BURNS & LEVINSON LLP

SECURITIES LAW UPDATE

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Crowdfunding: SEC Proposes to Exempt From Registration Internet Offerings Up to $1 Million

Late in 2013, the Securities and Exchange Commission (SEC) proposed new rules that would, if approved, authorize the use of the Internet for so-called crowdfunding campaigns seeking up to $1 million per 12-month period from unlimited numbers of investors. As proposed, these campaigns would be exempt from traditional securities registration requirements.

The use of crowdfunding to date has typically involved raising modest sums of capital, in effect donations, from many small contributors over the Internet in order to fund a particular artistic project, such as the making of a film or musical CD. As employed in the U.S., it has not involved an investment through the sale of securities or participation in profits from a project; rather, contributors of funds have received a token of value, such as a film credit or a commemorative CD.

The Jumpstart Our Business Startups Act (the "JOBS Act"), enacted on April 5, 2012, established a legal foundation for business-related investment crowdfunding under new Section 4(a)(6) of the Securities Act of 1933, as amended (the "Securities Act"), directing the SEC to create a regulatory structure that would enable startups and small businesses to raise up to $1 million through crowdfunding over the Internet while protecting investors from fraud or deceit.

"There is a great deal of excitement in the marketplace about the crowdfunding exemption, and I'm pleased that we're in a position to seek public comment on a proposal to permit crowdfunding," said SEC Chairman Mary Jo White, adding that "we want this market to thrive in a safe manner for investors."

Nevertheless, since the SEC rule proposals were made, there has been much discussion by those involved in the capital markets as to whether the burdens put on issuers and intermediaries who might wish to take advantage of the crowdfunding exemption might outweigh the benefits, particularly in light of the $1 million limit in any 12-month period allowed by the exemption.

The JOBS Act, which mandated the promulgation of new rules, was previously summarized in our April 2012 Securities Law Update entitled, "JOBS Act Makes It Easier to Raise Capital." That update can be viewed at: http://www.burnslev.com/apps/uploads/publications/Securities_Law_Update_Apr2012.pdf

Following is a summary of the proposed rules, which generally provide the public with guidance as to:

- The parameters of the crowdfunding exemption, including limits on permitted capital raising, per-investor limits on securities purchases, and exclusions from eligibility applicable to certain issuers;
- The requirements imposed on crowdfunding issuers, including disclosure requirements, ongoing reporting requirements, filing requirements and prohibitions on advertising;
- The requirements imposed on crowdfunding intermediaries, including requirements regarding transactions with investors, rights to cancel subscriptions, and obligations to obtain and check certain issuer representations;
- The unique requirements and rights of funding portals, such as streamlined registration requirements, compliance and record-keeping requirements, exemption rights, and safe harbors for certain activities; and
- Special crowdfunding rules pertinent to restrictions on resale, information sharing with state regulators, disqualifications from exemption, and the scope of statutory liability.

In order to insure safety for investors, the SEC also proposed that all crowdfunding transactions must be conducted through a single (per offering) registered intermediary, and it offered a streamlined registration process for electronic funding portals that do not wish to become broker-dealers. One requirement for an electronic crowdfunding portal that wishes to be exempt from broker-dealer registration is that, as proposed, it must become a member of a registered national securities association, the only such association today being the Financial Industry Regulatory Authority ("FINRA").

The full text of the 585-page SEC Release no. 33-9470; 34-70741 (the "SEC Release") regarding proposed crowdfunding regulations can be viewed at: http://www.sec.gov/rules/proposed/2013/33-9470.pdf.

To view the related rule proposals issued by FINRA as an attachment to FINRA Regulatory Notice 13-34 regarding regulation of electronic funding portals (the "FINRA Release"), see the FINRA site at: http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/industry/p369763.pdf.

Public comments on both the SEC proposal and the FINRA rule proposals are due no later than February 3, 2014.

PARAMETERS OF THE CROWDFUNDING EXEMPTION

The SEC Release states that an issuer seeking the exemption from Securities Act registration requirements that Congress made available for crowdfunding transactions would have to comply with certain proposed requirements regarding:

- The dollar amount of securities to be sold in an offering;

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- The dollar amount that may be invested by any individual; and
- The use of registered intermediaries as offering conduits.

The SEC also describes limitations on who can and cannot rely on the new exemption.

