FEATURED ARTICLE

Crowd Funding and the JOBS Act

On April 5, 2012, President Obama signed the Jumpstart Our Business Startup Act, commonly referred to as the JOBS Act, into law. Within the JOBS Act, Crowd Funding has gotten the greatest amount of attention. Crowd Funding allows companies to attract investors through a controlled method of public solicitation, and raise funds in the process through the issuance of restricted securities. Basically a form of a public offering of privately held stock in a company.

Despite what you may have heard or read, the JOBS Act does not open up Crowd Funding into an unregulated free for all, akin to the Wild West of finance and investing. The JOBS Act actually attempts to regulate Crowd Funding and provide investors a variety of protections in the process. The JOBS Act places the following limitations on Crowd Funding:

Funding Through a Registered Intermediary: The JOBS Act places several restriction on intermediaries in the crowd funding process. The first is that intermediaries in the Crowd Funding process must register as either a broker/dealer or as a funding portal; and that they are also registered with the appropriate self-regulatory organization (SRO). For those who are not familiar, self-regulatory organizations are organizations that exercise regulatory authority over an industry or profession. Basically in order to do business within certain industries you either become a member and play by the rules of the appropriate self-regulatory organization or they kick you out of the organization and ban you from the industry. What this means for Crowd Funding is that it is either going to be conducted through broker/dealers who are members of the Financial Industry Regulatory Authority (FINRA) or a new Self Regulatory Organization is going to need to form and receive approval from the SEC to allow its members to participate in Crowd Funding activities. Until a new SRO is approved, only broker/dealers registered with FINRA will be able to serve as intermediaries in the Crowd Funding process.

The JOBS Act also places a requirement on Crowd Funding intermediaries to perform adequate due diligence on the companies that they assist in the fund raising process. These are pretty extensive requirements, and most likely the SEC will set the guidelines for these due diligence requirements in line with those set by FINRA under Regulatory Notices 10-22. (Additional information FINRA 10-22 can be found at our website www.coralcapital.com) The cost of performing and obtaining these due diligence reviews will most likely limit the number of smaller Crowd Funding projects.

Capital Raise Limitation: The JOBS Act limits the amount of funds that may be raised by business to $1 million during any 12 month period. The JOBS Act provides that the funds being raised shall only be available to the company when the targeted amount of capital has been raised. For example if a company needs to raise $500,000 to complete the development of a product or fund its operations for the next 12 months, the company will only receive the funds once the full $500,000 has been raised; not as the funds trickle in from investors. This is designed to protect investors from the risks associated with a company that is only able to raise a portion of the capital it needs. Additionally the JOBS Act gives investors the right to cancel their investment commitment prior to the actual release of funds.

Investor Limitation: The JOBS Act places strict limits on how much money an individual investor can invest in any single company or group of companies within a 12 month period. This limitation is broken down into two categories based upon an investor's annual income. If an investor's annual income or net worth is less than $100,000 per year, then that investor can only invest the greater of $2,000 or 5% percent of his annual income in a single company. If an investor's annual income or net worth exceeds $100,000 then the investor may invest up to 10% of their annual income or net worth in a company. However the amount invested cannot exceed $100,000.

■ BY ERIK S. NELSON

Issuer Disclosure and Reporting: There were a lot of articles prior to the passage of the JOBS Act deriding it for a lack of investor disclosure. However the JOBS Act significantly improves the disclosure requirements for private companies raising funds through the Crowd Funding process. While not as stringent as the current public company reporting requirements, the reporting requirements for a company in the Crowd Funding process are very similar and appear to be designed to contain a streamlined version of the same information that can be produced at a lower cost by the company seeking to raise capital. Additionally, companies that are privately held and participate in the Crowd Funding process will be required to file annual reports with the SEC, however they will not be required to file quarterly reports as publicly traded companies are required to do. Before people get too carried away criticizing the JOBS Act for the lack of requiring quarterly reports, everyone should remember that this is a vast improvement over the pre-JOBS Act requirements of no reporting by companies that have raised funds through private placements.

It is probably going to be late 2012 before the SEC finishes drafting the regulations governing Crowd Funding. Once the SEC publishes the new regulations it will be very important to have a good understanding of those regulations and ensure that one is working with a company that is in full compliance with those regulations. Hopefully I have been able to shed some light on the framework those regulations will be built upon. While Crowd Funding is currently focused on privately held companies, I believe that Crowd Funding will quickly be adopted by Micro-Cap companies seeking to fund their operations. As this process shakes out, it will obviously create some investor pain, however as the process refines itself and improves I believe it will become an important source of funding for America's next generation of high growth companies. ■

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