

The Definitive Guide to Equity & Debt Crowdfunding

THE CROWD FUNDING TEXTBOOK

by Scott Purcell



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The Definitive Guide to Equity & Debt Crowdfunding

This book is for accountants, lawyers, brokers and other professionals, as well as government officials, educators, students and entrepreneurs who want to get up to speed on crowdfunding rules and regulations so they can confidently assist clients who are either looking to raise capital or invest in private companies.



Forward & Acknowledgements

At the start of any endeavor, and especially a new industry, the most important initial activity is to educate those who will be involved. As an entrepreneur this means communicating a vision to the startup team (and investors and advisers). As a legislator or regulator it means communicating new laws or rules to constituents and those affected. And as an industry it means communicating the products, services and processes to participants.

Crowdfunding is ushering in a new era of capital formation for small to medium sized businesses. Rewards-based platforms such as Kickstarter and IndieGoGo already enable over \$2 billion in annual funding for arts projects and some select consumer businesses. And P2P ("peer-to-peer") platforms LendingClub and Prosper are on target to fund over \$5 billion in consumer and business loans in 2014, which is only the beginning of the disruption that the banking sector is about to experience. Yet this is only the tip of the iceberg. Trillions of dollars of capital sits on the sidelines, unable to help small to medium sized enterprises ("SME's") get funded due to archaic securities laws and regulations...something the JOBS Act is changing.

The new 506(c) and 4(a)(6) exemptions to the Securities Act of 1933, as created by Titles II and III of the JOBS Act, will make it easier for investors to find SME's who need capital and receive risk appropriate returns for helping businesses get funded, grow and create jobs. The disruption this will cause to traditional securities markets will be massive, and the positive impact on the US economy will be unprecedented. SME's already account for 64% of all new jobs and there are 28,000,000 companies with less than 500 employees versus just 18,500 with more than that. Lack of capital is the #2 reason for failure while low sales is #10 (wrong team is #1). With access to capital more businesses will grow and thrive rather than shrink and fail. With access to capital this country will soon have millions more growing businesses who need to hire people.

But it's complicated as there are numerous rules, regulations and best practices. We are talking about the securities industry, after all.

Hence the need for education. Especially for the accountants, lawyers, brokers, mentors, marketing & PR professionals and others who will help businesses prepare to raise money, embark on crowdfunding campaigns, and maintain compliance after a successful capital raise.

At the dawn of the commercial internet, way back in the mid-1990's, I was building one of the first internet service providers. I couldn't get my attorneys to communicate via email (they repeatedly said it was something they could never do). I met the CEO of a Fortune 500 company who, after I gave a presentation to him and his team, told me how much he appreciated the information and then stated categorically that no office of his would ever have a connection to the internet. I had to bite my tongue as I thought "yes you will, you just don't know it yet."

Crowdfunding is in a similar situation. Every broker, every accountant, every lawyer, every school, every investor, every business and every employee will be touched by crowdfunding. They just don't know it yet.

The Equity & Debt Crowdfunding eTextbook

Forward & Acknowledgements

continued

Education is needed, which has not yet been available as the industry is so new. But crowdfunding will eventually become a standard part of all business education curriculum. All lawyers, accountants and brokers will take continuing education courses on 506(c) and 4(a)(6). And all marketing professionals will have specialists helping businesses with their securities crowdfunding campaigns.

Everything needs a starting point, including industry education. It's critical to the success of the industry as it begins to overcome inertia and build momentum. This is why I decided to write this book and start Crowdfunding College.

There are a number of people I want to thank, as writing a book while in the middle of several startups catering to the securities crowdfunding ecosystem is no small task. These include Ruth Hedges of Global Crowdfunding Convention & Bootcamp and Crowdfunding Roadmap for her input on social media and marketing; Sara Hanks of CrowdCheck (and a former SEC staffer) for the countless edits and for slapping me in the head when I would get distracted by preconceived attitudes; Dave Feroe of Crowd Originals for illustrating the book and formatting it for an electronic world; Joan Adler and Doug Ellenoff of Ellenoff, Grossman & Scholte for the endless advice to keep me within legal bounds; Jason Best, Sherwood "Woody" Neiss, Zak Cassady-Dorion and my fellow Board members on the Crowdfunding Intermediary Advocates ("CFIRA") for all the work they've done to help make this industry a reality, without which this book wouldn't be needed; my investors for believing in my vision; and, most importantly, my wife, Nicoleta, 5 months pregnant with our first child, for tolerating a lifetime of the craziness that is part and parcel of being married to an entrepreneur. She endured the countless hours I spent writing, and was a sounding board whenever I've needed it. And a special note of thanks to the bi-partisan leaders in Congress for having the guts to craft and push this important legislation through the process; in particular to Rep Patrick McHenry (R-NC) for being the primary driver and first adopter, and Reps Carolyn Maloney (D-NY) and Stephen Lee Fincher (R-TN) for all their work to usher this through the House of Representatives, and to Sen Jeff Merkley (D-OR) for leading it through the Senate, along with Sen's Scott Brown (R-MA), Michael Mennet (D-CO), Eric Cantor (R-VA), and Mary Landrieu (D-LA), along with their staff who also deserve to be recognized for the countless hours they worked helping turn an extraordinary idea into a change-empowering reality.

