Angel Investor Alert

Don't Rely on the SEC to Screen Equity Crowdfunding Offerings

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Originally published May 13, 2016, by Crowdfunding Investor
Updated August 8, 2017

Since May 2016, average investors have had an opportunity to invest in startups and small businesses through registered crowdfunding portals. This represents the first time since 1933 that people of moderate income could easily buy securities (equity and debt) offered by private companies. Do not assume those securities offerings have been reviewed and approved by the Securities and Exchange Commission.

Although issuers of equity or debt securities must file new Form C with the SEC, showing many details of the offering with specific disclosures, the issuer does not have to wait for the SEC to approve the offering before selling securities on a funding portal, and the SEC has no obligation to review any aspect of the form before the offering "goes live."

May 16, 2016, was the day when seed-stage startups could, for the first time, raise capital from tens of millions of "new" angel investors online, thanks to Title III of the Jumpstart Our Business Startups (JOBS) Act of 2012. Title III opened the door for all moderate-income Americans to diversify their investment portfolios into private securities with the potential for spectacular returns, along with corresponding risk of catastrophic losses. Some sophisticated angel investors will methodically build portfolios of a dozen or more Title III investments over a period of three to five years, to diversify the risk within this new, non-correlated asset class; while some, probably less sophisticated, investors will invest in only one or few Title III offerings mainly for social reasons—because they want to support an entrepreneur in their community, or own a piece of the coolest new brand, or invest alongside a celebrity.

In October 2015, the SEC issued rules under Title III which limit the amount of money investors can commit per year to Title III offerings, based on net worth and income; which set forth restrictions and obligations of issuers (including a $1 million raise limit); and which govern the operation of funding portals. Among the obligations for issuers is the filing of Form C (electronically via the SEC's EDGAR data system) and the posting of the same information on the portal, which must happen at least 21 days before the offering can close. The SEC is not required to review or in any way evaluate the issuer's disclosures. It is possible that the commission will challenge offerings that appear to contain misleading statements or significant

omissions, or where “bad actors” are involved. But investors should not assume that offerings on a crowdfunding portal have been reviewed by the SEC. [Source: CrowdCheck]

When Form C information is filed, everyone can see it on EDGAR and on the portal at approximately the same time. This means that no “exclusive first look” or “sneak preview” is permitted, as “all potential investors must have access to the offering at the same time,” says Sara Hanks, a securities lawyer and CEO of CrowdCheck.

There is some confusion in the marketplace, and even in the mainstream financial media, about SEC approval of securities offerings under the JOBS Act. It is true that so-called Regulation A+ offerings (under Title IV of the JOBS Act) have to be reviewed and qualified by the SEC before going live. But the same is not true for Title III offerings. The SEC may or may not review any Forms C, and it may disqualify offerings if it finds a material misstatement or omission, or if it sees that a participant is a “bad actor,” but don’t count on it.

It is likely, but not guaranteed, that funding portals will thoroughly review each offering before accepting the issuer’s application to be listed. Some portals may explain their review and acceptance/rejection process (popularly referred to as deal curation) in their FAQs; if they don’t, you’re free to ask about it. Some portals rely on a third-party due diligence service like CrowdCheck to review offerings, but such services offer various levels of reviews and some are not really thorough due diligence—they may simply be background checks of the company’s founders and officers. In any case, even if the portal claims to thoroughly “vet” their issuers, you’re still responsible for conducting—on your own or in collaboration with other smart investors or your professional adviser—due diligence on every offering that you might invest in.

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