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About Navigant

Navigant Consulting, Inc. (NYSE: NCI) is a specialized, global professional services firm that helps clients take control of their future. Navigant's professionals apply deep industry knowledge, substantive technical expertise, and an enterprising approach to help clients build, manage and/or protect their business interests. With a focus on markets and clients facing transformational change and significant regulatory or legal pressures, the Firm primarily serves clients in the healthcare, energy and financial services industries. Across a range of advisory, consulting, outsourcing, and technology/analytics services, Navigant's practitioners bring sharp insight that pinpoints opportunities and delivers powerful results. More information about Navigant can be found at navigant.com.

JOBS ACT TITLE III: CROWDFUNDING RULE

MINIMIZING AML RISK WHEN RAISING CAPITAL THROUGH THE INTERNET

I. INTRODUCTION

In April 2012, the United States ("U.S.") enacted the Jumpstart Our Business Act (the "JOBS Act") with the goal of stimulating U.S. job creation and economic growth. To achieve this, the JOBS Act includes provisions to improve cost-effectiveness and speed of accessing capital for companies of all size through crowdfunding and the Internet-based platforms ("funding portal") that facilitate the raising of capital for business ideas.¹ On October 30, 2015, the Securities and Exchange Commission ("SEC") adopted the JOBS Act's final rules on Title III ("Title III") on crowdfunding, an evolving alternative source of capital made available through the Internet.²

The SEC explains crowdfunding as follows:

An entity or individual raising funds through crowdfunding typically seeks small individual contributions from a large number of people. A crowdfunding campaign generally has a specified fundraising target amount and an identified use for those funds. Potential investors, members of the 'crowd,' may share information about the project, cause, idea or business with each other and use the information to decide whether or not to fund the campaign based on the collective 'wisdom of the crowd.'³

To legitimize this new source of capital and to provide regulatory guidance for those seeking to raise funds, Title III permits companies to offer and sell securities through crowdfunding while specifying investment and fundraising limits.⁴ In addition to the new rules established by Title III, the SEC proposed amendments to Regulation D and Securities Act of 1933 to increase the aggregate amount of money that may be offered and sold, apply bad actor disqualifications for investor protection, and to modernize the rule for intrastate offerings.⁵ The Financial

1. US Securities and Exchange Commission, 2015. Jumpstart Our Business Startups (JOBS) Act. Available at: <<http://www.sec.gov/spotlight/jobs-act.shtml>> [Accessed 11 January 2016]
2. US Securities and Exchange Commission, 2015. SEC Adopts Rules to Permit Crowdfunding. Available at: <<http://www.sec.gov/news/pressrelease/2015-249.html>> [Accessed 11 January 2016]
3. SEC33-9470.
4. US Securities and Exchange Commission, 2015. SEC Adopts Rules to Permit Crowdfunding. Available at: <<http://www.sec.gov/news/pressrelease/2015-249.html>> [Accessed 11 January 2016]
5. US Securities and Exchange Commission, 2015. SEC Adopts Rules to Permit Crowdfunding. Available at: <<http://www.sec.gov/news/pressrelease/2015-249.html>> [Accessed 11 January 2016]

Crime Enforcement Network (“FinCEN”) also proposed amendments that would result in requiring funding portals to implement policies and procedures that are reasonably designed to achieve compliance with the Bank Secrecy Act (“BSA”), which are currently applicable to brokers or dealers in securities.⁶

It is important to note that Title III’s rules are in addition to the existing Securities Act of 1933 and Securities Exchange Act of 1934, regarding the rules governing the offer and sale of securities and include a framework for the regulation of registered funding portals and broker-dealers issuers are required to follow. Title III came into effect on May 16, 2016, while the forms enabling the registration of funding portals came into effect on January 29, 2016.

This article highlights important provisions companies looking to utilize crowdfunding, potential investors, and crowdfunding platform providers should be cognizant of for Title III.

II. TITLE III HIGHLIGHTS

Set forth below are several Title III provisions your organization should be aware of, including investment and fundraising limits, provisions for holders of securities, disclosure requirements, customers ineligible for crowdfunding and requirements for crowdfunding platforms.