Regardless of all the hard work, this book is a living document. It will need to be edited and updated frequently to accommodate new rules as they are written and regulatory interpretations as they are made. As of the date of first publication, most, but not all, of the 506(c) rules are in effect but a number of issues relating to escrow, confirmation of accredited investors, and other things remain to be clarified. And the 4(a)(6) crowdfunding rules are still in a "proposed" state. The comment period has ended, but powerful special interests hostile to small businesses, small investors and the crowdfunding industry continue to work toward killing this liberating exemption before it is ever used. I will continue to update this book as often as needed.

Scott Purcell
April, 2014

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Introduction

Education for equity and debt crowdfunding under the JOBS Act



Welcome to securities crowdfunding! This book is the first step in your participation in an exciting new world. We look forward to you being a part of this new era of capital formation!

The securities crowdfunding industry is gaining momentum every day, yet its impact is still only a fraction of its full potential for the economy. Our question to you is...are you ready to use the new rules to help businesses raise capital and create jobs?

April 5th 2014 marked the two year anniversary of the signing of the JOBS Act. Title II is live now. And even though the SEC has taken more time than expected, the rules will soon be solidified for Title III. The country needs crowdfunding professionals in every industry to help their clients and constituents use these new tools to ignite the American economic engine.

Crowdfunding is changing the economic landscape. This latest wave of disruption to investment and finance may be the most profound so far – or ever. If you serve small businesses then understanding this paradigm shift for the economy will put you in a position to provide insights, advice and leadership to your clients and those around you.

As awareness continues to grow, your clients will expect that they can rely on you for expert advice on how to raise capital or invest, and it's imperative that you understand how it works and what role you can play. How?

1. **Get informed** – our education course will quickly bring you up to speed on the finance industry in general, and on Titles II and III of the JOBS Act in particular.
2. **Take the Test** – once you've got the core knowledge, take the exam (3 hours, 125 questions, online).
3. **Stay up to date** – Keep informed of all the latest rule changes, safe harbors, no action letters and staff interpretations in the sector.

So if you are a lawyer, broker, accountant, Chamber of Commerce representative, government business development official, university professor, business mentor or consultant, this book is an essential foundation for your practice.

