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**PROMOTING A NEW SOURCE OF LIQUIDITY  
FOR SMALL BUSINESSES: AN EXAMINATION OF  
U.S. REGULATION OF CROWDFUNDING**

by

Roy J. Girasa\*  
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**INTRODUCTION**

One of the effects of the 2007 financial crisis in the United States was the highest level of U.S. unemployment since the 1929 Great Depression. This financial disaster caused a major rethinking in Congress: the 2010 Dodd-Frank Act<sup>1</sup> (the “Act”) sought to curb the abuses within the financial system with its 1,000 page, multiple titled divisions. The Act sought to regulate perceived abuses and causes of the crisis, particularly by banking institutions, and resulted in a major overhauling of substantive financial sectors. It forbade banks from engaging in

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risk-oriented investment activities including hedge funds, the unsuccessful prohibition of “too-big-to-fail” banks, reform of credit rating agencies, the creation of the Financial Stability Oversight Council<sup>2</sup> to regulate financial sectors of the economy that may create financial danger to overall U.S. financial stability, protection of consumers, and other provisions.

At the same time, Congress addressed the need to foster greater employment opportunities. The legislators lessened regulatory restrictions for new start-up companies so that numerous investors might add their substantial liquidity in relatively small sums for these start-up ventures. In this article, the authors examine the use and abuse of crowdfunding as a vehicle to encouraging financial investment, comparing it to the more traditional roles of angel and venture capital investors. The authors are particularly concerned with the possible abuses and with the regulatory environment that seeks to lessen the fraud that often accompanies diverse financial strategies. This article concludes that continued legislative and enforcement actions are needed both to encourage investors to participate and to protect investors from fraud.

## **CROWDFUNDING: A U.S. AND INTERNATIONAL PHENOMENON**

Crowdfunding refers to investments, other than the more traditional means of raising capital, by a substantial number of persons with respect to particular, mostly new, projects. In past years, such funding often originated from venture capitalists who assumed substantial risks in the hope of attaining more substantial financial rewards from innovative ideas that appeared to have financial merit. Although venture capital funding continues as an important source of capital for newly arising business ventures, crowdfunding has now overtaken venture capital as a major source of financing.

Crowdfunding investment rose from \$6.1 billion in 2013 to \$16.2 billion in 2014, and a projected \$34.3 billion in 2015. Venture capital investments constituted approximately \$30 billion in a comparable time frame.<sup>3</sup>

Crowdfunding has its roots several centuries in the past, but it appeared in its current incarnation in 1997 when a British rock band, desiring to accomplish a reunion tour, requested and received funds online from fans. This initiative led to the formation of ArtistShare, a platform connecting creative artists to fans to play a role in the creative process and fund creative artistic activities.<sup>4</sup> It was the first fan funding platform.<sup>5</sup>

Crowdfunding constitutes an investment of capital in order to seek a profit through the efforts of other persons. This practice usually comes within the parameters of the *SEC v. W.J. Howie Co.* test which requires, unless exempted, registration with the Securities and Exchange Commission (SEC).<sup>6</sup> Congress enacted such an exemption in the 2012 of the *Jumpstart Our Business Startups Act* (the “Jobs Act”).<sup>7</sup> Title III.<sup>8</sup> The Jobs Act specifically permits an exemption from the substantial filing requirements with the SEC mandated under Section 4 of the Securities Act of 1933 (the 1933 Act)<sup>9</sup>.

### *Benefits of Crowdfunding*

The crowdfunding statute specially states that the Jobs Act is “[t]o increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies.” In addition, the International Organization of Securities Commissions (IOSCO) lists a number of benefits of crowd-funding: economic growth through new and increasing flows of credit to small and medium enterprises and other users in the real economy; a complement to bank investment; increased leverage through a

lower cost basis; portfolio diversification; cost efficiency; convenient; and increased competition in an area traditionally dominated by a few providers.<sup>10</sup>

### *Risks of Crowdfunding*

A number of authors and regulatory bodies note risks inherent in the practice to both investors and to the issuers and promoters of crowdfunding ventures. The list is extensive:

- Fraud, when recipients of moneys convert the funds for personal needs and wants;
- Incompetence of the entrepreneurs, who often have creative ideas but lack ability to translate them into useable products or services and market them successively;
- Inability of the entrepreneurs to compete or protect their intellectual property rights against large, much better funded enterprises;
- Taxation issues, especially when marketed in other countries; regulatory requirements on each level of governmental entities;<sup>11</sup>
- Defaults and high failures of start-up businesses;
- Ultimate lack of liquidity irrespective of sums raised for the enterprise;
- Money laundering and terrorist financing; and
- Platform failure.<sup>12</sup>

It should be noted, in particular, that ideas are not protected by intellectual property statutes unless reduced to patents or copyrights in a fixed and tangible form. There is, then, the pressing danger of theft of such ideas by other prospective entrepreneurs.<sup>13</sup>

## U.S. CROWDFUNDING PLATFORMS

There are many hundreds of crowdfunding platforms<sup>14</sup> or methodologies (models) that may be used by persons seeking funding which to date have raised more than \$65 billion for startup companies resulting in the creation of over 270,000 jobs by the statutory enactment.<sup>15</sup> The major models of which the first two models are the primary types, may be summarized as follows:

1. *Rewards-based Model*: The rewards-based crowdfunding model offers certain perks to non-accredited investors such as t-shirts, movie passes, free software, and other perks at little cost to investors but without receipt of any ownership in the company.
2. *Equity-based Model*. The equity-based model gives accredited investors an opportunity to invest in new companies that have unique offerings with potentially sizeable future monetary returns. The best known example of the equity model is that of Kickstarter.com. Kickstarter was launched in Brooklyn, New York on April 28, 2009 by three individuals taking the form of a public benefit corporation.<sup>16</sup> The company, which has raised over \$2.1 billion dollars 10 million people has funded almost 100,000 projects. Its stated mission is to help bring creative projects to life.<sup>17</sup> Among the projects launched include the arts, fashion, music, food, publishing, film, theatre and other noteworthy areas. Other platforms have raised some \$10 billion for comparable projects.<sup>18</sup>
3. *Charity-based Model*. This model offers investors moral satisfaction rather than monetary or other such rewards by donations to worthy non-profits seeking to promote social enterprises. An example of charitable crowdfunding is the

website at these authors' university whereby donors are encouraged to contribute donations for a multitude of students' projects and endeavors including undergraduate students' research travel fund, internships in nonprofits and social enterprises, and environmental studies in Cuba.<sup>19</sup>

4. *Peer-to-Peer (P2P) Debt Model.* In the crowdfunding debt-model investors pool moneys into a fund that lends unsecured money online to potential borrowers based on their credit-risk portfolios permitting investors to receive from interest received. The model offers alternatives to borrowers particularly when moneys from banks or mortgage companies become unavailable.
5. *Litigation Model.* The litigation model of crowdfunding provides moneys for purposes of commencing or continuing litigation against companies for perceived wrongdoing and other related alleged malfeasance. Investors receive a stake in the potential result of the litigation. An example of this model is LexShares, wherein the raised capital may be used for litigation expenses such as attorneys' fees, expert witnesses, trial exhibits and court fees investors; working capital for rent, supplies, and other business related expenses; personal expenses for the litigants; and serve as a means of acquiring high quality legal talent that lessen the perceived need to settle cases for less money than the desired outcome.<sup>20</sup>
6. *Product Pre-order Model.* The product pre-order model enables investors to receive products being manufactured before becoming available to the public at a discount price.<sup>21</sup> It has some degree of similarity to the rewards-based model.<sup>22</sup>

## **U.S. COMPARISON OF CROWDFUNDING TO VENTURE CAPITAL AND ANGEL INVESTMENT**

As noted, venture capital was a primary means of raising capital for startup companies or those in their early stages of potential expansion. Crowdfunding is the most current means of doing so, compliments of favorable statutory requirements. The problem addressed by Congress is the requirement of extensive registration provisions under the Securities Act of 1933 and the Securities Exchange Act of 1934 (the “1934 Act”). The 1933 Act mandates that an offer and sale of securities requires that the securities be registered with the Commission unless otherwise exempted. Crowdfunding was permitted by Congress in order to permit numerous small investors to invest or donate small amounts of moneys either in the hope of gaining significant financial advantages or simply to participate in good causes or receipts of certain perks. The Jobs Act removes most prohibitions of general solicitation and advertising that otherwise would make such investments prohibitive due to the extensive costs and expenses related to Securities Acts requirements.

