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SEC'S CROWDFUNDING RULE PROPOSAL TURNS ONE YEAR-OLD - BUT STILL NOT FINAL

On October 23, 2013, the U.S. Securities and Exchange Commission staff proposed a 500+ page set of rules and regulations for Title III of the 2012 JOBS Act, better known as Crowdfunding. Crowdfunding was the most publicly discussed portion of the JOBS Act, but the Reg D general advertising change was finalized first, and the Reg A+ component may have generated more excitement in some circles. Now, one year after their proposal, the federal Crowdfunding rules have not been adopted or finalized, so the nascent securities crowdfunding industry has had to take some detours to actual activity.

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State Crowdfunding

Apparently not content to wait for the Commission to finalize the federal Crowdfunding rules, and likely in response to demand by their constituents, several state regulators have proposed and finalized statutes or regulations creating state-specific investment-grade crowdfunding. Alabama, Georgia, Idaho, Indiana, Kansas, Maine, Maryland, Michigan, Nebraska, Tennessee, Washington and Wisconsin have all approved some form of an exemption from state securities registration that features an Internet-based platform for soliciting investments. The great majority of these states use the classic intrastate exemption (SEC Rule 147) requiring that the issuer restrict its offer and sales to purchasers residing in the state where the issuer was incorporated or organized and conducts most of its business. Several other states are considering similar intrastate crowdfunding exemptions, and while placing state-border restrictions around internet-based securities offerings presents a variety of challenges, the industry is responding. New platforms that specialize in intrastate crowdfunding are raising funds for startups and entrepreneurs, including localstake.com, which has raised several million dollars, and Potluck Capital, an Indiana-based "CrowdVesting" platform. Intrastate crowdfunding has brought the JOBS Act's concept to the public, but the eventual finalization of the Commission's version will have a definite impact on these state-level efforts. Further, the broker-dealer and investment adviser industry is faced with new challenges as their clients begin to explore these new investment vehicles.

Accredited Crowdfunding

Other components of the JOBS Act appear to be borrowing from the Title III crowdfunding concept, none more obviously than the softened restrictions on general solicitation under Title II of the 2012 law. The JOBS Act lifted the generations-old ban on general advertising of private securities offerings – Regulation D, Rule 506 exempt securities offerings traditionally allowed investors to avoid costly registration activities when selling to accredited investors, but prohibited public advertising of those offers. Now, under the new Rule 506(c), issuers can publicly advertise the sale of their securities, as long as they only sell to accredited investors and take reasonable steps to verify that status. This significant change has led to the introduction of equity or investment crowdfunding Internet platforms that cater to accredited investors. The change allows these platforms to publicly advertise and promote private investments available only to accredited investors. Some of these platforms continue to utilize the still-available, non-general-solicitation Rule 506 exemption (now known as 506(b)), but such offers are presumably hidden behind registration requirements and other indicia of the traditional accredited approach. One sector where this expansion of the Rule 506 approaches has gained particular traction is real estate, led by new-ish platforms such as CrowdStreet, Fundrise and RealtyMogul. Other, non-real-estate-specific platforms are also developing, including well-known AngelList.

What's Next

Though a full year has now passed since the Commission proposed its Crowdfunding rules, every indication is that those rules will, eventually, be finalized and available to investors and those seeking capital. There is a large amount of activity and resources standing by for this development, though some, as noted above, have already made certain plays in an attempt to stake out valuable territory. Formal implementation of the Title III Crowdfunding regulations will undoubtedly affect the various state exemptions cropping up nationwide, and the platforms offering services through these intrastate crowdfunding exemptions will have to adapt and react. The Accredited Crowdfunding sites will also have the opportunity, or at least the option, to expand into the non-accredited, JOB Act-contemplated area of crowdfunding when the rules are finalized, bringing diversity (and new compliance challenges) along with it.