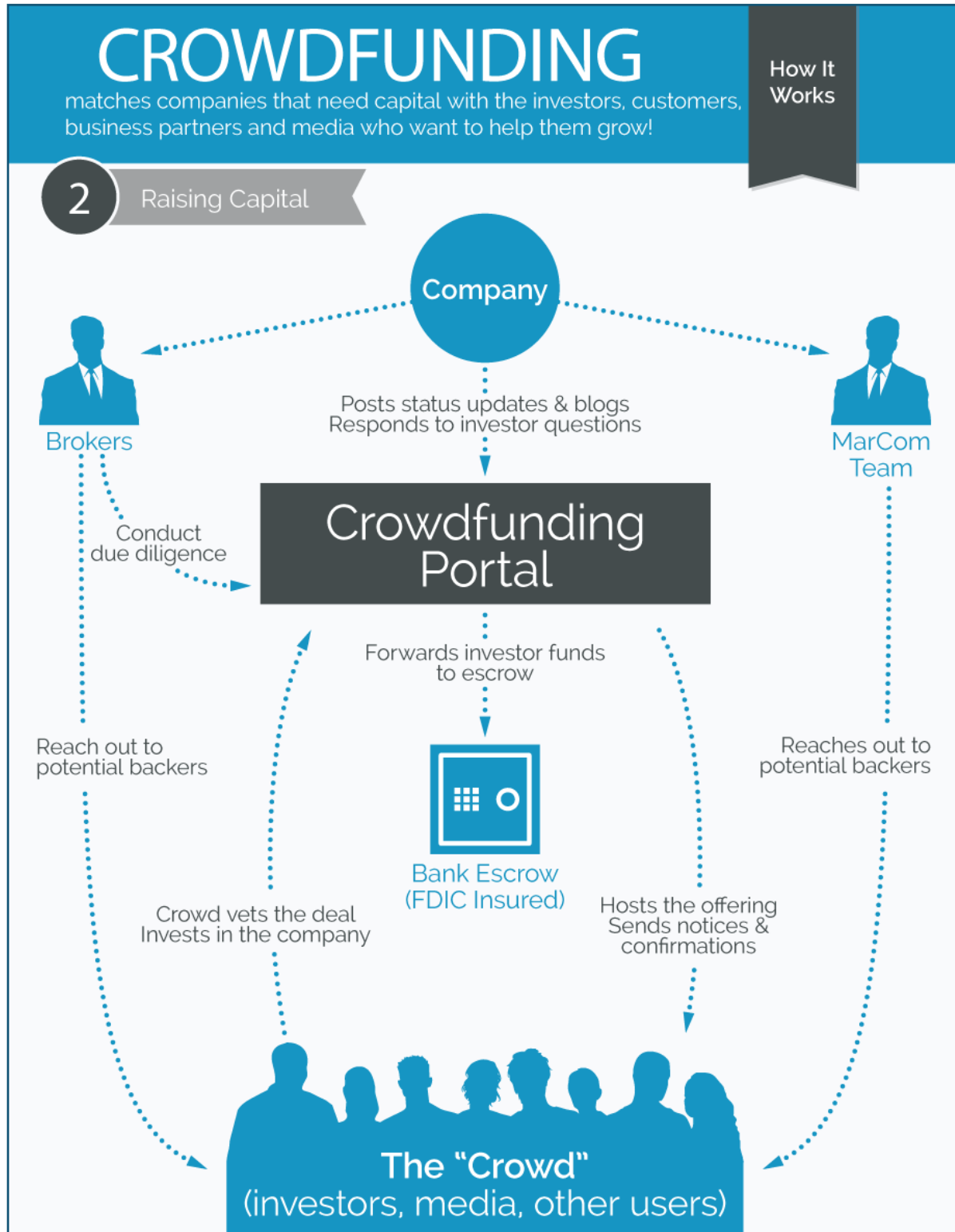


This book immerses professionals in all aspects of securities crowdfunding, including rules, regulations, processes and methodologies.

