What is crowdfunding?
For years, crowdfunding has been a way for an organization, company, or individual to raise money over the Internet for a cause, project, service, or product. People who contributed money through crowdfunding did so without expecting any type of substantial financial return.

In 2012, Congress passed the JOBS Act, which directed the Securities and Exchange Commission (SEC) to formulate rules to exempt “equity crowdfunding” from securities registration laws as a way to assist small businesses and start-ups looking for investment capital to help get their business ventures off the ground. These rules went into effect in May, 2016 and removed restrictions on start-ups and small businesses using the Internet to find investors.

As a result, the concept and practice of crowdfunding has expanded and is now available for small businesses and start-ups looking for investment capital – and for investors to buy ownership interest in these companies.

Businesses can raise up to $1 million in a 12-month period from individual investors. An individual's maximum investment amount is determined by their net worth and income level. An investor may not invest more than $100,000 over a 12-month period.

6 things to know about how to crowdfund

1. Through crowdfunding, individuals will be able to invest in entrepreneurial start-ups or small businesses through an intermediary, such as a broker-dealer or a “funding portal,” which is a type of website.
2. The funding portal facilitates the investment, including the payment from the investor to the business.
3. Some portals may list a variety of investment opportunities on one website, allowing investors to select one or more projects.
4. By law, “funding portals” are not allowed to provide investment advice and must be registered with the SEC.
5. Companies using crowdfunding may not make investment opportunities directly to individual investors.
6. You can find information about portals at: www.finra.org/about/funding/portals-we-regulate

Crowdfunding disclosure and liability
The crowdfunding exemption is only an exemption from legal registration requirements. You still must abide by legal disclosure requirements, including disclosures of all material facts and risks to investors.

If you do not comply with these disclosure requirements, you and your business could be liable for securities law violations and subject to private lawsuits as well as enforcement actions by regulators. Existing 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 start-ups and small businesses that may be unaware of the legal pitfalls that await them when such disclosures are not made.
Carefully choose a broker or funding portal

Be aware of unscrupulous persons offering to take fees from you to help you raise capital over the Internet.

If your broker or funding portal does not comply with the SEC’s crowdfunding rules, your exemption may be voided, subjecting you to liability for an unregistered offering. When you do select an intermediary, be sure that the broker or funding portal thoroughly complies with SEC crowdfunding rules.

Ask questions to ensure that your broker or funding portal is following the law. For example, since small businesses will be held responsible for making misrepresentations to investors or failing to disclose important information, you should be wary of crowdfunding platforms that seem careless about making adequate disclosures to investors.

Don’t go it alone

The crowdfunding exemption is meant to lower your capital-raising costs by exempting $1 million or less capital formation efforts from registration. However, a small business using this exemption still needs legal guidance as to how to comply with legal crowdfunding requirements as well as the other securities laws. Consider speaking with a licensed and experienced securities law attorney to help you in your offering.

Avoid distractions

Having hundreds of “owners” as a result of crowdfunding 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.

Bottom line

Do your due diligence and get advice from a competent professional to determine the appropriate course of action for your particular circumstances. Be sure to guard your company’s reputation by avoiding crowdfunding platforms and intermediaries that appear unconcerned about compliance with laws and regulations.

For more information on offering securities and raising capital contact the Pennsylvania Department of Banking and Securities at 1.800.PA.BANKS or 1.800.600.0007. Visit dobs.pa.gov to learn more about crowdfunding.

Special thanks to the North American Securities Administrators Association (NASAA) www.nasaa.org.