A comparison of the two popular means of attaining funding is illustrated below.

	<b>Crowdfunding</b>	<b>Venture Capital</b>
Sources of Funding	Small individual contributions from numerous investors	Moneys from a few wealthy from numerous investors accredited investors
Means of investing	Online through the Internet	Direct investment with firm; offline
Sums that may be invested	Limited to \$1 million	Unlimited



Sophistication of investors	Low	High
Share of financial returns	Dependent on platform chosen (equity model may permit but most do not share)	Significant profit or revenue
Registration requirements	Exemption under Securities Act	May require registration and compliance with other requirements under Securities Acts

Angel investors are similar to venture capital investors in that they are ordinarily wealthy investors investing directly with the prospective company but generally differ by becoming financially involved at the onset or early stages of a prospective enterprise while venture capital is ordinarily invested in relatively large sums (\$2 million or more) once there is evidence of that the enterprise has commenced and is gaining credibility as one with potential sizeable financial returns. Angel investors assume greater risk but also may demand a greater percentage of equity for the *perceived* additional risk.<sup>23</sup>

## U.S. STATUTORY ENVIRONMENT FOR CROWDFUNDING

### *Prior Securities Exemption Provisions*

The 1933 Act was enacted as a result of Congressional investigations that uncovered significant fraud during the halcyon days of the “roaring 20s” when fraudulent securities were commonly sold to unsuspecting investors. With certain major exceptions,<sup>24</sup> the 1933 Act required that investors receive financial information from the issuer in order to better evaluate whether or not to provide capital in the hope of receiving financial profit through the efforts of other persons.

Issuers, generally through their underwriters, brokers, and dealers, provide the relevant information by means of a registration process. Pertinent information of the proposed security is filed with the SEC, created under the Securities Exchange Act of 1934. The investment information is contained in a detailed prospectus and is available to the public on the Commission's website EDGAR.

### *The Crowdfunding Exemption*

With respect to crowdfunding, §302 of Title III amends §4 of the 1933 Act to provide an additional exemption from registration by adding a sixth exemption to §4(a)<sup>25</sup> for:

transactions involving the offer or sale of securities by an issuer (including all entities controlled by or under common control with the issuer), provided that—

(A) the aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction, is not more than \$1,000,000;

(B) the aggregate amount sold to any investor by an issuer, including any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction, does not exceed—

(i) the greater of \$2,000 or 5 percent of the annual income or net worth of such investor, as applicable, if either the annual income or the net worth of the investor is less than \$100,000; and

(ii) 10 percent of the annual income or net worth of such investor, as applicable, not to exceed a maximum aggregate amount sold of \$100,000, if

either the annual income or net worth of the investor is equal to or more than \$100,000.<sup>26</sup>

Within the crowdfunding exemption, Congress limited financial exposure and possible losses by (1) limiting the amount raised by a startup to \$1 million over a 12-month period and (2) restricting individual investments over a 12-month period to either the greater of \$2,000 or five percent of the annual net worth of the individual investor if the investor's income is less than \$100,000 annually so as to protect less sophisticated investors; or the greater of 10 percent of the investor's annual income if such income is \$100,000 or more but not to exceed the an amount sold to investors of \$100,000.

#### *SEC Final Rule*

Pursuant to the crowdfunding amendment to the 1933 Act, the SEC issued a Final Rule effective May 16, 2016 with 685 pages of the Rule and commentaries detailing the requirements for issuers, intermediaries, and other requirements in an endeavor to limit exposure of unsophisticated investors and provide a framework for the registration which registered funding portals and broker-dealers are required to use as intermediaries.<sup>27</sup>

#### *Limitations on Investments:*

The question arises concerning how an intermediary is to determine the net worth of the investor. The final rule provides that the person's annual income and net worth are to be calculated in accordance with the values calculated for determining accredited investor status (in essence, net worth exceeding \$1 million and annual income exceeding \$200,000<sup>28</sup>). The issuer may rely on the efforts of the intermediary to ensure that the appropriate limits on investments have been met.<sup>29</sup> The

exemption applies only to transactions involving the sale or offering of securities that are organized within the U.S., is not an investment company, and is not otherwise ineligible to sell securities.

