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FINANCIAL LITERACY TIP OF THE WEEK

FOR IMMEDIATE RELEASE

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APRIL IS FINANCIAL LITERACY MONTH CROWDFUNDING: ARE YOU AN EDUCATED INVESTOR?

Boise, Idaho Idaho Governor C.L. "Butch" Otter has declared April as Financial Literacy Month. As part of an ongoing effort to promote financial literacy in Idaho, the Department of Finance offers Idahoans valuable tips on investments and those who sell investments.

The Internet has become an inexpensive and easy way for individuals and businesses to raise money for their activities. Congress recently passed the JOBS Act, which directs the U.S. Securities and Exchange Commission (SEC) to create rules exempting crowdfunding from the securities registration laws. Once implemented, these rules will remove restrictions on start-up companies seeking investors over the Internet. That should provide a new and exciting opportunity for legitimate small businesses to raise capital inexpensively and quickly in order to start or expand their businesses. However, investors should be on the lookout for unscrupulous issuers and intermediaries who may attempt to engage in crowdfunding before the rules are written or misuse crowdfunding to defraud investors through false and misleading representations.

What is Crowdfunding?

Crowdfunding is an online money-raising strategy that began as a way for the public to donate small amounts of money, often through social networking Web sites, to help artists, musicians, filmmakers and other creative people finance their projects. The concept recently has been promoted as a way of assisting small businesses and start-ups looking for investment capital to get their business ventures off the ground.

Traditionally, investment opportunities are offered by professionals, such as licensed broker-dealer firms and investment advisers, who must recommend investments that are based on their clients' investment objectives and levels of sophistication. Through crowdfunding, individuals are able to invest in entrepreneurial start-ups through an intermediary, such as a broker-dealer or a "funding portal." By law, "funding portals" are not allowed to provide investment advice.

What is a funding portal?

A funding portal is a Web site, also called a "platform," that advertises the investment opportunities and facilitates the payment from the investor to the issuer. Some portals advertise a variety of investment opportunities on one Web site, allowing the investor to select one or more projects in which to invest.

How Crowdfunding Works

Joe's small business sells goat cheese made from his special pygmy goats. To keep his business afloat or to help it grow, Joe can turn to the Internet to seek online donations from the public who contribute small amounts

of money and **expect nothing in return**. Joe usually sends a sample of his cheese as a thank you for the donation and large donors might even get a cheese named in their honor.

New legislation has directed the SEC to write rules that will change how Joe can raise money online. Once the rules are written, Joe will be able to use the Internet to raise up to \$1 million each year by selling investments in his company to thousands of investors. Because Joe will be issuing shares in his company in exchange for investment capital, his supporters are no longer donors. These supporters become investors and will **expect a financial return for their investment**.

Why Investors Must be Cautious About Crowdfunding Investments

- ✦ Crowdfunding investments cannot be offered legally until the SEC adopts rules to permit them. **Beware of offerings that seek investments immediately.**
- ✦ All investments have risk, but small business investments have even greater risk than normal. About 50 percent of all small businesses fail within the first five years.
- ✦ Issuers using funding portals to raise money may be inexperienced. Their track records may be unproven, unsubstantiated or outright fraudulent.
- ✦ The information about the investment is limited to what is provided through the funding portal. Investors may need to rely on their own research and due diligence to determine the issuer's track record.
- ✦ Because state regulators are not allowed to review crowdfunding issuers or their offerings, full and complete disclosure may not be available to investors.
- ✦ Investors may have limited legal ability to take action against the issuer should the investment not perform as represented. With state regulatory jurisdiction limited to anti-fraud authority, investors may be left on their own to pursue costly private lawsuits if things go wrong.
- ✦ Crowdfunding investments are mostly illiquid and investors must be prepared to hold their investments for lengthy periods of time or even indefinitely. It also may be difficult or impossible to resell these securities due to the lack of a secondary market.
- ✦ Funding portals must be registered with the Securities and Exchange Commission (SEC), belong to a self-regulating organization (SRO) such as a bona fide stock exchange or Financial Industry Regulatory Authority, and comply with other rules the SEC may issue.
- ✦ Crowdfunding portals claiming an accreditation or "seal of approval" from a standards program or board may not be legitimate.

The Bottom Line

It pays to be skeptical of investment opportunities you learn about through the Internet. When you see an offering on the Internet — whether it is on a funding portal, in an online newsletter, on a message board or in a chat room — you should be cautious until you have done your homework and proven that it isn't a scam. Always remember to investigate **BEFORE** you invest!!

To learn more about investment scams and how to safeguard your savings, please visit the Department of Finance website at <http://finance.idaho.gov>. Go to Education, then Financial Literacy.



Consumers can obtain information about financial firms, professionals or products, as well as view more Department press releases and other information on the Internet at <http://finance.idaho.gov> or by contacting the Department at (208) 332-8000 or Idaho toll-free at 1-888-346-3378.