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New SEC Rules Soon to Facilitate Crowdfunding

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On November 2, 2020, the Securities and Exchange Commission ("***SEC***") voted to amend the rules on exempt securities offerings to harmonize various fundraising rules and facilitate access to capital for companies. Some long-awaited changes concern the crowdfunding rules (also known as Regulation Crowdfunding or "***Reg CF***"). These changes are due to come into effect on March 15, 2021.

1. What is Reg CF?

Reg CF (CFR Sections 227.100 through 227.504) enables certain companies to offer and sell their securities through crowdfunding. The rule is used by many startups to get funding at early stages.

More about Reg CF here.

2. Reg CF changes and what they mean for startups

Following the amendment to Reg CF, to be implemented starting mid-March 2021, the offering limit in Regulation Crowdfunding is raised from a total of $1.07 million to $5 million within a 12-month period. The former limit of $1.07 million was too low for many startups to survive on only Reg CF fundraising for 12 months. A startup's burn rate, being what it is in a highly competitive environment like Silicon Valley, resulted in Reg CF being underutilized. But a $5 million limit will allow startups to rely on Reg CF as a standalone fundraising option, keeping the company functioning until its next development milestone and maybe even providing some cushioning for unexpected slow-downs such as many startups saw with COVID.

The U.S. is not alone in increasing the crowdfunding limit, but it is somewhat late. France increased its limit to €2.5 million as early as 2016. In 2018, both the U.K. and Germany upped their respective limits to allow companies to crowdfund without a prospectus (similar to the registration statement in the U.S.) up to €8 million.

The SEC also amended the investment limits for investors in Regulation Crowdfunding offerings by:

- Removing investment limits for accredited investors; and
- Using the greater of (as opposed to the lesser of under the current rules) a non-accredited investor's annual income or net worth when calculating the investment limits for such investors.

The SEC's amendment extends for 18 months the existing temporary relief, providing an exemption from certain Regulation Crowdfunding financial statement review requirements for companies offering $250,000 or less of securities in reliance on the exemption within a 12-month period.

Prior to the amendment, there were no clear rules as to the ability of a company to benefit from several exemptions in parallel or in close time proximity. The amendment establishes a new framework for companies to follow and allows companies to use newly created safe harbors for multiple offerings. Of particular interest for companies wishing to lead several successive crowdfunding campaigns is the new rule under which an offering will be a standalone offering (not integrated with another subsequent or previous offering) if it was made over 30 days before the commencement of any other offering or over 30 days after the completion or termination of any other offering. Additional conditions apply if the crowdfunding follows an offering that allows general solicitation (for example, if the company had an offering under rule 506(c)). More information regarding the amendment can be found on the SEC's website.

What does all this mean for companies, early stage ones in particular?

This amendment means that early stage companies now can count Reg CF offerings as an alternative to Rule 506 offerings and non-accredited investors can invest much more money than allowed in current Reg CF offerings. All these measures ultimately contribute to enhancing a company's ability to raise funds.

Reg CF offerings are somewhat costly for early stage companies and such costs become more taxing if the crowdfunding campaign fails to reach its fundraising target. The new rules will allow companies to use generic solicitation of interest materials to "test the waters." This should help companies test investors' interest in the offered securities and thereby weed out offerings that risk failing. This will help companies save the money they would otherwise have spent on filing the costly offering disclosures with the SEC for a Reg CF campaign that would have eventually failed.

If you have questions regarding the new crowdfunding rules or the other amendments to the rules regarding exempt securities offerings, please contact the attorneys below, or any member of our Emerging Companies and Venture Capital group.