Be a well-informed investor on Crowdfunding

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. 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 to help expand or get their business ventures off the ground – and for investors to buy ownership interest in these companies.

Who can invest?

Crowdfunding is not limited to wealthy or financially sophisticated investors. Anyone can invest in crowdfunding. Individuals can invest in start-ups and small businesses directly or through an intermediary, such as a broker-dealer or a "funding portal." You can find information about portals at: **www.finra.org/industry/funding-portals**.

Under the SEC's rules, 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.

Protecting investors in crowdfunding

All companies offering securities for sale – through traditional or crowdfunding methods – must either register their securities or find an exemption from registration from the SEC or a state regulator. Registration protects investors by ensuring they receive accurate financial and other significant information about the securities being offered for sale and preventing fraud and misrepresentation in the sale of the securities.

How crowdfunding works

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 laws that govern the offer and sale of securities. For investors, Joe will be required to issue shares in his company and will be expected to provide a financial return on the investment.

Be a well-informed investor on Crowdfunding

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.
- 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.

Crowdfunding investment basics

- **Finances**: Review closely the financial projections in the company's offering, as well as any other financial statements from the company or the offering's intermediary/funding portal.
- **Timeline**: Review closely the projections for bringing a company's product or service to the market, as well as other issues such as strategies, costs, manufacturing, and distribution.
- **Capitalization**: Assess whether the company will raise sufficient capital to ensure success, as well as any information about future capital needs.
- **Management**: Assess the backgrounds of the managers and directors to satisfy yourself that they have the experience and skills to successfully start, build, and grow a business.

Crowdfunding 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 over 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 investigate before you invest.

Connect ··· Learn ··· Contact

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.

a well-informed Marketplace

Financial Services for Consumers and Business

Special thanks to the North American Securities Administrators Association **www.nasaa.org**.

pennsylvania
DEPARTMENT OF BANKING AND SECURITIES

Market Square Plaza | 17 N. Second Street, Suite 1300 | Harrisburg, PA 17101
1.800.PA.BANKS | 1.800.600.0007 | dobs.pa.gov |