INNOVATION LECTURE SERIES

“Your Must-Know Guide to Crowdfunding Regulations for 2016”

featuring

Alexander McClean
Harter, Secrest & Emery LLP

AGENDA:  Introduction
Featured Speaker
Q&A
WELCOME

Christina P. Orsi
Associate Vice President for Economic Development
University at Buffalo
UB CAT 2016-2017 RFP Opens Today!

January 21, 2016

University at Buffalo Center for Advanced Biomedical and Bioengineering Technology (CAT) Request for Proposals

- Info Session #1: Wednesday, February 10 | 9 a.m. at the CBLS
- Info Session #2: Monday, February 22 | 4:30 p.m. at the CBLS
- Applications due by 5 p.m. EST on April 1, 2016
- For more information, visit: buffalo.edu/cbls/cat
UPCOMING EVENTS

January 31, 2016

Launch Pad PITCH Competition
Collision Conference
New Orleans, Louisiana

- Compete for title of “Best Startup” at this year’s Collision Conference
- Tech entrepreneurs encouraged to apply. Only 3 will be chosen to compete in New Orleans against 18 of the nation’s strongest tech startups for the top prize
UPCOMING CMI EVENTS

February 18, 2016 | 2:45 p.m. – 3:45 p.m.

CMI Industry Collaboration Showcase
CBLS, 701 Ellicott Street

- Hear how the CMI is helping fund industry collaboration by driving innovation and helping new and existing businesses become more competitive through technological innovation.

- Featuring representatives and principal investigators from Healthcare Hub, Vader Systems, POP Biotechnologies and Unifrax

- Innovation Lecture Series to follow

- To register, visit industry-panel.eventbrite.com
UPCOMING CMI EVENTS

February 18, 2016 | 4 p.m. – 5 p.m.

Innovation Lecture Series: “Introduction to UB’s Department of Materials Design and Innovation (MDI)”
CBLS, 701 Ellicott Street

- Featuring Krishna Rajan, PhD – MDI Chair

- Leverages UB’s faculty strengths in materials science, engineering, and informatics to meet regional and national demands for accelerated materials’ discovery and development.

- Beakers & Beer to follow at HWI.
To register, visit ub-mdi.eventbrite.com
UPCOMING CBLS EVENTS

May 17 – May 25, 2016

Pre-Seed Workshop, Buffalo
CBLS, 701 Ellicott Street

- A forum for high-tech ideas with potential—bring an idea from concept to plan in just two days

- Looking for **Idea Champions and volunteers** for the 2016 workshop

- Contact Sandra Small, PhD at **sksmall@buffalo.edu** for more information
PARTNER EVENTS

January 27-28, 2016

SUNY Academic Industry Roundtable (SUNY AIR)
SUNY Global Center, 116 E 55th St, New York, NY 10022

- Theme: Clinical and Translational Research
- Opening remarks by Alexander Cartwright
- Questions? Contact Bryan Allinson
  bryan.allinson@rfsuny.org | 518.434.7264
KEYNOTE SPEAKER

Alexander McClean
Partner
Harter, Secrest & Emery LLP
Overview

- New Crowdfunding rules adopted by the SEC on October 30, 2015
  - Become effective on May 16, 2016
  - Documentation to allow portals (website platforms) to register with the SEC will become available on January 29, 2016

- Current General Solicitation Rules for Rule 506 Offerings

- Regulation A+

- New Opportunities Exist for Capital Raising and New Markets being created
Crowdfunding Overview

- Title III of the JOBS Act required the SEC to adopt rules permitting crowdfunding.
- Crowdfunding is a method of capital raising that involves collecting small investments from many people through the Internet without having to file a registration with the SEC under the Securities Act and become a public company.
- The SEC issued proposed crowdfunding rules on October 23, 2013.
- Final rules were issued on October 30, 2015 – will become effective on May 16, 2016.
Overview of New Crowdfunding Rules

- Permits companies to raise up to $1 million over a 12-month period
- Sales must occur on a registered funding portal
- Mandates certain pre-offering and post-offering disclosures that must be filed with the SEC
- Limitations on the amount an individual investor can invest
- No general advertising
Crowdfunding Rules - Companies

Disqualification provisions

The following companies are prohibited from engaging in crowdfunding:

- Foreign companies (not incorporated in a US State or the District of Columbia)
- Public companies
- Investment companies and investment companies exempt from the definition of an investment company under Sections 3(b) or 3(c) of the Investment Company Act (primarily hedge funds, venture capital funds and private equity funds)
- Companies subject to certain bad actor disqualification provisions (modeled on, and substantially similar to, the “bad actor” disqualification criteria under Rule 262 of Regulation A and Rule 506 of Regulation D);
- Companies that have failed to comply with the annual reporting requirements during the two years immediately preceding the crowdfunding offering
- Companies with no specific business plan or purpose
- Companies whose business plan is solely to engage in mergers and acquisitions
Crowdfunding Rules - Companies

