October 5, 2017)

How many platforms?

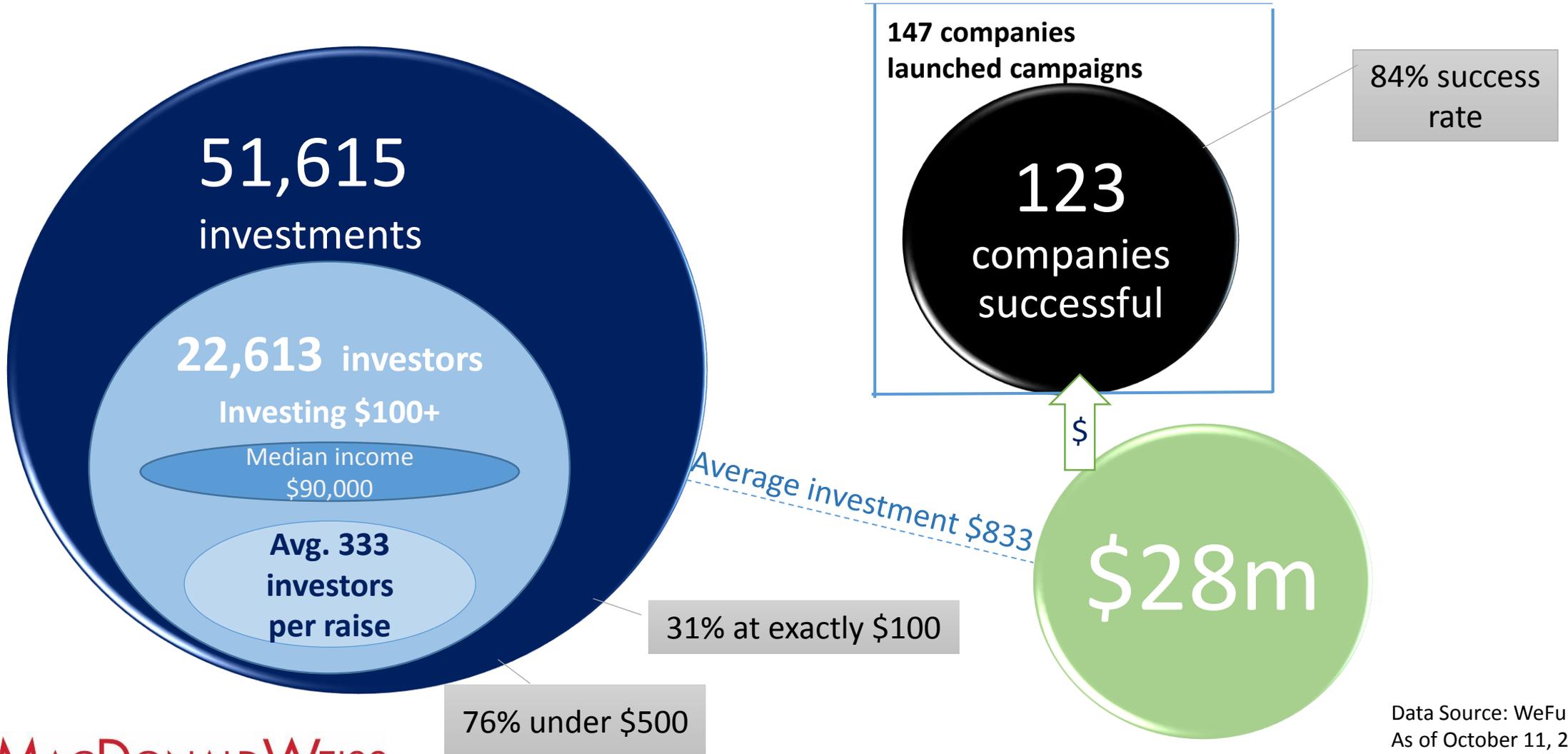
Platforms launched:

- **21 debt and equity crowdfunding platforms launched**
- 1, Ufunding Portal, was shut down by the SEC because it did not meet some of the statutory requirements required of a funding portal (like a communication channel where potential investors could ask questions to issuers).