*Requirements Relating to Issuers:*

The definition of an issuer varies dependent upon the context in which it is used. In the context of crowdfunding, it is defined under §2(4) of the 1934 Act as “every person who issues or proposes to issue any security” with a number of exceptions not applicable in this context. Title III of the Jobs Act requires an issuer that offers or sells securities to file with the Commission and provide investors and the relevant broker or funding portal and make available to potential investors detailed information concerning the issuer’s name, legal status, physical and website addresses, names of directors and officers and persons holding 20 percent or more of the issuer’s shares; a description of the business and business plan; material factors concerning risk or speculation; the financial condition certified by the chief executive officer of the issuer for the preceding 12-month period for target offering amounts of \$100,000 or less including tax returns and if over \$100,000 and under \$500,000; financial statements by an independent public accountant and audited statements if over \$500,000; a description of the purpose and intended use of the proceeds; the price of the offerings to the public; a description of the ownership and capital structure of the issuer;<sup>30</sup> and numerous other details concerning price structure, return of funds if investment is cancelled, rights of principal shareholders, and other pertinent data. Thus, the degree of information to be filed and given to investors and intermediaries increases exponentially as the target investments increases.<sup>31</sup>

The issuer offering or selling securities has to file an offering statement with the Commission as well as any

amendments, progress updates, and an annual report.<sup>32</sup> Advertising by prospective issuers is strictly limited to directing the potential investor to the intermediary's platform and must include a statement of the offering, name of the intermediary, terms of the offering, factual information about the proposed business and location, and how to communicate with the intermediary.<sup>33</sup> Compensation from the issuer to the promoter is permitted but the extent of compensation is to be disclosed through the intermediary.<sup>34</sup> The Final Rule has an appendix displaying the forms required under the rule, to wit, forms for offering statement, progress update, amendments to the offering statement, annual report and amendment, and termination of reporting.

*Requirements Relating to Intermediaries:*

Investors generally act through intermediaries respecting the sale or purchase of securities. These persons or entities must register with the Commission as either a *broker* defined as “any person engaged in the business of effecting transactions in securities for the account of others”<sup>35</sup> or as a *funding portal* defined as “any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others but does not offer investment advice, solicits purchase or sales of securities or holds or manages such securities”.<sup>36</sup> The person or entity must also register with any applicable self-regulatory organization<sup>37</sup> (generally, the Financial Industry Regulatory Authority [FINRA]) and provide disclosures to investors of risks and other educational materials as the Commission may require to ensure that each investor reviews relevant information of the crowdfunding offering, affirms an understanding that the person or entity understands the risks associated with the investment including that of a total loss of the investment and understands the level of risk

applicable to the investment, and an understanding of the risk of illiquidity.<sup>38</sup>

Before accepting any investment commitment and additional commitment, the intermediary must have a reasonable belief that the investor satisfies the investor limitations cited above although the intermediary may rely on the investor's representations such as his or her annual income, net worth, and the amount of the investor's other investments unless the intermediary has reasons to question the reliability of the representations. The intermediary is required to obtain from the investor a representation that the investor has read the intermediary's educational materials, understands that the entire amount invested may be lost, and that the investor is in a financial position to absorb the loss. Other data to be received from the investor include a completed questionnaire that demonstrates his or her understanding of restrictions on cancelling a commitment to invest or difficulty in reselling the said securities, and the risk of loss that is otherwise not affordable.<sup>39</sup>

Additional provisions relating to intermediaries include the requirement that the Commission take measures to reduce fraud by mandating a background check and regulatory history with respect to each officer, director, and persons holding more than 20 percent of the outstanding equity of every issuer whose securities are being offered under the Jobs Act; provide that all proceeds from the offer may be given and used by the issuer only when the target offering amount is reached and allow investors to withdraw their proceeds if such target is not met; and information collected from investors; and protections relating to promoters, finders, or lead generators.<sup>40</sup> Any director, officer, or partner of the intermediary may not have a financial interest in the *issuer* (defined as "a direct or indirect ownership of, or economic interest in, any class of the issuer's

securities”) including compensation for services rendered to the intermediary. The intermediary also may not have a financial interest in the issuer unless it receives compensation for services provided respecting the sale or offer for sale of the particular class of crowd-funded securities.<sup>41</sup>