Disclosure Requirements

- Required to file Form C containing the information below with the SEC prior to the commencement of the offering
- Information about officers and directors and owners of 20% or more of the company
- Description of the company’s business, current number of employees and the stated purpose and intended use of the offering proceeds
- The offering price of the securities or the method for determining the price (provided that the final price and required disclosures are provided to each investor prior to any sales)
- The terms of the securities and the valuation method
- The target offering amount, the deadline to reach the target offering amount, regular updates about the issuer’s progress in meeting the target offering amount and whether the issuer will accept investments in excess of the target offering amount
Crowdfunding Rules - Companies

Disclosure Requirements (continued)

- Description of any related party transactions
- A description of the company’s ownership and capital structure
- Material indebtedness
- Risk factors tailored to the company’s business and the offering
- A description of transfer restrictions
- Information about exempt offerings conducted within the past three years
- All compensation paid or to be paid to the intermediary for conducting the offering (which may be disclosed as a dollar amount or as a percentage of the offering amount), as well as any other direct or indirect interest in the company held by the intermediary
- A narrative discussion of the company’s financial condition (including, to the extent material, liquidity, capital resources and the company’s historical results of operations, as well as any material changes or trends known to management subsequent to the period for which financial statements are provided)
Disclosure Requirements (cont.)

- Financial statements
  - If total aggregate offering amount is $100,000 or less, then company will be required to include financial statements derived from the company’s income tax return that the CEO must certify as accurate
  - If total aggregate offering amount is more than $100,000, but less than $500,000, then the company will be required to include financial statements reviewed by an independent public accounting firm
  - If total aggregate offering amount is more than $500,000, then the company will be required to include financial statements that have been audited by an independent public accounting firm

- Also require company to disclose in its offering statement if it, or any of its predecessors, previously failed to comply with the ongoing reporting requirements

Updates to Disclosure

- Updates to the disclosure are required to be filed with the SEC within five business days of the following events:
  - commitments for 50% of the deal are received
  - commitments for the full deal are received
  - subscriptions will be accepted in excess of the initial offering amount
  - or the issuer closes the offering
Crowdfunding Rules - Companies

Annual Disclosure Requirements

- Within 120 days of its fiscal year end, companies that complete a crowdfunding offering must file an updated Form C including the same information, except for the offering specific information.

- Only have to provide financial statements certified by CEO, unless the company has financial statements that have been reviewed or audited by an independent accounting firm.

- Obligation to file an annual report continues until the earlier to occur of the following:
  - The company becomes a public company.
  - The company has fewer than 300 stockholders of record and has filed at least one annual report.
  - The company has total assets of $10 million or less and has filed at least three annual reports.
  - The company or another party purchases or repurchases all of the securities offered in the crowdfunding offering.
  - The company liquidates or dissolves.
Crowdfunding Rules - Companies

**Advertising Limits**

- Company not permitted to advertise the offering except to release an offering notice containing only the following information:
  - Statement that company is conducting offering
  - Name of the funding portal being used and a link to the funding portal’s website
  - The amount of securities being offered
  - Nature of the securities and price of the securities
  - Closing date for offering
  - Name, address, phone number and website for company
  - Email address of representative of the company
  - Brief factual description of business

- Company can only communicate directly with potential crowdfunding investors through the funding portal.
**Use of Promoters**

- In addition to using a funding portal, a company may hire promoters to facilitate crowdfunding transactions.
- Promoter must only communicate with potential investors through communication channels provided on the portals website or the promoter can only use the company’s notice to promote the offering outside the portal.
- Promoter must disclose the compensation it is receiving to potential users.

**Restrictions on Transfer**

- Securities sold cannot be transferred by the purchaser for at least one year from the date of purchase except for transfers to:
  - The company
  - An accredited investor
  - In connection with a registered offering
  - Family member of the purchaser or for estate planning purposes.
- SEC indicated that each company will be required to establish a means for tracking its shareholders.
Crowdfunding Rules - Companies

**Exemption from Exchange Act Section 12(g)**

- The final rules permanently exempt securities sold in a crowdfunding offering from the Exchange Act “holder of record” count for the purposes of determining if the company is required to register with the SEC and become a public company, provided that the following conditions have been satisfied:
  - is current in its annual reporting obligations
  - has engaged the services of a registered transfer agent and
  - has total assets as of the end of its last fiscal year not in excess of $25 million