1. Limitations on Capital Raised

Under the crowdfunding exemption, an issuer is allowed to raise an aggregate amount of not more than $1 million in a 12-month period without being subject to public offering registration requirements. However, capital raised under Regulation D or other exemptions will not, as proposed, be counted toward the $1 million limitation. Likewise, an issuer will not be required to count amounts offered but not sold in a 12-month period.

Under the proposed rules, amounts of securities sold by means of crowdfunding by "entities controlled by or under common control with the issuer" must be aggregated for purposes of determining compliance with the 12-month limitation.

2. Limitation on Investments

As proposed, the total amount of securities sold to any particular crowdfunding investor cannot exceed (though they may be calculated jointly with an investor's spouse):

- The greater of $2,000 or five percent of the annual income or net worth of an investor, whichever is greater, if either the investor's annual income or net worth is less than $100,000; and
- The greater of 10 percent of the annual income or net worth of such investor, not to exceed a total amount of $100,000, if either the investor's annual income or net worth is equal to or more than $100,000.

An individual's income and net worth would be determined in accord with the accredited investor calculation rules under Regulation D, and the allowable aggregate amounts per investor would be adjusted by the SEC at least once every five years based on the Consumer Price Index.

3. Intermediary Requirements for Transactions

As the SEC explained, new Section 4(a)(6)(C) of the Securities Act requires that a crowdfunding transaction must be "conducted through a broker or funding portal that complies with the requirements of Section 4A(a)."

The SEC interpreted this legislative requirement to mean that only one intermediary may be used for a crowdfunding offering in order to avoid potential mix-ups through multiple crowds.

The proposed rules would also require that an intermediary would have to effect crowdfunding transactions exclusively through its platform, and the term "platform" would be defined to mean an Internet site or similar electronic medium through which a registered broker or funding portal conducts an offering. The SEC explicitly ruled out the idea of permitting offerings through other widely accessible non-electronic means, stating that other means "would be inconsistent with the underlying principles of crowdfunding and the statute."

4. Exclusion of Some Issuers from Eligibility

Under new Section 4A(f) of the Securities Act, certain categories of issuers would not be eligible to use the crowdfunding exemption, including:

- Issuers that are not organized under the laws of a U.S. state or territory, or the District of Columbia;
- Public issuers that are subject to the reporting requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act");
- Investment Companies, as defined by the Investment Company Act of 1940 (the "Investment Company Act"), or similar companies that rely on exclusions from the definition of "investment company" under Section 3(b) or 3(c) of the Investment Company Act; and
- Any other issuer that the SEC determines appropriate by rule.

The proposed rules would also exclude any issuer that has sold securities in reliance on the crowdfunding exemption if that issuer has not filed with the SEC and provided to investors, as required, the ongoing annual reports during the two years preceding the filing of a new offering statement.

REQUIREMENTS IMPOSED ON ISSUERS

The SEC Release set forth a number of proposed requirements that would apply to issuers seeking to utilize the crowdfunding exemption from securities registration, including requirements pertinent to disclosure, ongoing reporting, filings, and certain prohibitions.

1. Disclosure Requirements

Under the crowdfunding regulatory scheme, an issuer would have to file specified disclosures with the SEC, and provide these disclosures to investors, potential investors, and the chosen intermediary for the offering.

1a. General Information and Offering Statements

The SEC proposed to require issuers to disclose information about crowdfunding offers on a new Form C. Among other things, a crowdfunding issuer would be required to disclose:

- Its name, legal status, form of organization, and jurisdiction and date of organization;
- Its physical address and Website address;
- The names of beneficial owners holding 20 percent or more voting securities; and
- The names of its directors and officers, including persons of similar status, their positions and offices held, the periods they have served in each position, and their business experience for the past three years.

1b. Description of the Business

A crowdfunding issuer would also have to disclose information about its business and business plan pursuant to proposed Rule 201(d). The SEC noted that some commenters to date have objected that business plans are for management's eyes only because they contain strategic information. The SEC stated that confidential information is not required to be disclosed, but the proposed rules do not specify exactly what kind of "business plan" disclosures are required.

1c. Use of Proceeds

An issuer must also disclose its definitive plan for use of proceeds from a crowdfunded

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offering under the proposed rules. The issuer, for example, would have to disclose its plan to use funds for acquiring assets, compensating employees or the intermediary, or repurchasing securities. If there is no definitive plan for the use of proceeds, then probable uses should be described.

