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# SEC Eases Rules for Crowdfunding to Assist COVID-19 Recovery

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The U.S. Securities and Exchange Commission (SEC) issued temporary final rules on May 4, 2020 relaxing certain requirements of Regulation Crowdfunding<sup>[1]</sup> to enable small companies to raise capital faster and gain access to the funds sooner. The rules were adopted to help small businesses recover from the financial impact of closures and safety measures designed to slow the spread of COVID-19. The amendments apply to securities offerings initiated under Regulation Crowdfunding between May 4 and August 31, 2020.<sup>[2]</sup>

The SEC recognized that a crowdfunding offering may be an attractive fundraising option for small businesses in the current economic downturn, as it allows a company to use the internet to reach out to customers and members of the local community as potential investors. The temporary rules:

- Allow companies to begin assessing investor interest before completing their financial statements;
- Relax the financial statement requirements for offerings of no more than \$250,000 in securities in reliance on Regulation Crowdfunding within a 12-month period; and
- Once launched, allow the issuer to close the offering and have access to funds sooner.

To be eligible to rely on the temporary rules, an issuer must be organized and have had operations for no less than six months prior to commencing its offering and, if the issuer has previously sold securities in a Regulation Crowdfunding offering, it must have complied with the applicable statutory and regulatory requirements in conducting each prior offering.<sup>[3]</sup>

Regulation Crowdfunding<sup>[4]</sup> which currently allows companies to raise up to \$1,070,000 every twelve months,<sup>[5]</sup> is effectively the only exemption from securities registration that enables small businesses to raise funds from the members of their communities who do not meet the minimum income and net worth standards to

qualify as accredited investors. By providing faster access to these “friends and family” investors, the temporary rules give small businesses a better chance to launch an Internet offering for a relatively small amount of capital and “see it to completion within a time frame that meets its urgent capital needs.”<sup>[6]</sup> The changes provide one additional tool for small businesses seeking to fund their financial recovery.

## Background

The term “crowdfunding” is commonly used to describe any offering of securities over the internet in reliance on an exemption from securities registration. However, Regulation Crowdfunding focuses on small businesses, allowing them to raise small amounts of capital by selling securities to anyone without regulatory review. Offerings must be conducted exclusively on the Internet through a website operated by registered broker-dealer or a “funding portal,” a new type of broker limited to facilitating crowdfunding offerings.

Before commencing a crowdfunding offering, a company must file certain information with the SEC<sup>[7]</sup> about the company’s business plan, financial condition and management as well as the terms of the offering. It must also deliver that information to the funding portal or broker that hosts the offering, where it will be posted on the host’s website and made available to potential investors. Among other requirements, the proceeds from a crowdfunding offering can only be released to the issuer from escrow if and when the minimum target amount of proceeds set by the issuer is met or exceeded.<sup>[8]</sup> The financial statements a company must provide depend on the size of the offering and whether the company has previously raised funds through crowdfunding.

## How it Helps

The temporary rules alleviate certain timing hurdles that lengthen the period until the issuer receives offering proceeds.<sup>[9]</sup> For a small business, preparing U.S. Generally Accepted Accounting Principles (GAAP) financial statements for review by an independent accountant can be a substantial and time-consuming undertaking. The temporary rules allow the company CEO to certify the financial

statements and certain tax return information for offerings of up to \$250,000; accountant review was previously required for offerings of more than \$107,000.<sup>[10]</sup> In addition, the company can begin contacting potential investors as soon as it can make an initial SEC filing without financial statements. Once the financial statements are filed, the company can accept investment commitments. It can then complete sales 48 hours after receiving investment commitments covering the minimum target amount. Previously, the company had to wait until its offering statement with financial statements had been publicly available on the website for 21 days to close, even if it received commitments covering the target amount sooner.<sup>[11]</sup>

The relaxation of the Regulation Crowdfunding financial statement and timing requirements, even if temporary, may give small private companies with popular followings, such as restaurants, brewpubs and craft retailers, a better opportunity to obtain a quick infusion of needed capital from their base of customers and supporters as they try to restart their businesses.

For more information, please contact [Alan MacDonald](#) or any attorney in Frost Brown Todd's [Securities & Corporate Governance](#) practice group.

***To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a [Coronavirus Response Team](#). Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.***

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<sup>[1]</sup> Temporary Amendments to Regulation Crowdfunding, SEC Rel. No. 33-10781 (May 4, 2020).

<sup>[2]</sup> *Id.* at 12.

<sup>[3]</sup> These conditions apply to companies already eligible to use Regulation Crowdfunding. See 17 C.F.R. § 227.100(b).

<sup>[4]</sup> 17 C.F.R § 227.100, *et. seq.*

<sup>[5]</sup> The SEC recently proposed to raise the maximum amount that can be raised through regulation Crowdfunding to \$5 million,

based upon recommendations of its Small Business Capital Formation Advisory Committee. See Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, SEC Rel. No. 33-10763 (Mar. 4, 2020). Increasing the amount that can be raised will substantially increase the utility of the Regulation Crowdfunding exemption for small companies.

[\[6\]](#) SEC Rel. No. 33-10781 at 3.

[\[7\]](#) Form C Offering Statement (17 C.F.R. 239.900).

[\[8\]](#) 17 C.F.R. § 227.303(e).

[\[9\]](#) The temporary final rules are codified at 17 C.F.R. §§ 227.201(z); 303(g); and 304(e).

[\[10\]](#) 17 C.F.R. § 227.201(t).

[\[11\]](#) 17 C.F.R. § 227.303(a).

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