Crowdfunding

The Internet has become an inexpensive and easy way for individuals and businesses to raise money. In 2012, Congress passed the JOBS Act, which directed the Securities and Exchange Commission (SEC) to formulate rules to exempt equity crowdfunding from the securities registration laws. These rules went into effect in May, 2016 and removed restrictions on start-up companies that use the internet to find investors.

While the SEC rules apply to crowdfunding on the national level, small businesses may also have the option to use state-based crowdfunding exemptions to raise investment capital from investors within their jurisdiction's borders. To date, nearly two-thirds of the states and the District of Columbia have laws on the books that allow businesses in their jurisdictions to raise money through crowdfunding.

What is Crowdfunding?

Crowdfunding is an online money-raising strategy. It began as a way for the public to donate small amounts of money, often through social networking websites, to help artists, musicians, filmmakers and others finance their projects. The concept has expanded and is now available for small businesses and start-ups looking for investment capital to help get their business ventures off the ground.

Traditionally, investment opportunities are offered by professionals, such as 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 can invest in entrepreneurial start-ups directly or through an intermediary, such as a broker-dealer or a "funding portal." By law, "funding portals" are not allowed to provide investment advice.

(revised: May 2016)

Who can invest?

Crowdfunding is not limited to wealthy or financially sophisticated investors. Anyone can invest in crowdfunding. Investments come with risks. Investors should learn as much as they can about the investment and the company and not discount disclosures.

Federal and State Crowdfunding

Under the SEC's rules and Federal crowdfunding, businesses can raise up to $1 million in a 12-month period from individual investors, who can invest up to $2,000 in a 12-month period but no more than $100,000, determined by their income and net worth. Offerings must be conducted online through a broker-dealer or funding portal.

Under state crowdfunding laws, businesses can raise money from local investors directly or through an intermediary—a broker-dealer or a state-based online platform or "portal". The amount a business can raise, and individual investment limits, are determined by each state's crowdfunding laws. (These amounts range from $100,000 to $4 million in a 12-month period, and $100 to $100,000 per investor, unless accredited.)

To learn more, contact:

Securities Bureau Chief - James Burns (208) 332-8080

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How Crowdfunding Works

Securities laws govern the issuance of securities such as stocks. Companies must either register securities or find an exemption from registration. , Registration protects both investors and legitimate issuers. Federal and state crowdfunding laws now provide exemptions from registration. Online equity crowdfunding allows investors to tap into the collective "wisdom of the crowd" and allows businesses to reach a lot more people over the Internet. For example, Joe's small business sells cheese. To keep his business afloat or to help it grow, Joe could turn to the Internet to seek online donations from the public who contribute small amounts of money and expect nothing in return. Or, he can go online to seek investors. By using the internet, Joe must be sure to comply with applicable state and/or federal laws that govern the offer and sell of securities including the crowdfunding rules and laws. For investors, Joe will be required to issue shares in his company and will be expected to provide a financial return on the investment. Under many state crowdfunding laws, Joe may issue a promissory note or other debt instrument in exchange for the investment.

Crowdfunding Considerations for Investors

- All investments have risk, but small business investments are particularly risky. Small businesses have high failure rates and there is very little information publicly available about the businesses.

- Crowdfunding portals or other online intermediaries claiming an accreditation or "seal of approval" from a standards program or board may not be legitimate.

- Issuers using funding portals to raise money may be inexperienced. Their track records may be unproven, unsubstantiated or outright fraudulent.

- Investors should rely on their own research to determine an issuer's track record and review an issuer's disclosures carefully.

- Crowdfunding investments are mostly illiquid and investors must be prepared to hold their investments indefinitely. It also may be difficult or impossible to resell these securities due to the lack of a secondary market.

The Bottom Line

While crowdfunding opens new capital raising opportunities for small businesses and investors, you should perform due diligence on investment opportunities you learn about through the Internet.

When you see an offering on the Internet — whether on a funding portal, in an online newsletter, message board or chat room — you should do your homework. For questions about crowdfunding offerings, contact the Idaho Department of Finance, Securities Bureau Chief - James Burns at (208) 332-8080.

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