The regulations require that an intermediary take measures to reduce risk of fraud. The intermediary must have a reasonable basis for believing that the issuer has complied with the requirements of the crowdfunding statute; that the issuer has established means to keep accurate records of the holders of the securities it would offer and sell through the intermediary’s platform; and deny access to its platform to an issuer which has a reasonable basis for believing that the issuer or officers thereof is subject to a disqualification.<sup>42</sup> The intermediary must assure that the investor has opened an account with the intermediary with consent for electronic delivery and provide all information on its platform and to the investors that is required by the intermediary including: educational materials that explains the process of the offer, risks, types of securities offered, restrictions on resales, limitations on amounts that may be invested and other relevant information; whether promoters have been used and the compensation thereof; and disclosure of compensation of the intermediary.<sup>43</sup>

The intermediary must provide communications channels on its platform to enable persons to communicate with each other and with representatives of the issuer unless the intermediary is a funding platform that does not participate in communications other than to provide guidelines for communication and remove abusive or potential fraudulent communications; permits public access to view the discussions in the communications channels; restricts posting of comments to those who have opened an account with the intermediary

on its platform; and requires persons posting comments clearly stating whether he or she is a founder or employee of the issuer engaged in promotional activities or is otherwise compensation for the comments.<sup>44</sup> When an investor receives an investment commitment from an investor the intermediary must promptly provide the investor with the dollar amount of the investment commitment; the price of the securities, if known; the name of the issuer; and the date and time by which the investor may cancel the commitment.<sup>45</sup>

An intermediary that is a registered broker must comply with regulations governing the transmission or maintenance of payments in connections with underwritings. It is a “fraudulent, deceptive, or manipulative act or practice” under Securities Act for any broker or dealer participating in any distribution of securities to accept any part of the sale price of any security being distributed unless (a) the money or other consideration received is promptly transmitted to the persons entitled thereto; or (b) if not to be payable to the person on whose behalf the distribution is made, then the money or other consideration received is promptly deposited in a separate bank account, as agent or trustee or in escrow for the persons who have the beneficial interests therein.<sup>46</sup>

An intermediary that is a funding portal must direct investors to transmit the money or other consideration to a qualified third (registered broker or dealer holding such funds or an insured bank or credit union) which has agreed in writing to hold the funds on behalf of the persons entitled to them. The funds are to be transmitted to the issuer when the aggregate amount of investment commitment achieves the target amount of the offering but no sooner than 21 days after the date on which the intermediary makes publicly available the required information on its platform. If the investment commitment has been cancelled then the funds are to be returned to the investor



upon failure to complete the offering. Investors are to receive a confirmation from the intermediary that discloses the date of the transaction type of security purchased, identity, price and number of securities, and other related information.<sup>47</sup>

*Special Rules for Registered Funding Portals:*

As discussed above, a funding portal is required to be registered with the Commission and become a member of a national securities association (*e.g.*, FINRA). It is exempt from broker registration requirements in connection with its activities as a funding portal.<sup>48</sup> When acting as a crowdfunding intermediary with respect to the offer or sale of securities it may not offer investment advice or recommendations; solicit purchases, sales, or offers to buy the offered securities displayed on its platform; or compensate other persons for such solicitation. It may not hold, manage, possess, or otherwise handle investor funds or securities.

It may, however, determine what terms to allow an issuer to offer and sell securities under its platform; apply objective criteria to highlight offerings on its platform that are reasonably designed to highlight the issuers' offering; provide search functions or other tools investors can use to examine the offerings available through the funding portal's platform; provide communication channels by which investors can communicate with each other and with representatives of the issuer concerning the offerings; advise an issuer about the structure or content of the issuer's offering, including assistance in the preparation of the offering documentation; compensate a third party for referring a person to the funding portal provided the third party does not provide the portal with personally identifiable information of any potential investor and the compensation is not based on the purchase or sale of a crowdfunding security except for compensation paid to a