A. Fund Raising and Contribution Limits

Title III specifies a twelve-month maximum time period, as well as limits on the amounts contributed by investors. Fund raisers are permitted to raise an aggregate maximum of USD1 million, while investor limits are divided into two groups:

1. For investors whose annual income or net worth is less than USD100,000, the contribution can be the greater of USD2,000 or 5% of the lesser of their annual income or net worth.
2. For investors whose annual income and net worth are equal to or greater than USD100,000, they can contribute up to 10% of the lesser of their annual income or net worth.⁷

B. Holders of the Securities

Holders of the securities generally cannot resell these securities for one year. In addition, these securities holders will not count towards the Exchange Act Section 12(g) investor threshold if the company is:

1. Current in its annual reporting obligations;
2. Retains the services of a registered transfer agent; and
3. Has less than USD25 million in total assets as of the end of its most recently completed fiscal year.⁸

C. Disclosure Requirements

Companies seeking crowdfunding must file the following information with the SEC and provide the information to the investors and intermediary facilitating the offering:

1. Price and target offering amount, including how those amounts were determined, the deadline to reach the target amount, and whether the company will accept amounts in excess of the target amount.
2. A description of the company, company’s financial condition, and the purpose of the raised funds.
3. Information about the officers and directors, as well as any owners with 20% or more ownership of the company;
4. certain related-party transactions; and
5. Annual report filings with the SEC, which also must be made provided to investors.⁹

D. Companies Ineligible for Crowdfunding

The following companies are prohibited from fundraising using Title III:

1. Non-U.S. Companies;
2. Exchange Act reporting companies;

6. Federal Register, 2016. 31 CFE Parts 1010 and 2012 RIN 1506-AB29 Amendments to the Definition of Broker or Dealer in Securities. Available at: < <https://www.gpo.gov/fdsys/pkg/FR-2016-04-04/pdf/2016-07345.pdf> > [Accessed 17 May 2016]

7. US Securities and Exchange Commission, 2015. SEC Adopts Rules to Permit Crowdfunding. Available at: <<http://www.sec.gov/news/pressrelease/2015-249.html>> [Accessed 11 January 2016]

8. US Securities and Exchange Commission, 2015. SEC Adopts Rules to Permit Crowdfunding. Available at: <<http://www.sec.gov/news/pressrelease/2015-249.html>> [Accessed 11 January 2016]

9. Securities and Exchange Commission, 2015. Crowdfunding. Available at: <<http://www.sec.gov/rules/final/2015/33-9974.pdf>> [Accessed 11 January 2016]

3. Certain investment companies
4. Companies that are subject to bad actor disqualification provisions under Title III. This includes any persons as the investor, fund raiser, promotor, solicitor, and any manager or beneficial owner of the above mentioned parties. The disqualifying events include, but are not limited to:
 - a. Felony or misdemeanor convictions;
 - b. Injunctions and court orders against engaging or conducting in securities transactions;
 - c. Violations of anti-fraud provisions; and
 - d. Suspension or expulsion from membership with a registered national securities exchange or association.¹⁰
5. Companies that have failed to comply to the annual reporting requirements under Title III during the two years immediately preceding the filing of the offering statement;
6. Companies that have no specific business plan; and
7. Companies that have indicated that their business plan is to engage in a merger or acquisition with an unidentified company or companies.¹¹

E. Crowdfunding Platforms

All transactions relying on Title III must take place through a designated SEC registered intermediary—either a broker-dealer or a funding portal. Funding portals must be registered with the SEC on a new Funding Portal Form and become a member of the Financial Industry Regulatory Authority (“FINRA”).¹² The new rules not only require that investors be provided information and a platform to share information, but also provide the funding portals safe harbor to engage in activities consistent with Title III.¹³

In order to facilitate information sharing and providing disclosure about the securities, Title III requires the intermediaries to:

