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New Tools for Raising Capital at Community Bank Holding Companies: General Solicitation and Crowdfunding

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Community bank holding companies have been showing renewed interest in raising capital. From enhanced new capital requirements to raising funds to support branch acquisitions, mergers, or organic expansion, bank holding companies are again considering different capital raising structures. With that in mind, we wanted to alert you to several recent regulatory developments aimed at easing some of the burdens of raising capital for small businesses, including community bank holding companies.

Lawmakers have been working hard at both the state and federal levels to relax private placement securities offering requirements, and have successfully created two new tools that community bank holding companies may consider when raising funds: (1) removing the prohibition on general solicitation in private placement offerings, and (2)

“crowdfunding.” Both tools offer the potential for community bank holding companies to reach out to a large number of prospective investors, yet still potentially avoiding the cost and burden of federal securities registration.

General Solicitation

Upon enactment of the **Jumpstart Our Business Startups Act (JOBS Act)** in September 2013, subject to certain conditions, you may now use general solicitation to advertise private offerings without needing to register the offering with the **U.S. Securities and Exchange Commission (SEC)**. Previously, SEC rules prohibited “general solicitation” of prospective investors in a private placement of securities, which is one of two principal manners that Wisconsin community bank holding companies have traditionally used to offer and sell their securities. The SEC has always allowed issuers to raise an unlimited amount of capital through a private offering to an unlimited number of “accredited investors” and up to 35 non-accredited investors, but general solicitation of prospective investors was explicitly prohibited. This old rule remains in place, but a new provision adopted by the SEC (Rule 506(c)) expressly permits an issuer to make a general solicitation in connection with certain private offerings.

So what can a community bank holding company do under the new rule? “General solicitation” means that you may advertise your capital raising efforts to a large audience of people. Examples include: mass newsletters or emails, billboards, public speaking engagements/conferences/panels, ads placed in newspapers, social media advertising through Facebook or other sites, including the company’s own website, to solicit investors. In addition, in order to satisfy certain of the conditions on the use of general solicitation discussed below, some companies have expressed interest in buying a list of individuals that are “pre-qualified” as accredited investors. Generally speaking, under SEC rules, an “accredited investor” includes individuals who have annual income in excess of \$200,000 in each of the two most recent spouse in excess of \$300,000 in each of those years, or whose net worth or joint net worth with their spouse at the time of investment exceeds \$1,000,000 (exclusive of any equity in their primary personal residence).

It is important to note that, while the use of general solicitation provides bank holding companies with the opportunity to reach a wider group of potential investors in their capital raising campaign who they otherwise

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might have been unable to contact without losing their exemption from registration, there continue to be significant investor accreditation requirements that must be adhered to in order to engage in general solicitation. Bank holding companies that wish to engage in general solicitation in conjunction with their offering must (1) allow only accredited investors into the funding round; (2) take reasonable steps to verify that the investors are accredited; and (3) declare in their notice filing with the SEC on Form D that they undertook a 506(c) publicly advertised offering.

These additional burdens, however, may be outweighed by the benefits of a larger pool of potential investors. The SEC provided a non-exclusive list of methods that issuers may use to verify that investors are accredited. Issuers are urged to consider the nature of the potential investor and the amount and type of information that the potential investor has about the company, the manner in which the potential investor was solicited to participate in the offering, and the terms of the offering (e.g. minimum investment) in determining the most appropriate verification methods.

It should be kept in mind that these new rules do not in any way limit the type and amount of information that must be provided to potential investors in the offering materials, but only speak to the manner of solicitation. In addition, the consequences of not complying with these conditions to the use of general solicitation in private placements are severe, including the loss of the ability to rely on the exemption. As such, bank holding companies are urged to work closely with legal counsel before engaging in any such offering.

In short, while the new SEC rule is not necessarily a game-changer, it does significantly expand what a community bank holding company may do when conducting a private placement. Issuers are now conditionally permitted to do something that has been prohibited since 1933 and is frankly a bit oxymoronic: public solicitation of their private placements.

Crowdfunding

No doubt you may recently have seen references in the media to what is referred to as “crowdfunding.” Crowdfunding has become a popular source of raising capital in the Internet era by offering a new method to raise small amounts of equity. Generally, crowdfunding occurs when a group of individuals pool their money, usually through internet sites, to support a company or cause. The concept started out as a popular source of funding for non-profit organizations, artists or special causes through the fund raising website called “Kickstarter.” Donors would receive incentives (e.g. t-shirts or concert tickets) depending on their level of “support.” Now, however, “equity crowdfunding” has become a potentially viable option through which small companies, typically startups, can sell small amounts of equity of their company. Though the JOBS Act embraced the concept of crowdfunding, this simplified method of raising funds has been met with some resistance from the SEC, which is rightfully concerned with sufficient disclosures and investor protections in these sorts of capital raises.

While most states in the country continue to wait for the SEC to adopt final rules on this issue, Wisconsin has followed the approach taken by Georgia and Kansas by proactively enacting legislation which, among other things, allows investors to invest in Wisconsin companies through equity crowdfunding. This new law allows a company to use the Internet as a significant source of solicitation of its stock using a crowdfunding site. A company may use crowdfunding to raise up to \$1 million from either accredited or non-accredited Wisconsin investors without audited financial statements, or up to \$2 million if the issuer has audited financial statements. Under the new law, non-accredited Wisconsin investors may purchase only up to \$10,000 of the issuer’s stock in such a crowdfunding offering.

Of course, a bank holding company or other company must meet certain requirements to qualify for this securities registration exemption. To conduct such an offering, an issuer is required to use a website registered with Wisconsin Department of Financial Institutions (DFI), provide certain disclosure statements, and fulfill several other requirements. In addition, it should be noted that these new Wisconsin rules only speak to exemptions from the Wisconsin registration requirements. Until final SEC rules are released, issuers may not yet engage in exempt crowdfunding offerings under federal securities law unless they qualify under another federal exemption (e.g. the intrastate offering exemption under §3(a)(11) of the Securities Act of 1933).

In addition to the newly enacted crowdfunding exemption, the new Wisconsin law also relaxes other requirements of private offerings. For example, the new law relaxes the definition of “accredited investor” by lowering the individual income threshold from \$200,000 to \$100,000, and lowering the net worth threshold from \$1,000,000 to \$750,000, as well as including the equity of the investor’s primary residence in his or her net worth calculation. It is important to note, however, that this new Wisconsin definition of accredited investor does not sync up with the federal definition. As such, an investor may be considered accredited under Wisconsin securities laws, but not under SEC rules.

Overall, it appears that legislators and regulators are trying to pave the way for small companies to raise capital without all of the attendant legal and related costs associated with a registered securities offering. Private placements have always been a popular option for capital raises by community bank holding companies, and these new tools attempt to ensure that such offerings continue to represent a viable method of doing so.

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