

# **New Regulatory Issues: Regulation Crowdfunding and Fiduciary Obligations for Retirement Investment Advice**

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# AGENDA

- **Regulation Crowdfunding.**
  - JOBS Act Overview.
  - Article III – Crowdfunding.
- **Fiduciary Obligations for Retirement Investment Advice.**
  - Overview of Regulatory Requirements.
- **Questions.**



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# REGULATION CROWDFUNDING



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## Types of Crowdfunding

- Rewards.
- Donations.
- Lending.
- Equity Crowdfunding.



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## Jumpstart Our Business Startups Act

Enacted in 2012

Intended to encourage funding of U.S.-based small businesses by easing securities regulations.



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## JOBS Act Structure

Title I – Reopening American Capital Markets to Emerging Growth Companies

Title II – Access to Capital for Job Creators

Title III – Crowdfunding

Title IV – Small Company Capital Formation

Title V – Private Company Flexibility and Growth

Title VI – Capital Expansion

Title VII – Outreach on Changes to the Law or Commission



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## JOBS Act – Title II

- Allows Issuers to use general solicitation and advertising to offer securities.
- Restrictions:
  - Must take reasonable steps to verify that investors are “Accredited Investors.”
  - All purchasers of the securities must fall within one of the categories of persons who are accredited investors under an existing rule or the Issuer reasonably believes that the investors fall under one of the categories at the time of the sale of the securities.



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## Accredited Investor

- Rule 501 – A person is qualified as an Accredited Investor if she has either:
  - Individual net worth or joint net worth with a spouse exceeding \$1 Million at the time of the purchase (excluding primary residence).
  - Individual annual income exceeding \$200,000 in each of the two most recent years or joint income with a spouse exceeding \$300,000 in each of two most recent years and expectation of same for current year.



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## JOBS Act Title III – Regulation Crowdfunding

- Codified at 15 U.S.C. 77d(a)(6)
- Provides an exemption from registration for the sale of securities by an Issuer, provided that:
  - The amount sold to all investors by Issuer does not exceed \$1,000,000 in a 12-month period.
  - The aggregate amount sold to any investor by an Issuer during a 12-month period does not exceed:
    - The greater of \$2,000 or 5% of the annual income or net worth of such investor, if the annual income or net worth of the investor is less than \$100,000.
    - 10% of the annual income or net worth of such investor, if either the annual income or net worth of the investor is equal to or more than \$100,000.



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## Regulation Crowdfunding – Aggregate Limit

- **\$1,000,000 Limit:**
  - Applied to any amount sold under the Crowdfunding exemption by any entity either controlled by or under common control with the Issuer.
  - Must count all amounts sold in the 12 months preceding the sale.
  - Limit will be reviewed by the SEC every 5 years and adjusted based on the Consumer Price Index.
  - An Issuer may sell securities through other types of exempt transactions, and the proceeds will not count toward the \$1,000,000 limit.
    - But the Issuer needs to be satisfied that the purchasers in other offerings (which do not allow general solicitations) were not solicited through the means of the Crowdfunding offering.



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## Control

- The term control (including the terms controlling, controlled by and under common control with) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.
- Also, an Issuer must include any amounts sold by a predecessor in the previous 12 months.



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## Individual Investment Limits

- If either annual income or net worth of individual is less than \$100,000:
  - Limit is the greater of \$2,000 or 5% of the lesser of the individual's annual income or net worth.
    - Ex. Individual with \$105,000 income and net worth of \$50,000: \$2,500 limit.
- If both annual income and net worth of individual are \$100,000 or greater:
  - Limit is 10% of the lesser of annual income or net worth of the investor (not to exceed \$100,000).
    - Ex. Individual with \$105,000 income and 150,000 net worth: \$10,500 limit.



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## Individual Investment Limits

- The individual investor limits apply to all amounts invested by such investor in any and all offerings under the Crowdfunding exemption for all Issuers in a 12-month period.
- Annual income and net worth are calculated the same as for accredited investor status.
- Spouses may calculate their income and net worth jointly, but the same limits apply as for a single investor with the same levels of income and net worth.
- Issuer may rely on efforts by the intermediary regarding whether a particular investor will exceed her individual investment limits in a particular transaction.



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## Regulation Crowdfunding - Intermediary

- The offering must be conducted through one (and only one) funding platform.
- The funding platform can be operated either by a registered broker or a registered funding portal.
- Funding Platform defined: “a program or application accessible via the internet or other similar electronic communication medium through which a registered broker or a registered funding portal acts as an intermediary in a transaction involving the offer or sale of securities in reliance on the [Crowdfunding exemption].”



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## Exclusion of Certain Issuers

- Statutory Exclusions:
  - Foreign Issuers.
  - Issuers subject to Exchange Act Reporting Requirements
  - Investment Companies – as defined in Investment Company Act of 1940.
- Regulatory Exclusions:
  - Issuers disqualified by Rule 503(a) of Regulation Crowdfunding.
  - Issuers that have not filed required annual reports with respect to previous Crowdfunding Offerings.
  - Issuers that have no specific business plan other than to engage in a merger or acquisition with an unidentified company or companies.



