

Small Business Advisory: Crowdfunding

The Jumpstart Our Business Startups (JOBS) Act, a series of legislative provisions designed to facilitate capital formation in the United States, was signed into law in 2012. Title III of the JOBS Act (also known as the CROWDFUND Act) allows entrepreneurs to raise capital by selling interests in their businesses over the internet through a third-party intermediary.

Under the CROWDFUND Act, a business can now raise up to \$1.07 million in a 12-month period by selling “securities” to investors without registering that offering with federal or state securities regulators. However, the Act places limitations on how and to whom a business can sell its securities. The law became fully effective on May 16, 2016, when the Securities and Exchange Commission (SEC) issued rules—Regulation Crowdfunding—to implement this new exemption.

What is Investment Crowdfunding?

Crowdfunding began as a way for the public to donate small amounts of money, often through social networking websites, to help artists, musicians, filmmakers and other creative people finance their projects. Through the JOBS Act, this concept was also promoted as a way to assist small businesses and start-ups looking for investment capital.

At its core, investment crowdfunding is a method of raising capital from a large number of people who each invest relatively small amounts of money. Securities sold in this way rely on federal and state securities registration exemptions. With investment crowdfunding, investors buy a “security” issued by the company with the expectation of some type of financial return. They often receive ownership or creditor rights in the company.

Individuals are able to invest in these entrepreneurial start-ups through an intermediary, such as a broker-dealer or a “funding portal.” A funding portal is a website, also called a “platform,” through which investors may invest in crowdfunding offerings. Companies using crowdfunding may not make investment opportunities directly to individual investors. The funding portal or platform facilitates the investment including the payment from the investor to the issuer.

Some portals may list a variety of investment opportunities on one website, allowing investors to select one or more projects. By law, “funding portals” are not allowed to provide investment advice and must be registered with the SEC.

What is State Crowdfunding?

While the SEC rules apply to crowdfunding on the national level, many states, including North Carolina’s Department of the Secretary of State, Securities Division, have enacted their own intrastate crowdfunding laws. Businesses in North Carolina have the option to use state-based crowdfunding exemptions to raise capital from investors within North Carolina’s borders. In general, businesses can raise money from local investors directly or through an intermediary such as a broker-dealer or a state-based online platform or portal. The amount a business can raise, and individual investment limits, are determined by North Carolina’s crowdfunding laws.

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 state-based crowdfunding. To see which jurisdictions now allow intrastate crowdfunding, visit <http://www.nasaa.org/industry-resources/corporation-finance/intrastate-crowdfunding-resource-center/intrastate-crowdfunding-directory>.

To learn more, contact:

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Considerations for Small Businesses and Entrepreneurs

Don't discount disclosure. Crowdfunding exemptions are only an exemption from securities law registration requirements. They do not change the securities law disclosure requirements. The requirements of federal and state securities laws regarding disclosures, including disclosures of all material facts and risks to investors, remain in place. If the issuer does not comply with these disclosure requirements, the issuer could be liable for securities law violations. Existing federal and state registration laws are specifically designed to protect small businesses soliciting investments by ensuring that the key terms and risks of their offerings are disclosed on brief, short-form filings. This is a significant benefit for entrepreneurs and other unsophisticated businesses that may be unaware of legal pitfalls when such disclosures are not made.

Carefully choose a broker or funding portal. Federal crowdfunding requires an issuer to work through an intermediary, and some state crowdfunding laws similarly require an intermediary. When an issuer selects an intermediary, be sure that the broker or funding portal complies with the requirements of the CROWDFUND Act and Regulation Crowdfunding (or similar state statutes and rules). Ask questions to ensure that the broker or funding portal is compliant with applicable laws and regulations. For example, since small businesses under the Regulation Crowdfunding are responsible for making misrepresentations to investors or failing to disclose important information, be wary of crowdfunding platforms that seem careless about the importance of providing adequate disclosures to investors. Finally, be aware of unscrupulous persons offering to take fees to help raise capital over the Internet. If a broker or funding portal does not comply with the SEC, or applicable state, rules, the exemption may be voided, subjecting the issuer to liability for an unregistered offering.

Don't go it alone. The crowdfunding exemption is meant to lower capital-raising costs by exempting capital formation efforts of \$1.07 million or less from registration. However, a small business using this exemption still needs legal guidance as to how to comply with the requirements as well as the other federal and state securities laws. Consider speaking with a licensed and experienced securities law attorney before offering and selling any securities.

Consider distractions. Crowdfunding is built around the premise of having a large numbers of owners of the company. Having hundreds of owners may distract the company's management from devoting the time and energy that is necessary to run a successful business. Venture capital companies or private equity funds may be less inclined to invest in a company that already has a large crowd of small investors.

Consider funding alternatives. Crowdfunding may be less expensive than doing a public offering of securities, but it may be more expensive than other alternatives. Federal and state laws provide other ways for a company to raise money from a limited number of investors with little or no cost.

The Bottom Line



For more information on offering securities and raising capital, contact the North Carolina Department of the Secretary of State, Securities Division at (800) 688-4507 or (919) 814-5400 or <https://www.sosnc.gov/divisions/securities/crowdfunding>.

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