

# REGULATION CROWDFUNDING: WHAT DOES IT MEAN FOR NORTHERN KENTUCKY?

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Starting May 16, 2016, the Securities and Exchange Commission's ("SEC") ruling on Regulation Crowdfunding ("Reg CF") will go into effect, creating a ripple effect of consequences that could reverberate throughout the Northern Kentucky entrepreneurial ecosystem. Before delving into the potential changes caused by Reg CF, it is important to understand what exactly is affected by this SEC ruling.

When entrepreneurs and start-up businesses go through the arduous task of raising capital, they will generally use an exemption offered through Regulation D so that the business does not need to register with the SEC. However, the majority of the exemptions offered through Regulation D place restrictions on the amount of non-accredited investors that a business can have without triggering the reporting requirement to the SEC while accredited investors have very few, if any, restrictions. The definition of an accredited investor includes bankers, stockbrokers, and other individuals who meet a certain income or net worth standard. This distinction exists because the accredited investors are presumed to be financially sophisticated and therefore will be able to access the information that would otherwise be found in an SEC registration statement while non-accredited investors may lack the institutional knowledge to make prudent investments on their own.

Understanding the difference between an accredited and non-accredited investor is crucial to grasping the impact

of Reg CF. Under Reg CF, a company may publicly fundraise up to \$1,000,000 over a twelve-month period without any restrictions on the amount of non-accredited investors that can participate. However, there are various limits as to how much each investor can contribute in a twelve-month period while still complying with Reg CF. These limits are determined by their annual income and/or net worth. If either their annual income or net worth is \$100,000 or less, their investment limit is the greater of \$2,000 or five percent of the lesser of their annual income or net worth. If their annual income and net worth are both over \$100,000, their investment limit will be ten percent of the lesser of their annual income or net worth. Additionally, the reselling of securities sold through Reg CF is restricted for a period of one year.

While investors face certain restrictions, the company seeking funding through Reg CF must also learn to navigate several new rules to ensure compliance if they wish to crowdfund. The most notable of these include the following:



1. the company is limited to raising \$1,000,000 in a rolling twelve-month period through Reg CF;
2. the company must use only one Financial Industry Regulation Authority ("FINRA") approved funding portal to sell the securities to investors;
3. the company must make certain disclosures to the SEC through a new "Form C," including general organizational,

offering, and financial information.

In addition to these new rules, there are also specific financial disclosure requirements depending on the amount of money a company raises through a Reg CF cycle. If a company raises \$100,000 or less, the company must provide financial statements certified by the executive officer of the issuer to be true and complete in all material respects. If a company raises between \$100,000 and \$500,000, the company must provide financial statements reviewed by a public accountant that is independent of the issuer. If a company raises between \$500,000 and \$1,000,000, the company must provide audited financial statements from a public accountant. A caveat to the financial disclosure requirements under Reg CF is that there is a one-time exclusion from the audit requirements for a company's first Reg CF offering.

Although investors and companies need to take note of Reg CF, those who wish to create/operate a funding portal through which Reg CF offerings are made must also abide. Although the Reg CF restrictions on funding portals are largely outside the scope of this article, the expenses companies may incur by using funding portals are very much relevant to the practicality of raising capital through crowdfunding in this way. Because the process has yet to begin, the exact cost of using a funding portal to raise capital through Reg CF has yet to be determined but some estimates have shown that the fees paid to the portal could range from \$2,500 to \$56,000 depending on the amount raised through the portal. Therefore, the less a company raises through a portal, the less a company will have to pay in



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fees but if a company raises \$1,000,000 through a portal, the fees payable to the portal could be substantial. An important note regarding portal fees is that the fees are included in the \$1,000,000 limit that can be raised through Reg CF. This means that the actual capital raised by the company through crowdfunding in this manner will always be less than \$1,000,000 because of the treatment of the portal fees.

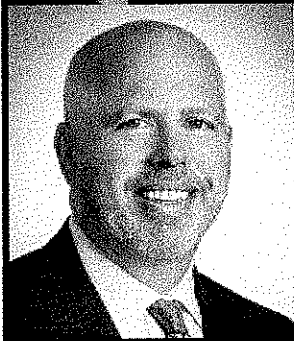
After outlining the nuances and mechanics of Reg CF, the natural question that follows is this: What does this mean for us in Northern Kentucky? Once Reg CF goes into effect, the pool of potential investors will expand exponentially. Instead of start-up businesses being forced to rely upon the benevolence of the aforementioned class of accredited investors, their pool of potential investors will include almost anyone who has a desire to support or purchase equity in a company regardless of their income

or net worth. While this will create the short-term benefit of new money into our entrepreneurial ecosystem, the long-term benefits of involving a significantly larger portion of the population in equity investing are incalculable.

As this region strives to become a haven for entrepreneurs, the opportunity presented by Reg CF to not only grow the base of potential investors but also create a culture of investing in a way that has never been possible must not be discounted. While there may be some growing pains associated with navigating the nuances of the funding portals and fee structures, the payoff associated with raising capital through Reg CF has the potential to be massive.

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