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## Issuer Disclosure Requirements

- Statutory disclosure requirements adopted in regulations:
  - Name, legal status, physical address and website.
  - Information regarding the directors, officers and holders of more than 20% of equity of the Issuer.
  - Description of Issuer's business and anticipated business plan
  - Description of Issuer's financial condition.
  - Purpose and intended use of the proceeds of the offering
  - Target offering amount, deadline to reach target, regular updates on progress in meeting target.
  - Price of the securities and method of determining the price
  - Description of Issuer's ownership and capital structure.



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## Issuer Disclosure Requirements (continued)

- Disclosure requirements adopted by Regulation:
  - Identity of the Intermediary.
  - Compensation Paid to the Intermediary.
  - Certain Legends regarding the risks of investing in a crowdfunding transaction.
  - Current Number of Employees.
  - Risk Factors.
  - Indebtedness.
  - Prior Exempt Offerings.
  - Related-Party Transactions.
  - Where to find annual reports.
  - Any other material information.
  - Any previous noncompliance with reporting requirements.



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## Financial Disclosure Requirements

- For the 12-month period preceding the sale:
  - Issuers offering \$100,000 or less:
    - Amount of total income, taxable income, and total tax.
    - Financial statements certified by principal executive.
  - Issuers offering between \$100,000 and \$500,000.
    - Financial statements reviewed by independent public accountant
  - Issuers offering more than \$500,000.
    - First time relying on Crowdfunding exemption, financial statements reviewed by independent public accountant.
    - If Issuer has previously relied on Crowdfunding exemption, financial statements audited by public accountant that is independent of the Issuer.



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## Ongoing Reporting Requirements

- Issuers must file annual reports within 120 days of the end of the fiscal year covered by the report.
- Reports must be posted to the Issuer's website.
- Reports must include financial statements certified by the principal executive of the Issuer.
  - If Issuer has financial statements that have been reviewed or audited by an independent CPA, they must provide those instead of the certified statements.
- Other Company information provided in offering.



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## Termination of Ongoing Reporting

- Earliest of:
  - The Issuer is required to file reports under the Exchange Act Section 13(a) or 15(d).
  - The Issuer has filed at least 1 annual report and has fewer than 300 holders of record.
  - The Issuer has filed at least 3 annual reports and has assets that do not exceed \$10 million.
  - The Issuer or another party purchases or repurchases all securities issued pursuant to the Crowdfunding exemption.
  - The Issuer liquidates or dissolves.



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## Other Important Requirements

- Investors may not sell securities within 1 year of purchase.
- Issuers (and intermediaries) will be liable to an investor if the Issuer makes an untrue statement of material fact or omits to state a material fact, provided the investor did not know the untruth.
- Intermediaries must register with the SEC and applicable self-regulatory bodies.



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# FIDUCIARY RESPONSIBILITIES FOR RETIREMENT INVESTMENT ADVICE



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## Overview

- The new DOL regulations redefine fiduciary to include those giving investment advice.
- The new regulations become effective April 10, 2017.
- Transition period – from April 10, 2017 until January 1, 2018.
  - Fewer conditions apply to the Best Interest Contract Exemption and the Principal Transactions Exemption.



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## Categories and Types of Fiduciary Advice

- Recommendations regarding the investment of plan or IRA assets, including recommendations regarding the investment of assets that are being rolled over or otherwise distributed from plans to IRAs.
- Recommendations regarding investment management of plan or IRA assets, including:
  - Recommendations on rollovers, distributions, and transfers from a plan or IRA.
  - Recommendations on the form of the rollover, distribution or transfer.
  - Recommendations on the insurance Issuer or investment provider to receive the rollover, distribution, or transfer.



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## What is a “Recommendation”

- A communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action.
- Includes recommendations made directly or indirectly by a person who:
  - Represents or acknowledges that they are acting as a fiduciary.
  - Renders advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is based on the particular investment needs of the advice recipient.
  - Directs the advice to a specific recipient or recipients regarding the advisability of a particular investment or management decision.



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## Fee or Other Compensation

- To constitute fiduciary investment advice, must be given for a “fee or other compensation.”
- Includes:
  - Any explicit fee or compensation for the advice received by the person from any source.
  - Including things such as commissions, loads, finder’s fees and revenue sharing payments.



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## Not Included in Covered Investment Advice

- Education.
- General Communications.
- Platform Providers.
- Transactions with Independent Plan Fiduciaries with Financial Expertise.
- Swap and Security-Based Swap Transactions.
- Employees of Plan Sponsors, Affiliates, Employee Benefit Plans, Employee Organizations, or Plan Fiduciaries.



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## Responsibility for Educators or Advisors

- Plan sponsor selection of third party to provide education or investment advice is an exercise of fiduciary authority.
- Designation of investment adviser to serve as a fiduciary may give rise to co-fiduciary liability.
- Exception: ERISA Section 404(c) plan where plan participants exercise independent control over investment choices.



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## Best Interest Contract Exemption

- Requires disclosure of important information, including information related to compensation of the firm or advisor.
- Requires firm to enter into an enforceable contract committing to protective provisions.
- Enforcement:
  - Breach of provisions can give rise to either breach of contract claim or ERISA claim.



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## Principal Transactions Exemption

- Investment advice fiduciaries may sell or purchase certain recommended debt securities and other investments out of their own inventories to or from plans and IRAs.
- Restrictions, fiduciaries must:
  - Adhere to impartial conduct standards.
  - Enact policies and procedures to mitigate impacts of conflicts of interest.
  - Disclose basic information about conflicts of interest.



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## Questions?

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