CROWDFUNDING
Overview

Origins / History / Statistics
• 1997 – Modern day Crowdfunding may have started with British rock band Marillion – Fans raised $60,000 online to fund US tour of the band.

• Roots in America stretch back to 1885 when $250,000 was raised to fund the plinth (pedestal) for the Statue of Liberty (without Social Media or the Internet).
• 2009 – Crowdfunding begins to rapidly emerge as a popular option for entrepreneurs to validate their ideas, gain exposure, and obtain funding. Crowdfunding revenue **tripled** from $530 million in 2009 to $1.5 billion in 2011. [Source: Fundable, LLC]
• At the end of 2012, there were approximately 191 Crowdfunding platforms in the US alone. And worldwide Crowdfunding dollar volume was $2.8 Billion [Source: Statista]

• Crowdfunding Platforms:
  - Kickstarter, Indigogo, RocketHub, Peerbackers (Donor/Reward Sites)
  - Grow Venture, MicroVenture, Angel List, Funders Club, CircleUp (Equity Sites)
Crowdfunding Types

- Current Use: social ventures, public interest or artistic endeavors, where contributions:
  1) simply take the form of donations,
  2) are rewarded with token of value, e.g., ticket,
    or reflect pre-purchase of a finished product, e.g., music album
    - Kickstarter, IndieGoGo, RocketHub
Crowdfunding Types

3) reflect peer-to-peer lending
   - contributors expect repayment, with or without interest

• The type that is of interest to securities regulators:

4) Equity Crowdfunding
   - Distinguishing feature: a security - a contract, transaction or arrangement whereby a person invests his money in a common enterprise and is led to expect profits from the efforts of others
Most active crowdfunding categories of 2012 (in percent)

- Social causes: 30%
- Other: 28%
- Business & entrepreneurship: 16.9%
- Films & performing arts: 11.9%
- Music & recording arts: 7.5%
- Energy & environment: 5.9%

Additional Information:
Worldwide, 2012

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Funds paid out per equity based projects on crowdfunding platforms in 2012

- Less than 10,000 USD: 6%
- 10,001 - 25,000 USD: 10%
- 25,001 - 50,000 USD: 16%
- 50,001 - 100,000 USD: 26%
- 100,000 + USD: 42%

Sources: Crowdsourcing.org; Crowdfunding.nl; Fundable Worldwide; 2012
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Securities Law Issues with Equity Crowdfunding

• Equity crowdfunding can easily:
  1) become an unlawful offering of securities
     a) under the Securities Act and
     b) under state “Blue Sky” laws
  2) violate broker-dealer registration requirements

• Can potentially trigger investment adviser and/or investment company registration
Securities Law Compliance: Offering

• Alternative 1: New Rule 506(c)
  – Permits “general solicitation and advertising”
  – Limited to “accredited investors”
  – State laws are pre-empted

• Alternative 2 (Not yet in Florida):
  Intrastate Offering Exemption in states that have enacted crowdfunding laws
Offering: Alternative 1 – 506(c)

- What is an “accredited investor”?
  - Individuals:
    - Net worth of >$1 million (excluding value of primary residence) OR
    - Annual income >$200,000 individually (or $300,000 with spouse) in each of last 2 years and reasonable expectation to reach same this year
  - Entities with >=$5 million in assets and certain other entities
- Note: “Bad actor” and proposed rules
Offering: Alternative 2 – Intrastate

- Issuer must be resident and do business in the relevant state
  - Organized under laws of that state
  - Principal office in that state
  - 80% of revenues, assets, proceeds in that state
- All offerees and purchasers must be resident in that state
- That state must have a crowdfunding law – Florida does NOT
Offering: Alternative 2 – Intrastate

- Must be *very careful* with use of the internet
  - Third party portals: OK as long as “adequate measures” in place to ensure that offers are made only to that state’s residents
    - Disclaimers and restrictive legends
    - Limit access to persons who represent that they are residents or provide zip code
  - Issuer’s own website: would “likely” violate Securities Act
Florida Funders Concept
Securities Law Compliance: Broker-Dealer Registration

• Broker = any person engaged in the business of effecting transactions in securities for the account of others
  – Hallmark is “transaction-based compensation”

• Two March 2013 SEC “No-Action Letters”: Platforms can avoid BD registration under certain conditions
Broker-Dealer Registration: FundersClub

- FundersClub:
  - Process:
    - FundersClub (FC) qualifies “accredited investors” (who must then wait 30 days)
    - FC vets private start ups and FC affiliate enters into non-binding agreement with same to set target amount
    - Investor accesses list of investment opportunities (provided by start-ups)
    - Investor submits non-binding indications of interest
    - Once target amount is met, FC closes investment opportunity, rechecks AI status and an affiliate of FC then negotiates deal docs with start up
Broker-Dealer Registration: FundersClub

- **FundersClub (ctd):**
  - Investors are then aggregated into a private venture capital (VC) fund formed with FC’s affiliate as investment adviser to fund and third party custodian takes custody of investor funds

  - In the absence of this No-Action letter, FC would be less inclined to participate in private company financings of a size that is not economical if it had to register as a broker-dealer
***Broker-Dealer Registration: AngelList***

- **AngelList (AL):**
  - Process very similar to FundersClub
  - Affiliate of AL provides investment advice and administrative services to investment vehicle

  - Two models:
    - Angel followed (where high net worth individual’s investment choices are followed by others) and
    - Angel advised (a “lead” angel takes active role in identifying opportunity and negotiating transaction; may provide management services, but not permitted to receive transaction-based compensation)
Broker-Dealer Registration: Take Away

- NOTE: No-Action Letters are highly fact-specific: vary the facts slightly, and you may get a different result
- HOWEVER, it is relevant that neither platform nor adviser entities were paid commissions/fees, but solely received carried interest
  - Carried interest is not compensation in connection with purchase or sale of securities in those circumstances
Broker-Dealer Registration: Take Away

- Platforms do not perform services typical of broker-dealers
  - receive no transaction-based compensation, but only carried interest
  - AL recoups formation expenses out of carried interest. FC uses administrative fee to defray actual out-of-pocket costs, but those fees are not paid to any FC entity/affiliate
  - do not handle investor securities – third party custodian did
  - do not solicit investors – at least not outside of their online platforms
- Adviser entities provide investment advice to the investment vehicle, not to individual investors
  - are either registered investment advisers (AL) or exempt from registration (FC)
- Access to platforms limited to accredited investors (verified in advance)
- Carried interest was fully disclosed to investors
- No associated person was subject to statutory disqualification
- Letters of interests and requests for info were non-binding on investors
SEC’s Crowdfunding Proposal

• SEC in 2013 proposed rules to implement JOBS Act crowdfunding provisions (so-called “Title III Crowdfunding” or “Regulation Crowdfunding”)

• These rules have NOT been adopted

• SEC is trailing JOBS Act-imposed implementation deadline by 20 months so far