1d. Target Offering Amount, Cancellation Rights and Offering Deadlines

The proposed rules would also require an issuer to disclose:

- The target amount of funds it is seeking;
- The deadline to reach that target;
- Whether it will accept investments in excess of the target amount, as well as the maximum amount that will be accepted; and
- How shares of oversubscribed offerings would be allocated.

Proposed Rule 201(j) would further require an issuer to make it clear that:

- Investors may cancel an investment commitment at any time until 48 hours prior to the deadline identified in the offering materials;
- The intermediary will notify investors when the target offering amount has been met;
- The issuer may close the offering early if it provides notice about the new deadline at least five business days prior to the new deadline; and
- If an investor does not cancel an investment commitment within the required time, the funds will be released to the issuer upon close of the offering.

1e. Offering Price, Ownership and Capital Structure

The proposed rules would require an issuer to disclose the offering price of its securities, or at least the method for determining the price. In any case, the issuer would have to provide each investor with written notice of the final offering price prior to sale.

In addition to providing a description of the terms of the securities being sold, the issuer would have to provide investors with:

- A description of each class of its existing securities, the number of securities being offered and outstanding, whether or not the securities have voting rights, any limitations on voting, how the terms of the securities may be modified, a summary of differences between all the securities, and how the rights of the securities may be limited, diluted or qualified by the rights of any other class of security;
- A description of how the exercise rights held by principal shareholders could affect the purchasers in the offering;
- The name and ownership level of all persons who are 20 percent beneficial owners;
- How the securities are being offered and valued with examples of methodology;
- The risks to purchasers relating to minority ownership, and the risks associated with potential future corporate actions (such as share repurchases or asset sales); and
- A description of the restrictions on transfer of the securities.

1f. Financial Disclosures

The crowdfunding rules also would establish a tiered set of financial disclosure requirements for affected issuers as follows:

- Issuers offering $100,000 or less will be required to file with the SEC, and provide to investors, potential investors and the intermediary, all issuer income tax returns for the most recently completed year, as well as financial statements that are certified as true and complete by the issuer's principal executive officer;
- Issuers offering more than $100,000, but not more than $500,000, will be required to file with the SEC, and provide to investors, potential investors and the intermediary, financial statements reviewed by an independent public accountant; and
- Issuers offering more than $500,000 will be required to file with the SEC, and provide to investors, potential investors and the intermediary, fully audited financial statements.

Any financial statements provided to the SEC or others would have to be prepared in accordance with U.S. generally accepted accounting principles, and cover the shorter of: (1) The two most recently completed fiscal years; or (2) The period since inception of the issuer's business. The SEC did not propose to prohibit issuers from providing financial statements that meet criteria for higher aggregate offering amounts if they so choose.

Affected issuers would also have to insure that financial statements are reviewed in accord with the Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants (AICPA).

Furthermore, for audited financial statements, the auditor would be required to be independent of the issuer, and the audit would need to be conducted in accord with auditing standards of either the AICPA, or the Public Company Accounting Oversight Board.

In addition, the proposed rules would require any affected issuer to provide a narrative discussion of its financial condition. Such a discussion should inform investors about the financial condition of the issuer in a manner similar to the management discussion and analysis required by Item 303 of Regulation S-K for registered offerings.

1g. Other Disclosure Requirements

The SEC also proposed that a crowdfunding issuer must disclose:

- The name, SEC file number and central registration depository number of the intermediary for the offering;
- The amount of compensation paid to the intermediary, including the amount of any referral or other fees associated with the offering;
- The current number of employees of the issuer;
- The material factors that could make an investment speculative or risky;
- The material terms of any indebtedness of the issuer;
- Any exempt offerings the issuer conducted in the last three years;
- Certain related-party transactions; and
- Certain boilerplate legends to be required by the SEC.

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1h. Progress Updates and Offering Statement Amendments

The proposed rules would further require that an issuer must prepare regular updates on its progress in meeting a target offering amount, and these updates would be filed on the SEC's EDGAR system under cover of new Form C, and provided to investors and the intermediary.

The updates would be required within five business days of the issuer meeting 50 percent and 100 percent of its target amounts for a crowdfunding offering. If an issuer accepts proceeds beyond its target amount, then it would have to file with the SEC and provide to investors and the intermediary a final progress update not later than five days after the offering deadline.