registered broker; pay compensation to a registered broker or dealer in connection with the offer or sale of crowdfunding securities pursuant to a written agreement and such services and compensation comply with the rules of the registered national securities association of which the funding portal is a member; receive compensation from a broker or dealer for services performed by the portal for sale or offer of the said securities; advertise the existence of the funding portal and identify one or more issuers or offerings available in accordance with certain designated criteria; deny access to its platform or cancel an offering of an issuer where it believes there may be fraud or concerns investor protection; accept on behalf of an issuer an investment commitment for the offered crowdfunding securities; direct investors where to transmit funds and remit payments in connection with the said securities; and direct a third party to release proceeds to an issuer upon completion of the crowdfunding offering.<sup>49</sup>

*Nonresident Funding Portal Requirements:*

A nonresident funding portal is defined as a funding portal incorporated in or organized outside the U.S. or having its principal place of business beyond U.S. borders. Registration by a nonresident funding portal is conditioned upon information sharing arrangement between the Commission and the competent regulator in the nonresident portal's jurisdiction. The said portal must have a designated U.S. agent upon whom any service of process, pleadings or other papers may be served and must maintain appropriate books and records.

*Completion of Offerings and Cancellations:*

An investor may cancel an investment commitment for any reason up to 48 hours of the deadline identified in the

issuer's offering materials. If there is a material change to the terms of the offering or with respect to the information provided by the issuer, then the intermediary is to notify the investor of such change and that the investment commitment is being cancelled unless the investor reconfirms the commitment within five business days of receipt of the notice.<sup>50</sup> If the target offering amount is reached prior to the deadline identified in the offering, the issuer may close the offering before the deadline date provided certain requirements are met, to wit, the offering must remain open for 21 days; notice is given to potential investors of the new deadline; his or her right to cancel the investment up to the said 48 hours of the new deadline offering; and whether any additional investment commitments will be permitted within the 48 hour deadline.<sup>51</sup>

*Miscellaneous Provisions Applicable to Funding Portals:*

Funding portals are subject to inspections and examinations by the Commission and by registered national securities organizations. Records are to be kept for a period of five years (2 years in an easily accessible place) concerning an investor's purchase or attempts to purchase crowdfunding securities; records relating to issuers for such offerings; communications regarding the platform; records relating to promotion of issuer's securities that use communication channels; notices to issuers and investors; written agreements relating to the offerings; all daily, monthly, and quarterly summaries of transactions effected; organizational documents; and financial recordkeeping and reporting of currency and foreign transactions.<sup>52</sup>

*Restriction on Resales and Disqualification Provisions:*

Securities issued under the crowdfunding exemption may not be transferred by any purchaser for one-year

commencing when the securities were issued unless the securities are transferred to the issuer; to an accredited investor; as part of an offering with the Commission; or to a family member of the purchaser.<sup>53</sup> The crowdfunding exemption is not available to the issuer if it or its predecessor, officers, director, general partner, or managing member, or any beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities has been convicted within 10 years before the offering statement of any felony or misdemeanor in connection with the sale or purchase of any security or made any false filing with the Commission or has been enjoined by any court of competent jurisdiction in connection with the purchase or sale of security. The prohibition also applies to such persons who have been suspended or registration revoked, or subject to other bars by the Commission.<sup>54</sup>

## **CONCLUSION**

Crowdfunding is the recognition by the U.S. federal government as well as state and local governments that small businesses (under 500 employees) are the lifeblood of the American economy constituting 28 million in number and generating 65 percent of new employment positions since 1995.<sup>55</sup> With manufacturing jobs having moved to cheaper labor force areas, particularly China, the need to create a replacement has become a priority that both political parties have recognized thus leading to the Jobs Act, which has been emulated by many countries worldwide. Crowdfunding is one of a number of initiatives which government regulators and industry has put forth to assist in the necessary job creation. Interestingly, its scope is well beyond funding new profit-motive businesses but is also the seed for charitable and social concerns. The plusses and minuses discussed in this article make it evident that potential investors must be wary about

investing hard-earned money in ventures that may have little chance of success. Nevertheless, with the monetary limitations and relative easing of regulations it is anticipated that crowdfunding is yet another in the proliferation of capital-raising ventures that will inevitably be the source of remarkable success stories as well as cautionary tales of misadventure. The authors await further developments to see which way balance will tip.