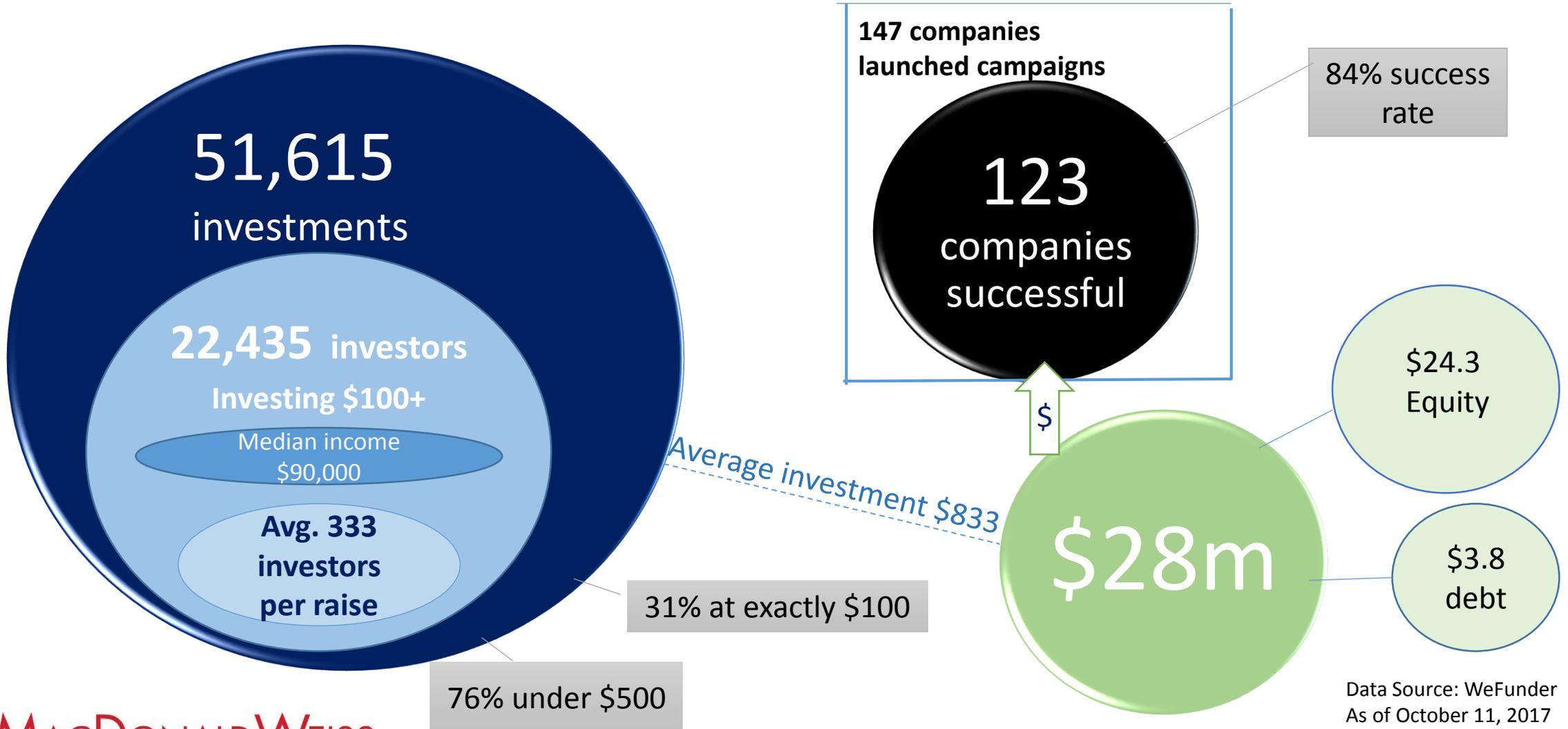
Startup Crowdfunding Investments May 2016 – Oct 2017



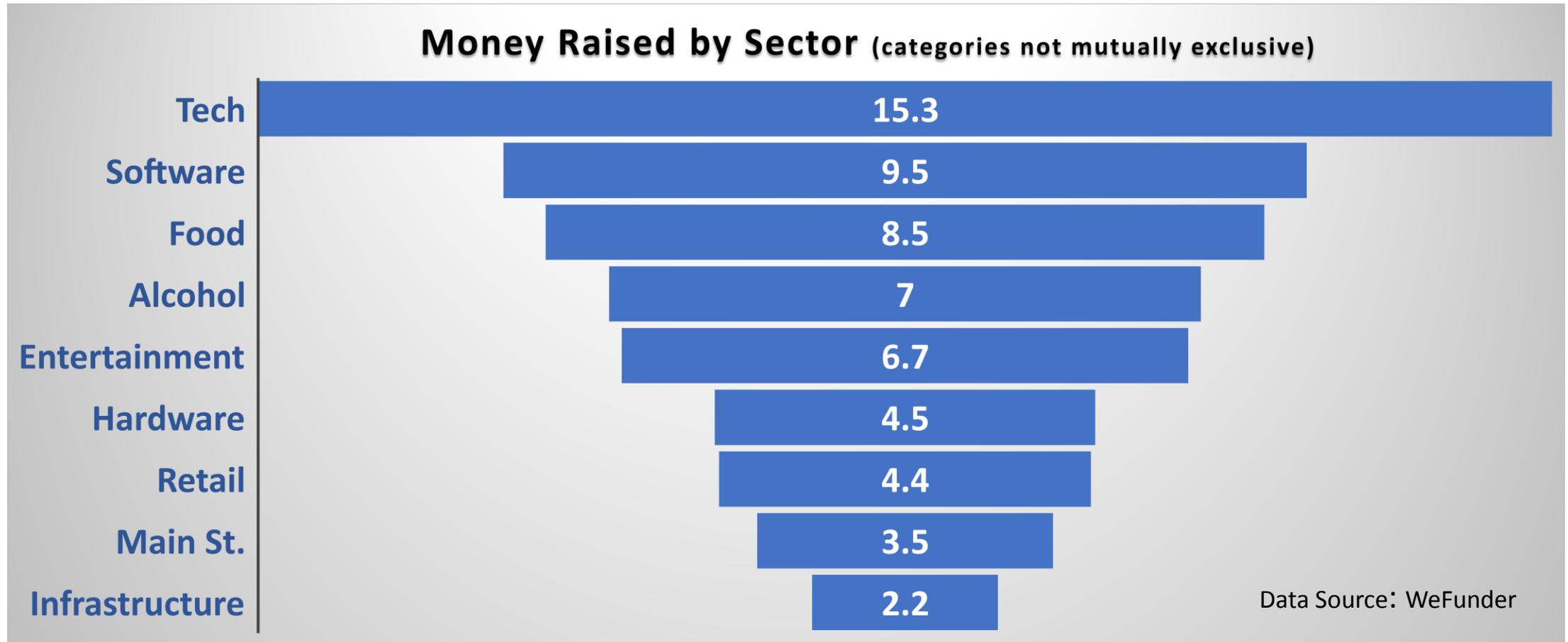
Startup Crowdfunding Investments May 2016 – Oct 2017