Furthermore, an affected issuer would have to amend its disclosures for any material change in the offer terms or the disclosures previously provided to investors.

2. Ongoing Reporting Requirements

To implement the ongoing reporting mandates prescribed by statute, the proposed rules would require a crowdfunding issuer to file a report on EDGAR annually, not later than 120 days after the end of the most recent fiscal year covered by the report. An issuer would also have to post the annual reports on its Website, but would not have to deliver physical copies to investors.

The SEC also proposed that an issuer be required to file such reports until one of the following events occurs:

- The issuer becomes a reporting company required to file reports under Sections 13(a) or 15(d) of the Exchange Act;
- The issuer or another party purchases all of the securities issued pursuant to the crowdfunding offering, including any payment in full for debt securities; or
- The issuer liquidates or dissolves its business in accord with state law.

3. Form C and Other Filing Requirements

Issuers would be required under the proposed rules to file their reports on new Form C. Various versions of Form C would be used for offering statements, amendments, progress updates, annual reports, and termination of reporting notices (to be filed within five business days of a terminating event).

4. Prohibition on Advertising

Under the proposed rules, an issuer could not generally advertise the terms of the offering, but could publish a notice advertising the terms if it includes the address of the intermediary's platform on which additional information about the issuer and offering may be found.

Such a notice could include no more than:

- A statement that the issuer is conducting an offering, the name of the intermediary, and a link to the intermediary's electronic platform;
- The terms of the offering; and
- Factual information about the identity and location of the issuer, limited to its name, address, phone number, and Website URL, along with the e-mail address for an issuer's representative, and a brief description of the issuer.

These notices would be similar to tombstone ads authorized by Rule 134 of the Securities Act.

5. Compensation of Promoters

The proposed rules would specify that an issuer could not compensate any person for promoting its offerings outside of the communications channels provided by the intermediary (the electronic platform and related Internet media) unless the promotional compensation is only for notices that comply with the advertising rules.

Furthermore, any compensation for promotion through the communication channel provided by the intermediary would be prohibited, unless the issuer takes reasonable steps to insure that the compensated person clearly discloses the receipt of compensation for each promotional communication.

REQUIREMENTS IMPOSED ON INTERMEDIARIES

The SEC also proposed a number of requirements on those who serve as intermediaries for crowdfunding offerings.

1. Brokers and Funding Portals

Under the statutory scheme provided by the JOBS Act, a "funding portal" is defined as any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to the crowdfunding rules, provided that the person does not:

- Offer investment advice or recommendations;
- Solicit purchases, sales or offers to buy securities displayed on its electronic portal;
- Compensate employees, agents or other persons for such solicitation;
- Hold, manage, possess or handle investor funds or securities; or
- Engage in other activities the SEC may determine inappropriate by rule.

2. Requirements and Prohibitions

The proposed rules make clear that funding portals are brokers under the federal securities laws, but such portals would be permitted by rule to utilize a more streamlined process for registration proposed by the SEC. As a condition of exemption from the requirement to register as a broker, a funding portal would have to be a member of a national securities association registered with the SEC under the Exchange Act, the only such association being FINRA at present.

It is important to note that, as proposed, the rules would not only apply to funding portals, but also to their "associated persons" (partners, officers, directors, or managers) for many purposes.

Consistent with the JOBS Act provisions, the rules, would prohibit directors, officers or partners of a broker or funding portal from having any financial interest in an issuer using its services, and such financial interest would include any interest in any class of the issuer's securities.

3. Measures to Reduce Risk of Fraud

The rules would also require an intermediary to take measures established by the SEC to reduce the risk of fraud with regard to crowdfunding transactions, specifically including the obtaining of background checks and securities enforcement histories on each issuer officer and director, and persons holding more than 20 percent of an issuer's securities. The SEC proposed no additional procedures for intermediaries to follow to reduce the risk of fraud beyond the

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statutorily prescribed background checks and regulatory history checks.

However, the proposed rules would additionally require an intermediary to "have a reasonable basis for believing that the issuer is in compliance with relevant regulations and has established means to keep accurate records of holders of the securities it offers." The rules would further require that "the intermediary deny access [to its platform] if it believes the issuer or its offering would present a potential for fraud."

Under these rules, the SEC stated, the intermediary could reasonably rely on appropriate representations of the issuer with regard to compliance, absent actual knowledge or other indications that the representations are not true.