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## ENDNOTES

<sup>1</sup> Dodd–Frank Wall Street Reform and Consumer Protection Act (Pub.L. 111–203, H.R. 4173, July 21, 2010).

<sup>2</sup> The Financial Stability Council was created under Title I, subtitle A of the Dodd–Frank Act.

<sup>3</sup> Massolution, *2015CF: The Crowdfunding Industry Report*, <http://www.crowdsourcing.org/editorial/global-crowdfunding-market-to-reach-344b-in-2015-predicts-massolutions-2015cf-industry-report/45376>. See also commentary by Chance Barnett, *Trends Show Crowdfunding to surpass VC in 2016*, FORBES (June 9, 2015), <http://www.forbes.com/sites/chancebarnett/2015/06/09/trends-show-crowdfunding-to-surpass-vc-in-2016/#18e99839444b>.

<sup>4</sup> artistShare, <http://www.artistsshare.com/v4/>.

<sup>5</sup> *The History of Crowdfunding*, Fundable (date visited), <http://www.fundable.com/crowdfunding101/history-of-crowdfunding>.

<sup>6</sup> *Securities and Exchange Commission v. W. J. Howey Co.*, 328 U.S. 293 (1946).

<sup>7</sup> Pub.L. 112-106 enacted into law April 5, 2012.

<sup>8</sup> Section 301 of the Act states that the full title of Title III is the Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012 or the CROWDFUND Act.

<sup>9</sup> 15 U.S.C. 77d

<sup>10</sup> Eleanor Kirby and Shane Worner, *Crowd-funding: An Infant Industry Growing Fast*, Staff Working Paper SWP3/2104, OICU-IOSCO, 21-22, <http://www.iosco.org/research/pdf/swp/Crowd-funding-An-Infant-Industry-Growing-Fast.pdf>. NOT SURE IF CITED CORRECTLY

<sup>11</sup> Garry A. Gabison, *Understanding Crowdfunding and its Regulations: How can Crowdfunding help ICT Innovation*, JRC Science and Policy Report, (2015), <http://publications.jrc.ec.europa.eu/repository/bitstream/JRC92482/lbna26992enn.pdf>.

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<sup>12</sup> OICU-IOSCO, Crowdfunding: 2015 Survey Responses Report, FR29,2015 (Dec. 2015), iv.

<sup>13</sup> Nicholas Wells, *The Risks of Crowdfunding*, Risk Management, RIMS (March 4, 2013), <http://www.rmmagazine.com/2013/03/04/the-risks-of-crowdfunding/>.

<sup>14</sup> Platform is defined as “a program or application accessible via the Internet or other similar electronic communication medium through which a registered broker or a registered funding portal acts as an intermediary in a transaction involving the offer or sale of securities in reliance on section 4(a)(6) of the Securities Act (15 U.S.C. 77d(a)(6). Final Rule §227.300 (4).

<sup>15</sup> Martin Zwilling, *Will These 5 Models of Crowdfunding Replace Angel and VC Investors*, Entrepreneur (Feb. 3, 2016), [www.entrepreneur.com/article/242767](http://www.entrepreneur.com/article/242767).

<sup>16</sup> A “public benefit corporation” is a relatively new type of business corporation form for the purpose of creating a “general public benefit” in addition to business purposes. In New York it is governed by Art. 17 of the New York Business Corporation Law. The purposes may be found in New York BCL §1702(e). [http://www.dos.ny.gov/corps/benefit\\_corporation\\_formation.html](http://www.dos.ny.gov/corps/benefit_corporation_formation.html). Approximately 20 states recognize public benefit corporations including Delaware, California and New York.

<sup>17</sup> <https://www.kickstarter.com/about?ref=nav>.

<sup>18</sup> For an excellent review for crowdfunding participants in making their selection of a crowdfunding platform to invest in together with a colorful diagram of possible choices, see Eric Markowitz, *22 Crowdfunding Sites (and How To Choose Yours)*, INC., <http://www.inc.com/magazine/201306/eric-markowitz/how-to-choose-a-crowdfunder.html>.

<sup>19</sup> Pace Crowd Funding, <https://crowdfunding.pace.edu/>.