*Crowdfunding transactions not subject to state securities laws*

*Can only post offering on one crowdfunding portal at a time*

*No limit on the type of securities that may be sold*
Crowdfunding Rules - Investors

- Within a 12-month period an investor is not permitted to invest more than the following amounts in all crowdfunding offerings:
  - $2,000 or 5% of their annual income, whichever is greater, if an investor’s annual income or net worth are less than $100,000
  - 10% of their annual income or net worth, whichever is lesser, but in no event more than $100,000, if either an investor’s annual income or net worth is equal to more than $100,000

- Net worth and annual income is calculated in the same manner as the accredited investor test under Regulation D

- Spouses may calculate their annual income and net worth jointly, but if they elect to do so, their aggregate investment cannot exceed the limit applicable to an individual investor at the same income or net worth level

- The company is allowed to rely on the efforts that the funding portal is required to undertake to ensure investor compliance with the investment limitations, provided the company does not have knowledge to the contrary.
Crowdfunding Rules - Portals

Crowdfunding transactions must be conducted exclusively online through platforms operated by an SEC-registered intermediary.

Intermediary must be either:
- SEC registered broker-dealer
- SEC registered funding portal

The registration requirements for funding portals are less extensive and less costly than those that accompany broker-dealer registration

Funding portal is required to become a member of FINRA in addition to being registered with the SEC
Portal is responsible for hosting a platform to:

- Facilitate the offer and sale of securities
- Provide information about the issuer and the offering for a minimum of 21 days before any security may be sold
- Take measures to reduce the risk of fraud
- Provide educational materials
- Provide communication channels to permit discussions to take place on the platform
- Provide notice of investment commitments and confirmation at or before completing a transaction
- Comply with maintenance and transmission of funds requirements
Crowdfunding Rules - Portals

- A funding portal may receive equity in the company that is offering or selling securities on its platform, provided that the portal receives the financial interest as compensation for its services, and the financial interest consists of securities of the same class and having the same terms, conditions and rights as the securities being offered or sold in the offering.

- Portal will not otherwise be permitted to invest in the offering.

- The portal must clearly disclose any financial interest it has in a company on the portal.

- A portal’s directors, officers or partners, however, are prohibited from having any financial interest in a company using the portal’s services and from receiving equity in the company as compensation for such services.
Crowdfunding Rules - Portals

- **Account Opening**
  - Investor must open account on portal and consent to the electronic delivery of documents
  - Portal must deliver investor educational documents including information about the use of paid promoters
  - Must disclose compensation portal will receive from company

- **Public disclosure filed with the SEC must be available on portal for the entire offering period** – must be posted for at least 21 days before securities can be sold

- **Portal must have “reasonable basis” for believing the investor satisfies investment limitations** – may rely on investor’s representations

- **Communication channel must be available and the portal cannot participate in these communications, except to establish guidelines to remove abusive or potentially fraudulent communications**
Crowdfunding Rules

Concerns with proposed crowdfunding rules

- Popularity of Rule 506(c) – concern that best companies will crowdfund on 506(c) sites due to reduced cost and additional flexibility
- Cost to prepare disclosure documents and requirement to hire funding portal
- $1 million limitation and investor limitations
- Inability to engage in general solicitation
- Due diligence required and liability of funding portals
- Cost of annual reporting requirements, transfer agent, large shareholder base, corporate formalities – board meetings, annual shareholder meeting, etc.
- Concerns that venture capital funds and other institutional funds will avoid companies that have raised money from crowdfunding
- Downsides will likely discourage many small companies from relying on the exemption – may end up as the option of last resort for small businesses
State Crowdfunding Exemptions

- Rule 147 of the Securities Act exempts offerings of securities limited to residents of one state.

- At least 29 states and the District of Columbia (but not New York) have adopted state crowdfunding exemptions, legislation proposed in seven states.

- Exemptions in each state differ significantly, but many are less restrictive than the SEC’s crowdfunding rules.

- Opportunity for local businesses and local who to invest and support the growth of local businesses.
General Solicitation in Rule 506 offerings

- New Rule 506(c) – an exemption under Section 201 of the JOBS Act as opposed to a safe harbor under Section 4(a)(2) of the Securities Act
- Permits general solicitation
- Sales solely to accredited investors
  - In December 2015 the SEC released recommendations regarding new accredited investor definition
  - Adds sophistication test (securities license, educational background, sophistication test)
  - Investment limit of 10% of income or net worth for investors with annual income of less than $500k or Net Worth of less than $2.5 million
- Must take reasonable steps to verify accredited investor status
- Bad actor disqualification
- General solicitation still prohibited under Section 4(a)(2) of the Securities Act
Regulation A+