Compliance with recordkeeping requirements associated with crowdfunding could be delegated to a registered transfer agent, bank, broker or other responsible third party, the SEC added.

4. Account Opening Requirements

The proposed rules would prohibit an intermediary or its associated persons from accepting investment commitments unless the investor has opened an account with the intermediary and the intermediary has obtained from the investor consent to electronic delivery of disclosure and notice materials.

Under the JOBS Act provisions, an intermediary would also have to "provide such disclosures, including disclosures related to risks, and other investor education materials" as the SEC shall determine.

Those materials, by rule, would include disclosures relating to:

- The process for offer, purchase and issuance of securities;
- The risks associated with the securities offered;
- The types of securities offered on the intermediary's platform and the risks associated with each type of security;
- The restrictions on resale of securities offered;
- The types of information that an issuer is required to provide in annual reports, the frequency of delivery of that information, and the possibility that the issuer's obligation to file annual reports may terminate in the future;
- The limitations on the amounts investors may invest;
- The circumstances in which the issuer may cancel an investment commitment;
- The limitations on an investor's right to cancel;
- The need for the investor to consider whether investing in a security is appropriate for him or her; and
- The fact that following the offering, there may or may not be any ongoing relationship between the issuer and the intermediary.

An intermediary would also be required to update these materials over time as the types of offerings on its platform change or other material changes occur.

The proposed rules would also require the intermediary to disclose, on or before account opening, the manner in which it will be compensated for its crowdfunding work.

5. Transaction Requirements

The crowdfunding proposals would require each intermediary to make available to the SEC and potential investors, not later than 21 days prior to the first sale of securities, any disclosure information provided by the issuer as required.

The proposed rules further require that:

- An intermediary make this information publicly available on the intermediary's platform in a manner that permits saving, downloading or storing of the information;
- This information be made publicly available on the intermediary's platform for a minimum of 21 days before any securities are sold in the offering; and
- This information and any additional information provided by the issuer shall remain publicly available on the intermediary's platform until the offer and sale of securities is completed or cancelled.

An intermediary would also need a reasonable basis to believe that an investor satisfies the applicable statutory investment limitations before allowing that investor to make an investment commitment on its platform. In doing so, an intermediary may rely on an investor's representations concerning compliance, such as representations regarding net worth, annual income, and total amount of investments made in the past 12 months. Prior to acceptance of any investment commitment, an investor would also have to answer questions (the SEC endorsed the use of a questionnaire) to demonstrate an understanding that there are restrictions on their ability to cancel a commitment and obtain a refund, or to resell the securities after purchase.

To leverage the ability of the Internet to facilitate social scrutiny of an offering, the proposed rules would also require an intermediary to provide, on its electronic platform, channels through which investors can communicate with one another and with representatives of the issuer about offerings made available on the platform.

Under the proposed rules, an intermediary that is a funding portal would be prohibited from participating in any communications in these channels, apart from establishing the guidelines for communication and removing abusive or potentially fraudulent communications.

Furthermore, people posting on the channels would have to disclose with each post whether they are a founder or employee of the issuer, or are compensated to promote the issuer's offering.

An intermediary that is a funding portal only would be required to direct investors to transmit money or other consideration only and directly to a qualified third party that has agreed in writing to hold the funds for the benefit of investors and the issuer. A funding portal could not hold, manage or possess investor funds or securities.

6. Completion of Offerings, Cancellations and Reconfirmations

The proposed rules would give investors an unconditional right to cancel an investment commitment for any reason until 48 hours prior to the deadline identified in the issuer's offering materials. Thereafter, an investor would not be able

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to cancel any investment commitment, except in the event of a material change to the offering.

If there should be a material change to the terms of the offering or the information provided by the issuer with regard to the offering, then the proposed rules would require the intermediary to send a notice of material changes to the investors, stating that their commitments will be cancelled unless they reconfirm each commitment within five business days of receipt.

If an issuer does not complete an offering because a target is not reached, or if the issuer otherwise decides to terminate the offering, then the rules would require an intermediary, within five business days, to do the following:

- Send to each investor who has made a commitment a notice disclosing the cancellation, the reason for it, and the refund amount that the investor should expect;
- Direct the refunding of all investor funds; and
- Prevent investors from making further commitments on the intermediary's electronic platform.