<sup>20</sup> LexShares, <https://www.lexshares.com/pages/plaintiffs?gclid=CMG22JCKu8sCFRMIgQodwSYG1Q>

<sup>21</sup> Eric Markowitz, *When Kickstarter Investors Want Their Money Back*, INC. (Jan. 10, 2013), <http://www.inc.com/eric-markowitz/when-kickstarter-investors-want-their-money-back.html>.

<sup>22</sup> robotS, *Crowdfunding versus pre-orders, Backing the future* (Date), <http://backersmanual.com/2014/03/01/crowdfunding-is-not-a-pre-order>.

<sup>23</sup> SterlingFunder, *Comparison of Crowdfunding, Angel Investors and Venture Capital*, <https://www.sterlingfunder.com/page/comparison-of-crowdfunding-angel-investors-and-venture-capital>.

<sup>24</sup> Exempt securities include short-term commercial paper not more than 9 months; not-for-profit organizations; insurance products and policies, which are regulated by state insurance departments; common carriers; banks and savings and loan associations; government securities; and securities by a receiver or trustee in bankruptcy with prior court approval with respect to corporate reorganization. Exempt transactions include intrastate offerings as well as those governed by regulation A, Rule 504, Rule 50rule, and Rule 506,

<sup>25</sup> Securities Act of 1933, 15 U.S.C. §77(d)(a)(6).

<sup>26</sup> §4(a)(6) of the Securities Act of 1933.

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<sup>27</sup> Securities and Exchange Commission, 17 C.F.R. 200, 227, 239, 240,249, 269, 274 2016.

<sup>28</sup> Rule 17 C.F.R. §230.501.

<sup>29</sup> 17 C.F.R. §227.100(a)((2)(ii).

<sup>30</sup> Jobs Act, amended to Securities Act of 1933

<sup>31</sup> Final Rule, §227.201(r).

<sup>32</sup> Final Rule, §227.203.

<sup>33</sup> Final Rule, §227.204.

<sup>34</sup> Final Rule, §227.205.

<sup>35</sup> Securities Act of 1934, §3(a)(4)(A).

<sup>36</sup> Securities Exchange Act of 1934, §3(a) (80). The Final Rule, §227.300 (a)(2) defines *funding portal* as “a broker acting as an intermediary in a transaction involving the offer or sale of securities in reliance on section 4(a)(6) of the Securities Act ... that does not: (i) Offer investment advice or recommendations; (ii) solicit purchases, sales or offers to but the securities displayed on its platform; (iii) Compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its platform; or (iv) Hold, manage, process, or otherwise handle investor funds or securities.

<sup>37</sup> A “self-regulatory organization” is defined under the Securities Act of 1934, §3(a)(26) as “any national securities exchange, registered securities association, or register clearing agency”.

<sup>38</sup> Jobs Act, §302(b), which amends the Securities Act of 1933 (15 U.S.C. 77a et seq.) by adding a §4A, Requirements with Respect to Certain Small Transactions.

<sup>39</sup> Final Rule, §227.303(b).

<sup>40</sup> *Id.*

<sup>41</sup> Final Rule, §227.300 (b).

<sup>42</sup> Final Rule, §227.301.

<sup>43</sup> Final Rule, §227.302(b).

<sup>44</sup> Final Rule, §227.302(c).

<sup>45</sup> Final Rule, §227.302(d).

<sup>46</sup> 17 CFR §240.15c2-4.

<sup>47</sup> Final Rule, §227.302(e)(f).

<sup>48</sup> Final Rule, §227.401.

<sup>49</sup> Final Rule, §227.402.

<sup>50</sup> Final Rule, §227.304(a)(c).

<sup>51</sup> Final Rule, §227.304(b).

<sup>52</sup> Final Rule, §227.404.

<sup>53</sup> Final Rule, §227.501.

<sup>54</sup> Final Rule, §227.503.

<sup>55</sup> Nazar, Jason, *16 Surprising Statistics About Small Businesses*,

FORBES/Entrepreneurs (Sept. 9, 2013),

<http://www.forbes.com/sites/jasonnazar/2013/09/09/16-surprising-statistics-about-small-businesses/#3d5943593078>.