1. Provide investors with educational materials on the securities being offered, using the platform, and information required to be provided to the investors;
2. Take certain measures to reduce the risk of fraud, comply to Title III, and to accurately record the transactions and investor records;
3. Disclose information that must be publicly available for a minimum of 21 days before any security may be sold in the offering;
4. Provide communication channels to permit discussion about offerings on the platform;
5. Provide disclosure about the compensation the intermediary receives;
6. Accept an investment commitment from an investor only after the investor has opened an account;
7. Have a reasonable basis for believing an investor complies with the investment limitations;
8. Provide the investors notices once they have made investment commitments and confirmations at or before completion of a transaction;
9. Comply with maintenance and transmission of funds requirements; and
10. Comply with completion, cancellation, and reconfirmation of offering requirements.¹⁴

In addition, intermediaries are prohibited from engaging in certain activities, such as:

1. Providing access to their platforms to companies that they have reasonable basis for believing have the potential for fraud or other investor protection concerns;

10. Securities and Exchange Commission, 2015. Crowdfunding. Available at: <<http://www.sec.gov/rules/final/2015/33-9974.pdf>> [Accessed 11 January 2016]

11. Securities and Exchange Commission, 2015. Crowdfunding. Available at: <<http://www.sec.gov/rules/final/2015/33-9974.pdf>> [Accessed 11 January 2016]

12. US Securities and Exchange Commission, 2015. SEC Adopts Rules to Permit Crowdfunding. Available at: <<http://www.sec.gov/news/pressrelease/2015-249.html>> [Accessed 11 January 2016]

13. US Securities and Exchange Commission, 2015. SEC Adopts Rules to Permit Crowdfunding. Available at: <<http://www.sec.gov/news/pressrelease/2015-249.html>> [Accessed 11 January 2016]

14. US Securities and Exchange Commission, 2015. SEC Adopts Rules to Permit Crowdfunding. Available at: <<http://www.sec.gov/news/pressrelease/2015-249.html>> [Accessed 11 January 2016]

2. Having a financial interest in a company that is offering or selling securities on its platform unless the intermediary receives the financial interests as compensation for the services, subject to certain conditions; and
3. Compensating any person for providing the intermediary with personally identifiable information of any investor or potential investor.

Further, funding portals are prohibited from:

1. Offering investment advice or making recommendations;
2. Soliciting purchases, sales, or offers to buy securities;
3. Compensating promoters and other persons for solicitations or based on the sale of securities; and
4. Holding, possessing, or handling investor funds or securities.¹⁵

III. ADDITIONAL SEC PROPOSED CHANGES

To enhance Title III's effectiveness, the SEC proposed changes to Rule 504 of Regulation D and Rule 147 of the Securities Act of 1933. The purpose of the proposed changes is to help facilitate capital formation by smaller companies by increasing the utility of the rules while maintaining appropriate protections for investors.

A. Rule 147 of the Securities Act of 1933 ("Rule 147")

Rule 147 allows the sale of securities of a small local company within a single state or territory, by a resident of the same state or territory, to be sold to investors in the same state or territory from registering with the SEC.¹⁶ The proposal would modernize Rule 147 by establishing a new way to facilitate capital formation:¹⁷ The proposed amendments would:

1. Eliminate current restrictions on offers, while continuing to require that sales be made only to residents of the issuer's state or territory.
2. Redefine "intrastate offering" and ease some of the issuer eligibility requirements, making the rule available to more businesses seeking intrastate financing.
3. Limit the availability of the exemption to offerings that are: (a) registered in the state in which all of the investors are resident or (b) conducted pursuant to an exemption from state law registration in states capping the amount of securities an issuer may sell to USD5 million in a 12-month period and imposing investment limitations on investors.¹⁸

B. Rule 504 of Regulation D ("Rule 504")

Further, the proposed changes to Rule 504 would increase the aggregate amount of securities that may be offered and sold in any 12-month period from USD1 million to USD5 million and disqualify certain bad actors from participation in Rule 504 offerings.¹⁹

C. Definition of "Broker or Dealer in Securities" and Broker-Dealer"

FinCEN is proposing amendments to the definition of "broker or dealer in securities" and "broker-dealer" under the regulations implementing the BSA, to help prevent money laundering, terrorist financing, and other financial crimes. This proposal would amend those definitions to explicitly include funding portals that are involved in the offering or selling crowdfunding securities pursuant to Title III. This amendment would require funding portals to implement policies and procedures that reasonably achieve compliance with BSA requirements, as applicable to brokers or dealers in securities.²⁰