7. Payments to Third Parties

Under the proposed crowdfunding rules, an intermediary cannot compensate "promoters, finders or lead generators" for providing any personal identifying information of any potential investor. Such information would include any data that can be used to distinguish or trace an individual's identity, either alone or in combination with other data about the individual.

However, the rules would permit an intermediary to compensate someone for directing issuers or potential investors to the intermediary's platform (by Internet ads, for instance) provided that:

- The person does not provide the intermediary with personal identity information; and
- The compensation, unless paid to a registered broker or dealer, is not based on the purchase or sale of a security the intermediary or issuer is offering.

SPECIAL RULES FOR FUNDING PORTALS

For intermediaries who are funding portals rather than registered brokers, there are special additional requirements under the proposed rules.

1. Registration Requirements

The SEC proposed a streamlined registration process under which a funding portal could register by filing a form with information consistent with, but less extensive than, the information required for broker-dealers on Form BD.

The form for funding portals would require disclosure of the funding portal's principal place of business, its legal organization and disciplinary history, its business activities (including types of compensation it receives), its control affiliates and their disciplinary history, all of its Website addresses, certain escrow information, and information about its membership in FINRA or any national securities association.

The proposed rules would also require as a condition of registration that a funding portal have in place and maintain a fidelity bond that:

- Offers minimum coverage limits of $100,000;
- Covers any associated person of the funding portal (unless exempted by FINRA rules); and
- Meets any other requirements of FINRA or another national securities association of which the portal is a member.

This rule imposes coverage mandates equivalent to those for FINRA-registered broker-dealers.

2. Exemption from Broker-Dealer Registration

Under the proposed rules, a funding portal is exempt from broker-dealer registration requirements provided that the portal is a member of a national securities association, and remains subject to the authority of the SEC with regard to examination, enforcement, rulemaking and other requirements the SEC deems appropriate.

As a condition of exemption, the SEC has proposed to require that funding portals permit the examination and inspection of all their business operations, including their premises, systems, platforms, and records. The rules also would impose certain minimum record-keeping requirements.

3. Other Requirements

A funding portal would not generally be allowed to make recommendations, actively solicit purchases, compensate people for solicitations, or hold, manage or possess investor funds or securities, except as permitted by the SEC.

The proposed rules would require a funding portal to implement written policies and procedures reasonably designed to achieve compliance with the federal securities laws and regulations, and they would require compliance with certain federal anti-money laundering provisions.

The proposed rules would also require a funding portal to create and maintain certain records, as similarly required of brokers.

OTHER NEW RULES

1. Resale Restrictions

The SEC noted that Section 4A(e) of the JOBS Act explicitly provides that securities sold through crowdfunding cannot be transferred by the purchaser for a full year after purchase, except when transferred:

- To the issuer;
- To an accredited investor (as defined by Rule 501 of Regulation D);
- As part of an offering registered with the SEC; or
- To a family member of the purchaser, or in connection with certain events, such as death or divorce of the purchaser, or other similar circumstances allowed by the SEC in its discretion.

2. Disqualifications, Insignificant Deviations and Waivers

The crowdfunding statutory scheme also required the SEC to establish disqualification provisions under which an issuer would not be eligible to offer securities and an intermediary would not be able to facilitate sales of those securities.

The SEC proposed that these disqualification provisions should apply to:

- The issuer and any of its predecessors or affiliates;

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- Any director, officer, general partner or managing member of the issuer;
- Any 20 percent beneficial owner of the issuer;
- Any promoter connected with the issuer at the time of sale;
- Any person what has been or will be compensated for solicitation of purchasers in connection with the offering; and
- Any director, officer, general partner or managing member of any such compensated solicitor.

As suggested by the SEC, issuers and persons other than the issuer would be disqualified from participating in an offering if they were the subject of any:

- Felony or misdemeanor convictions in connection with the purchase or sale of a security involving the making of a false filing with the SEC (within the last five years for issuers or the last ten years for "covered persons");
- Injunctions or court orders within the last five years against engaging in or continuing conduct in connection with the purchase or sale of securities, or involving a false filing with the SEC;
- U.S. Postal Service false representation orders within the last five years;
- Filing or being named as an underwriter in a registration statement or Regulation A offering statement that is the subject of a proceeding to determine whether a stop order should be issued, or as to which a stop order was issued within the last five years; or
- Final order issued by any state securities, banking, savings association, credit union or insurance regulator, federal banking regulator, or the National Credit Union Administration or the U.S. Commodities Future Trading Commission that (1) bars a person from association with a regulated entity, or from engaging in the business of securities, insurance or banking, or from engaging in savings association or credit union activities, or (2) is based on violation of any law or regulation prohibiting fraudulent, manipulative or deceptive conduct within a ten year period ending on the date of filing of the offer for sale.
- SEC cease and desist order related to the scienter-based anti-fraud provisions of the federal securities laws, or related to non-scienter based, Section 5 "strict liability" provisions of those laws.
- Statutory disqualification as defined by Exchange Act Section 3(a)(39) (pertaining to conduct while associated with brokers or dealers) from acting as an intermediary or being associated with one unless permitted to do so by SEC rule or order.

However, the rules would create an exception from disqualification for offerings in which the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed because of a covered person's participation. The rules would also include a waiver provision allowing the SEC to grant a waiver of disqualification if an issuer shows good cause "that is not necessary under the circumstances that the [registration] exemption… be denied."

FUNDING PORTAL RULES PROPOSED BY FINRA

FINRA also solicited public comment on its own funding portal rules that it proposed in the FINRA Release.

Pursuant to Funding Portal Rule 100, funding portal members of FINRA and their associated persons would be subject to the FINRA bylaws and specific funding portal rules.

FINRA also proposed, in Funding Portal Rule 110, a streamlined process for funding portal membership applications, which was a slimmed-down version of the process currently applicable to broker-dealer members of FINRA.

A funding portal member would have to "observe high standards of commercial honor and just and equitable principles of trade" under Funding Portal Rule 200, which would also prohibit participation in "any manipulative, deceptive or other fraudulent device of contrivance" to effect the purchase or sale of a security.

Funding portals would additionally be required to maintain systems to supervise the activities of associated persons, implement anti-money laundering programs, and report certain regulatory proceedings and disciplinary events to FINRA, pursuant to Funding Portal Rule 300.

The proposed rules would make funding portal members subject to investigations and sanctions by FINRA, disqualifications and certain arbitration and mediation procedures.

Explanatory Notes:

This update is intended to call your attention to various proposed rule changes of possible interest and relevance to you, but it is not intended to constitute a legal opinion or definitive summary of all changes and information that could be material to you.

Please contact a member of the Securities Law Group at Burns & Levinson if you have any questions about these rule changes or if you want to learn more about our expertise in this area.

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Burns & Levinson's attorneys have extensive experience representing public and private issuers, stockholder groups and individual investors. Our attorney team counsels clients on IPOs and follow-on offerings of equity, debt and other securities (including shelf registration takedowns), corporate acquisitions involving registered and restricted stock, mergers and acquisitions where one or both parties are publicly traded, private investment in public equity (PIPE) transactions, private placements, venture capital financings, and complex securities law transactions and issues, including corporate governance/ Sarbanes-Oxley and SEC and stock exchange reporting and compliance.

In the securities compliance area, we advise our clients on corporate governance/Sarbanes-Oxley and SEC and stock exchange reporting and compliance. Specifically, we assist our clients in fulfilling their ongoing SEC and stock exchange reporting obligations, managing sensitive disclosure issues internally and with industry analysts, preparing proxy statements and handling stockholder meetings, structuring employee benefit plans and executive compensation packages under the SEC's "short-swing profit" reporting and liability rules, effecting re-sales of securities in the public trading markets under the SEC's Rule 144, and advising boards of directors and board committees concerning the requirements and restrictions imposed on their actions by the securities laws and corporate governance laws such as Sarbanes-Oxley. We have served as special securities counsel to the Boards and Audit Committees of publicly traded companies looking for opinions or advice of counsel other than their regular outside counsel.

We have counseled clients both domestic and international, from emerging growth companies to large public companies, and are positioned to provide clients with timely, expert, efficient and cost effective advice that they need to meet their business objectives. We take a practical and proactive approach to the rapidly changing securities disclosure and corporate governance laws, providing our clients with timely updates, identifying specific situations in which the new laws will impact particular clients either operationally or structurally, and working with clients to implement the changes that are either required or advisable to comply with the new regulatory schemes and investor sentiment.

Underwriters and Investment Banks

Our attorneys also represent underwriters in initial and follow-on public offerings and investment banks in private placements and mergers and acquisitions.

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