Crowdfunding

The Internet is a popular 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 investment crowdfunding from the securities registration laws. These rules went into effect in May 2016 and eased restrictions on start-up companies that use the internet to find investors.

What is Investment Crowdfunding?

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. Investment crowdfunding is not to be confused with donations-based or rewards-based crowdfunding where no securities are offered.

While the SEC rules apply to crowdfunding on the national level, many states have enacted their own intrastate crowdfunding laws. Now small businesses in those states have the option to use state-based crowdfunding exemptions to raise 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 state-based crowdfunding. To see which jurisdictions now allow intrastate crowdfunding, please visit http://www.nasaa.org/industry-resources/corperation-finance/intrastate-crowdfunding-resource-center/intrastate-crowdfunding-directory/.

(revised: August 2017)
**Who Can Invest?**

Investment crowdfunding is not limited to wealthy or financially sophisticated investors. In fact, anyone can invest in a crowdfunded securities offering. But investors must remember that all investments come with risks. Investors should learn as much as they can about the investment and the company and carefully read all of the disclosures.

**Federal and State Crowdfunding**

Under the SEC’s rules and federal crowdfunding, businesses can raise up to $1.07 million in a 12-month period from individual investors, who can invest amounts ranging from $2,000 to $107,000 in a 12-month period depending on 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 a broker-dealer or funding portal. The amount a business can raise, and individual investment limits, are determined by each state’s crowdfunding laws. For more information about what each jurisdiction allows, please refer to the link provided on the first page.

**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. Investors should be prepared to lose their entire investment.

- 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 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 in South Dakota, contact the Division of Insurance - Securities Regulation at 605.773.3563 - ask for Securities Regulation.

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