- JOBS requires the SEC to adopt rules to create a new exemption that is similar to Regulation A
- Permits offerings of up to $50 million over a 12-month period (Tier 1 up to $20 million and Tier 2 offerings in excess of $20 million)
- Able to engage in general solicitation with no restriction on resale of securities sold
- Tier 1 subject to state blue sky law, but NASAA has developed a multi-state streamlined review process for Regulation A+ offerings
- Companies can solicit interest from potential investors before filing an offering statement with the SEC
- Requires filing of an offering statement subject to SEC review and periodic disclosures with the SEC – reduced disclosure for Tier 1 offerings and Tier 1 does not require audited financial statements
- No requirement that company have operations – leaving open ability of private funds, including REITs to use Regulation A+ to crowdfund online to non-accredited investors
## New Alternatives for Unregistered Capital Raising under the JOBS Act

<table>
<thead>
<tr>
<th>Feature</th>
<th>Crowdfunding</th>
<th>Regulation A+</th>
<th>Regulation D Rule 506</th>
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</thead>
<tbody>
<tr>
<td>Maximum Offering Amount</td>
<td>$1 million per 12-month period</td>
<td>$50 million per 12-month period</td>
<td>Unlimited</td>
</tr>
<tr>
<td>Number of Investors</td>
<td>Unlimited</td>
<td>Unlimited</td>
<td>Unlimited accredited investors, up to 35 non-accredited investors</td>
</tr>
<tr>
<td>Maximum investment per investor</td>
<td>Limited by income/net worth</td>
<td>Unlimited</td>
<td>Unlimited</td>
</tr>
<tr>
<td>Disclosure Required</td>
<td>Yes, Form C must be filed with SEC</td>
<td>Yes, offering statement must be filed with SEC</td>
<td>Not required if sold only to accredited investor – if sold to unaccredited investors disclosure is required but no requirement to file with the SEC</td>
</tr>
<tr>
<td>Ongoing SEC Disclosure Required</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Intermediary Required</td>
<td>Yes, broker-dealer or funding portal</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Advertising permitted</td>
<td>No</td>
<td>Yes</td>
<td>Yes, if sold solely to accredited investors.</td>
</tr>
<tr>
<td>Resale Restrictions</td>
<td>Yes, for one year</td>
<td>No</td>
<td>Yes, up to one year</td>
</tr>
<tr>
<td>State filings required</td>
<td>No</td>
<td>Yes for Tier 1 offerings, no state review of Tier 2 offerings</td>
<td>No registration is required, but must provide notice in each state securities are sold</td>
</tr>
<tr>
<td>Liability</td>
<td>Full disclosure liability with a knowledge exception</td>
<td>Full disclosure liability with knowledge exception</td>
<td>Only anti-fraud liability</td>
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</table>
New Alternatives for Unregistered Capital Raising under the JOBS Act

Key Takeaways

- For companies seeking capital there are many new alternatives available to you.
- Many of these new alternatives represent entirely new markets that have yet to consolidate around established providers.
- Go in eyes open – be aware of the risks and dig in and complete your own due diligence – watch the fees.
- Don’t be afraid of innovation – be creative and work with your trusted advisers to find creative and legal ways to raise capital.
Blurring of line between public and private company under the JOBS Act

- JOBS Act revised registration provisions of Section 12(g) of the Exchange Act
- Previously a private company had to register with the SEC if it had 500 or more shareholders of records and more than $10 million in total assets
- Now companies can have up to 2,000 shareholders of record so long as not more than 500 of its shareholders are non-accredited investors
- The following shareholders are excluded from shareholder of record calculation:
  - Shares issued to employees in reliance on a Securities Act exemption (such as Rule 701)
  - Shares issued in crowdfunding and Regulation A+ offerings
Blurring of line between public and private companies

- Now possible for a company to have thousands of shareholders and not be required to register with the SEC.

- With the rise of platforms such as SecondMarket that match sellers of private company stock with buyers, there is a more liquid market for the stock of private companies with a broad shareholder base.
  - Passage of RAISE Act in December 2015 formalizes an exemption permitting shareholders in private companies to sell their shares on a secondary market.

- Robust private offering market, reduces the need for a private company to go public to raise operating capital or because of the size of its shareholder base.
Trends in Private Capital Raising

- "Private" capital raising is becoming more public, blurring the line between public and private offerings.
- As solicitation moves to the Internet, more opportunity for fraud.
  - Moving away from private capital raising model that was based on personal relationships to raising capital from complete strangers – natural safeguards from fraud are no longer present.
- Rising use of trading platforms and financial intermediaries in the private capital space.
- Companies are now able to elect when they want to become subject to the Exchange Act and become public.
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Thank You

Q&A