15. US Securities and Exchange Commission, 2015. SEC Adopts Rules to Permit Crowdfunding. Available at: <<http://www.sec.gov/news/pressrelease/2015-249.html>> [Accessed 11 January 2016]

16. Cornell University Law School Legal Information Institute. 17 CFR 230.504 - Exemption for limited offerings and sales of securities not exceeding \$1,000,000. Available at: <<https://www.law.cornell.edu/cfr/text/17/230.147>> [Accessed 11 January 2016]

17. Securities and Exchange Commission, 2015. Exemptions to facilitate Intrastate and Regional Securities Offerings. Available at: <<https://www.sec.gov/rules/proposed/2015/33-9973.pdf>> [Accessed 11 January 2016]

18. Securities and Exchange Commission, 2015. Exemptions to facilitate Intrastate and Regional Securities Offerings. Available at: <<https://www.sec.gov/rules/proposed/2015/33-9973.pdf>> [Accessed 11 January 2016]

19. Securities and Exchange Commission, 2015. Exemptions to facilitate Intrastate and Regional Securities Offerings. Available at: <<https://www.sec.gov/rules/proposed/2015/33-9973.pdf>> [Accessed 11 January 2016]

20. Federal Register, 2016. 31 CFE Parts 1010 and 2012 RIN 1506-AB29 Amendments to the Definition of Broker or Dealer in Securities. Available at: <<https://www.gpo.gov/fdsys/pkg/FR-2016-04-04/pdf/2016-07345.pdf>> [Accessed 17 May 2016]

IV. WHAT THIS MEANS FOR YOU

Title III indicates the regulators' willingness to adjust to the changing technology and investing opportunities. The new rules will allow individuals of greater range of wealth and interests to invest in a greater range of ventures and investments, using a greater number of intermediaries.

As the crowdfunding industry matures, both investors and crowdfunding platforms would be wise to be aware of potential anti-money laundering ("AML") and reporting requirements that may be imposed on the industry, especially in light of FinCEN's proposed amendments. Those who are seeking to take advantage of the new rules, would do well to consider taking the following compliance steps.²¹

1. Risk Assessments

Existing broker-dealers and newly established portals will need to develop risk assessment programs that include the risks of acquiring new investors of varying backgrounds, verifying their assets, and validating the companies' seeking crowdfunding and their products and services.²²

2. AML Compliance Program

AML programs that are tailored to the types of clients, businesses, products, services, and transaction amounts and volume will need to be developed.²³

3. Customer Identification Program

Crowdfunding intermediaries will most likely be required to conduct customer identification, verification and due diligence. The firms must develop a methodology to conduct the verification process, via public records or proprietary services using a vendor.²⁴

4. Transaction Monitoring and SAR Reporting

The regulators may require that transactions conducted for crowdfunding purposes be monitored for any unusual, terrorism financing, suspicious or fraudulent activity and reported to the proper authorities, if necessary. The intermediary should consider the monitoring system options available.²⁵



21. Ellen Zimiles, Alma Angotti, Stephen Bidwa. SEC and FINRA Crowdfunding Guidance Review. Available at: < http://www.navigant.com/-/media/WWW/Site/Insights/Disputes%20Investigations/GIC_CrowdsourcingAML_ClientAlert_TL_1213.ashx > [Accessed 23 March 2016].

22. Ibid

23. Ibid

24. Ibid

25. Ibid

5. Economic Sanctions

The intermediaries must ensure that they comply with the Office of Foreign Asset Control and other relevant government entities' notifications on sanctions and restrictions.

6. Compliance Organization and Governance

A qualified AML Compliance Officer should be appointed, in addition to training employees and developing governance structure and escalating process for implementation.²⁶

7. Independent Test

Periodic independent tests of the compliance programs' design and implementation is recommended to ensure that it meets regulatory requirements and expectations, has been effectively implemented and properly addresses the risks and needs of the organization.²⁷

Navigant has critical expertise and resources in assisting financial institutions and broker dealers in BSA/AML risk management, including evaluating new technology and products and conducting risk assessments. As such, Navigant is well situated to assist both investors and fundraisers considering utilizing crowdfunding technologies.

26. Ibid

27. Ibid