

New rules for small business investments

by John Callegari

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The [Securities and Exchange Commission](#) has reversed an 80-year ban on startups, hedge funds and venture capitalists openly advertising for private investment.

The reversal, green-lighted by the SEC on July 10, is one of the last pieces planned under the Jumpstart Our Business Startups Act of 2012.

With just one more month before it takes effect, the new policy is expected to make it easier and cheaper for new businesses to find private investors willing to take a chance on them.

“Most startups don’t have access to the broker-dealers that have the relationships with investors, because they’re just too expensive,” said David Hoepfner, an attorney with Bohemia-based [Campolo, Middleton & McCormick](#). “Advertising is much cheaper than hiring a broker-dealer to help you with your offering.”

Although the aggregate amount of capital raised each year through private offerings is large, the average offering size is a modest \$30 million, according to a July study by the SEC. And the median offering size is significantly lower – around \$1.5 million – indicating a large number of small offerings. Removing the advertising prohibition is designed to funnel even more of these smaller investments into fledgling businesses.

The federal government first banned companies from advertising to private investors in 1933, during the throes of the Great Depression, to protect investors from dishonest salesmen making impossible promises of shares that would go through the roof. Think “Boiler Room,” if written by John Steinbeck.

The Securities Act of 1933 required startups and other businesses to have existing relationships with investors, creating the need for broker-dealers to do introductions. But now, with that stipulation gone, companies are free to seek private investments through simple print or online advertising.

Of course, not everyone can invest. The provision is limited to accredited investors only. For individuals, that’s anyone with a net worth of \$1 million or more – excluding a home’s value – or with an annual income of \$200,000 per year, or \$300,000 per year per couple. Investment entities must meet other criteria, such as being wholly owned or having at least \$5 million in assets.

Beyond finding accredited investors, companies looking for investments must now take “reasonable steps to verify that the purchasers of the securities are accredited investors” before taking any cash, according to the JOBS Act.

The SEC left the requirements for fulfilling this process fairly open-ended, but said it would accept things like documentation of income through prior tax returns, reviews of bank and brokerage statements, and verification from an accountant or lawyer.

The standards for individuals to become accredited has come under fire since the SEC relaxed its advertising restrictions, with many saying the standards for income and net worth are too low. Those standards have not been updated since 1982, although the Dodd-Frank Act made a slight change to the standard for accredited investors by excluding the value of individuals’ homes.

“Some feel that if you allow the standard to be so low, you’ll get people who are not sophisticated enough to understand what they’re investing in,” Hoepfner said. “If they lose their investments, people will lose their trust in the market and there will be a wholesale chilling effect. That’s not good for anybody.”

The SEC is reportedly looking into revising the standards for accredited investors, although no proposed changes have been offered as yet.

The JOBS Act also amended the Securities Act by allowing companies to raise up to \$1 million per year through crowdfunding, in which nonaccredited investors come together through designated online communities and receive a stake in a company ahead of an initial public offering, giving new companies even more of a leg up when seeking private investments.

“There are a lot of people out there with good ideas but don’t have the relationship or capital to fund those ideas,” Hoepfner said. “I think this will be a good way for them to make those necessary connections on the smaller scale to get them off the ground.”

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