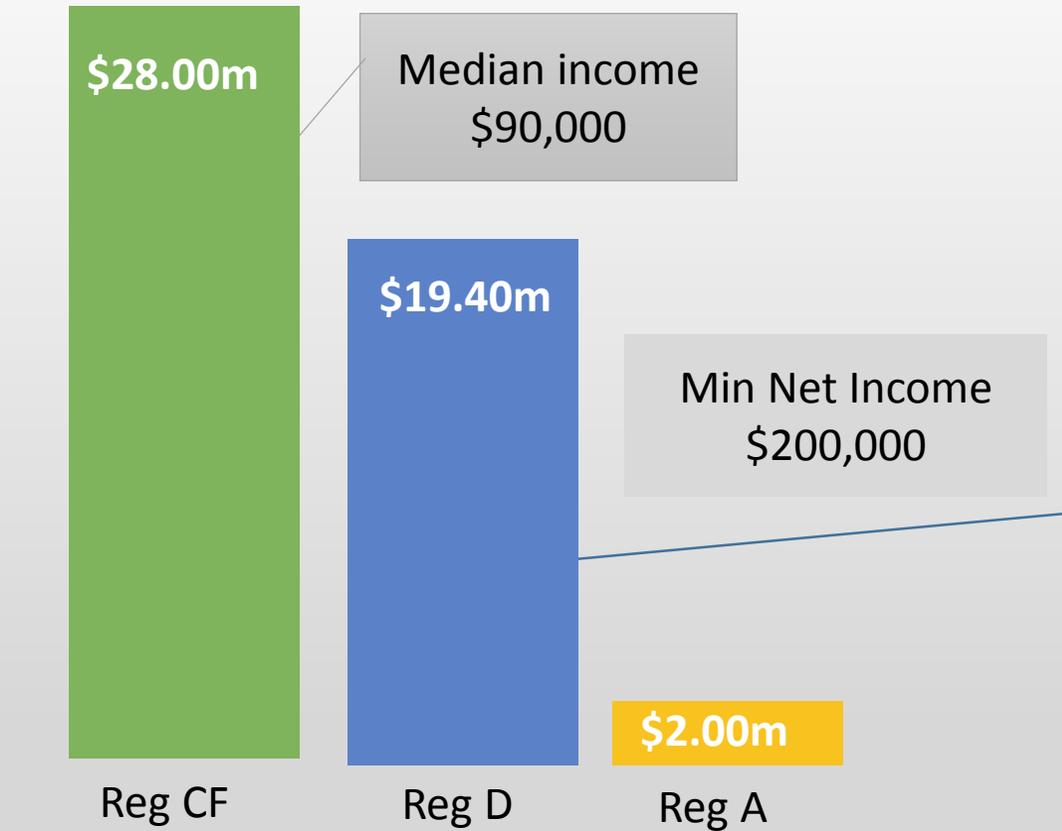


Startup Crowdfunding Investments May 2016 – Oct 2017



Total Startup Capital Raised by Sector (all private funding methods)





FUNDS RAISED

Data Source: WeFunder

Figures represent funds raised on WeFunder only

Valuations are in line with VC funded companies

The average valuation for a funded campaign was
\$5.3 million.

Source: WeFunder

Job creation looks good

Together, the companies funded in 2016 plan to create about

- 173.8 jobs over the next 90 days
- 2.2 jobs per funding company.

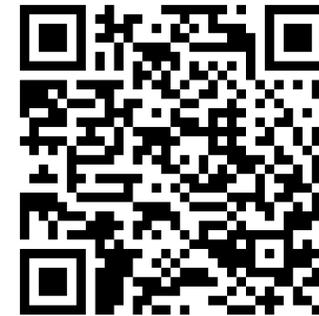
Source: WeFunder

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