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S.E.C. Adopts JOBS Act Title III to Allow Equity Crowdfunding

By Joyce Li, J.D. Candidate 2018 | November 09, 2015

As of October 30, the S.E.C. has adopted new crowdfunding rules that will allow small investors to purchase equity shares in startup companies. Under Title III of President Obama's JOBS Act (Jump-Start Our Business Start-Ups), the revisions seek to improve upon an earlier draft that was widely rejected for requiring unworkable compliance costs and procedures.

The new Title III rules cap companies at \$1M per year, and limit individual investor contributions based on annual income and net worth. Those with an annual income or net worth of less than \$100K are restricted to investing between 5% of such or \$2K, while those with greater than \$100K, are limited to investing 10% of such. Each company is also required to disclose financial statements that must be independently audited, unless they are seeking less than \$500K or are equity crowdfunding for the first time. Further, each funding portal must register with the S.E.C. and be subject to regulation.

Industry experts are at odds on both the future of crowdfunding and the potential impact of the new rules. The New York Times quoted Andrew Stoltmann, a securities fraud lawyer, describing equity crowdfunding as a "disaster waiting to happen," in light of what he sees as an abundance of low quality investments. Meanwhile, James Dowd, the chief executive of broker-dealer North Capital Private Securities, expressed excitement for potential increase of capital flow into ordinary consumer and retail businesses that are less "fashionable" for professional investors.

Among existing crowdfunding platforms, Title III is generally seen as a step in the right direction, with disagreement on the size of the step. Chance Barnett, the chief executive of Crowdfunder.com, analogized the new rules to the transition from stockbroker based investing in the 1980's to modern retail investing through firms like eTrade. Although he acknowledges that there is still work to be done, he sees Title III as the start of the end for wealthy institutions, venture capitalists, and accredited angel investors' exclusive access to early stage startups. In contrast, Rory Eakin, the chief executive of CircleUp, predicts Title III will have minimal impact due to its still onerous prerequisites to raising capital.

Eakin is not alone in his views—cost estimations have shown that Title III may not be the boon for equity crowdfunding that it was hoped to be. With average first round funding hitting a peak of \$1.9M in 2014, a cap of \$1M means that founders will likely have to seek funding from other sources simultaneously with their crowdfunding efforts. Further, while traditional funding via angel investors carries an estimated cost of \$5K to \$20K and a preparation period of several weeks, the S.E.C. estimates that crowdfunding may incur costs of over \$250K and require several months of preparation. As a result, the Commission estimates that less than 2% of startups will raise capital through crowdfunding this coming year.

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Title III will go into effect in early 2016. Despite mixed expectations, it marks the first opportunity for small private investors to purchase equity in early stage startups, and will no doubt provide vital insight into the future of equity crowdfunding.