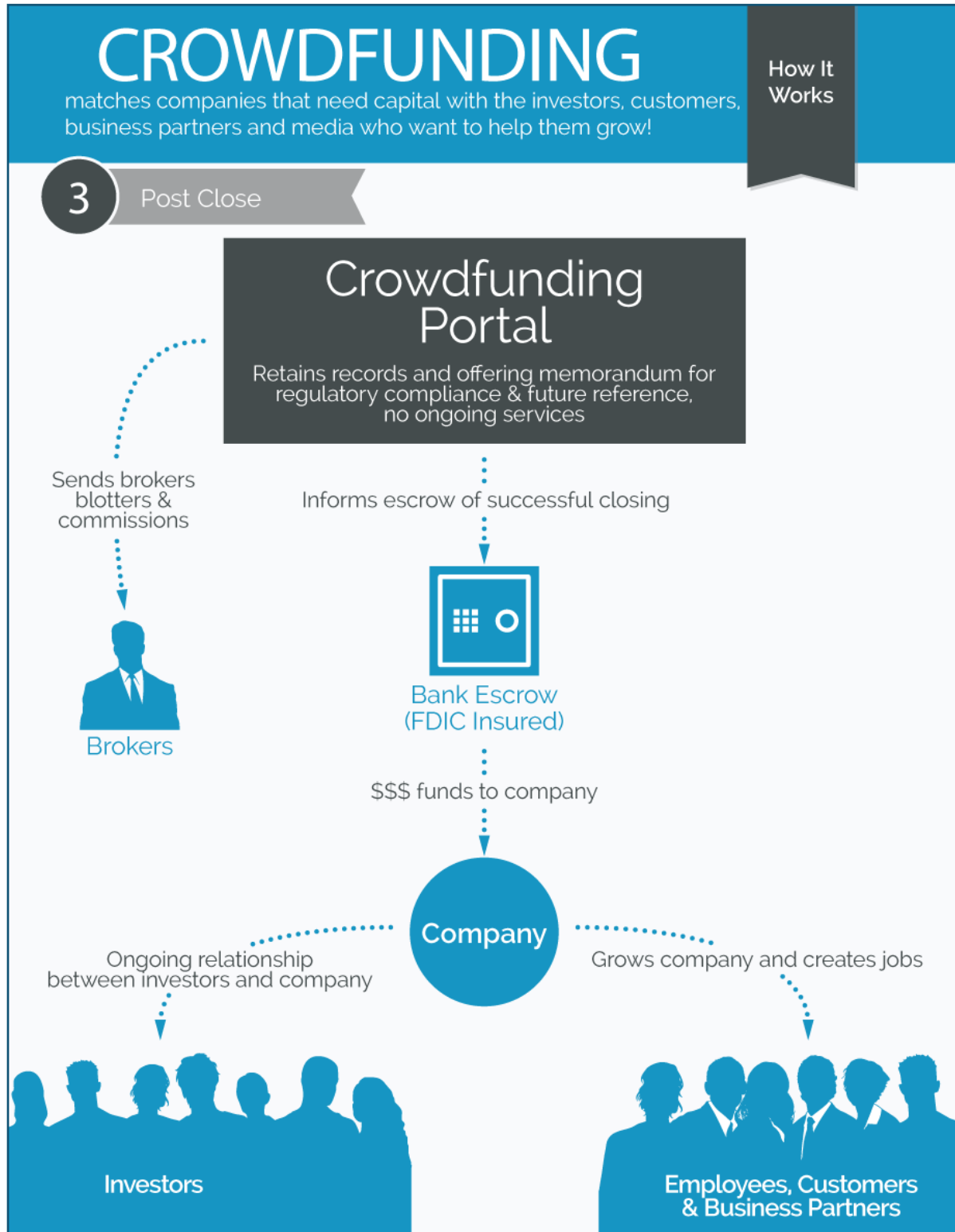
Getting Ready



Raising Money



Funded!



History of Crowdfunding

CF101

Understanding “Crowd****”:

“CrowdSourcing” – is the group (crowd) being leveraged (sourced) to achieve a common goal. This is a generic term and not specific to any particular form of CrowdSourcing (e.g. Crowdfunding).

- ✓ Groups of people have joined together to collectively accomplish things since the dawn of time.
- ✓ It's in our nature, humans have historically formed packs and social collectives (groups).

“Crowdfunding” – is the crowd coming together, through individual contributions, to collectively fund something (a business, a film, an art project, a student's tuition, disaster relief, Olympic dreams, etc.).

“Securities-Crowdfunding” – is the use of exemptions from the registration requirements of the Securities Act of '33 pursuant to Title III (aka Section 4(a)(6) of the '33 Act) and Title II (aka Rule 506(c) of Regulation D under the '33 Act) of the JOBS Act, to fund a business by means of investors acquiring the debt or equity securities of a company.

People started crowdfunding via...

- 1. Donation:** many charities and similar orgs have reached out to the public for money, especially in times of crises (e.g. Katrina, Sandy, etc.).

How It Works – People give money directly to people and charities...



Katrina Disaster Relief Fund



2. Rewards: The rapid growth of rewards-based crowdfunding has staggered naysayers and helped usher in the JOBS Act. Businesses can post their need for capital on sites like Kickstarter and, although it's illegal to say they will ever pay any of the money back or get equity in the company, as that would be a "security", they can get personal thank you notes, product samples, t-shirts, facility tours, free services, Twitter posts, party invitations, etc.


Rewards such as website postings, Twitter mentions, thank you notes, photographs, recordings and videos, products and samples services, and event invitations)

How It Works – People give money directly to people and businesses in exchange for non-monetary rewards...

Amanda Palmer: The new RECORD, ART BOOK, and TOUR

A Music project in Boston, MA by Amanda Palmer · [send message](#)

[PROJECT HOME](#)
[UPDATES 0](#)
[BACKERS 6,810](#)
[COMMENTS 212](#)
[REMIND ME](#)



6,810
BACKERS

\$379,420
PLEDGED OF \$100,000 GOAL

29
DAYS TO GO

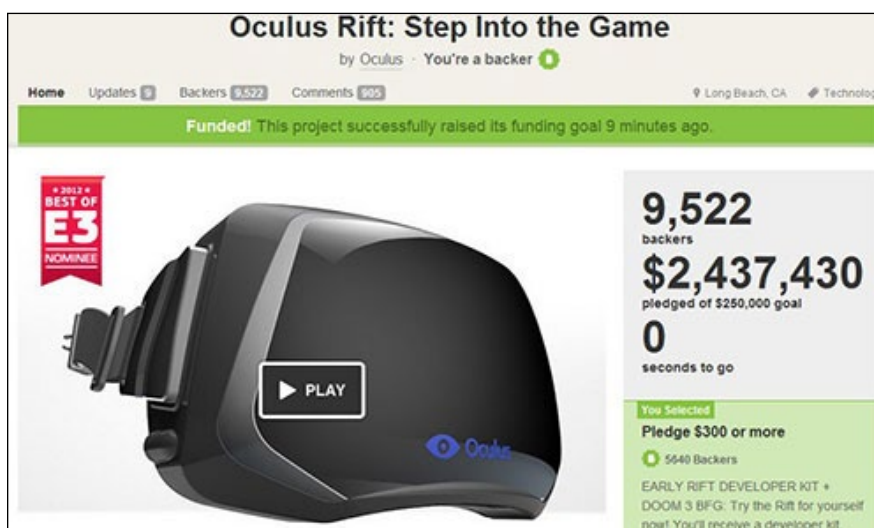
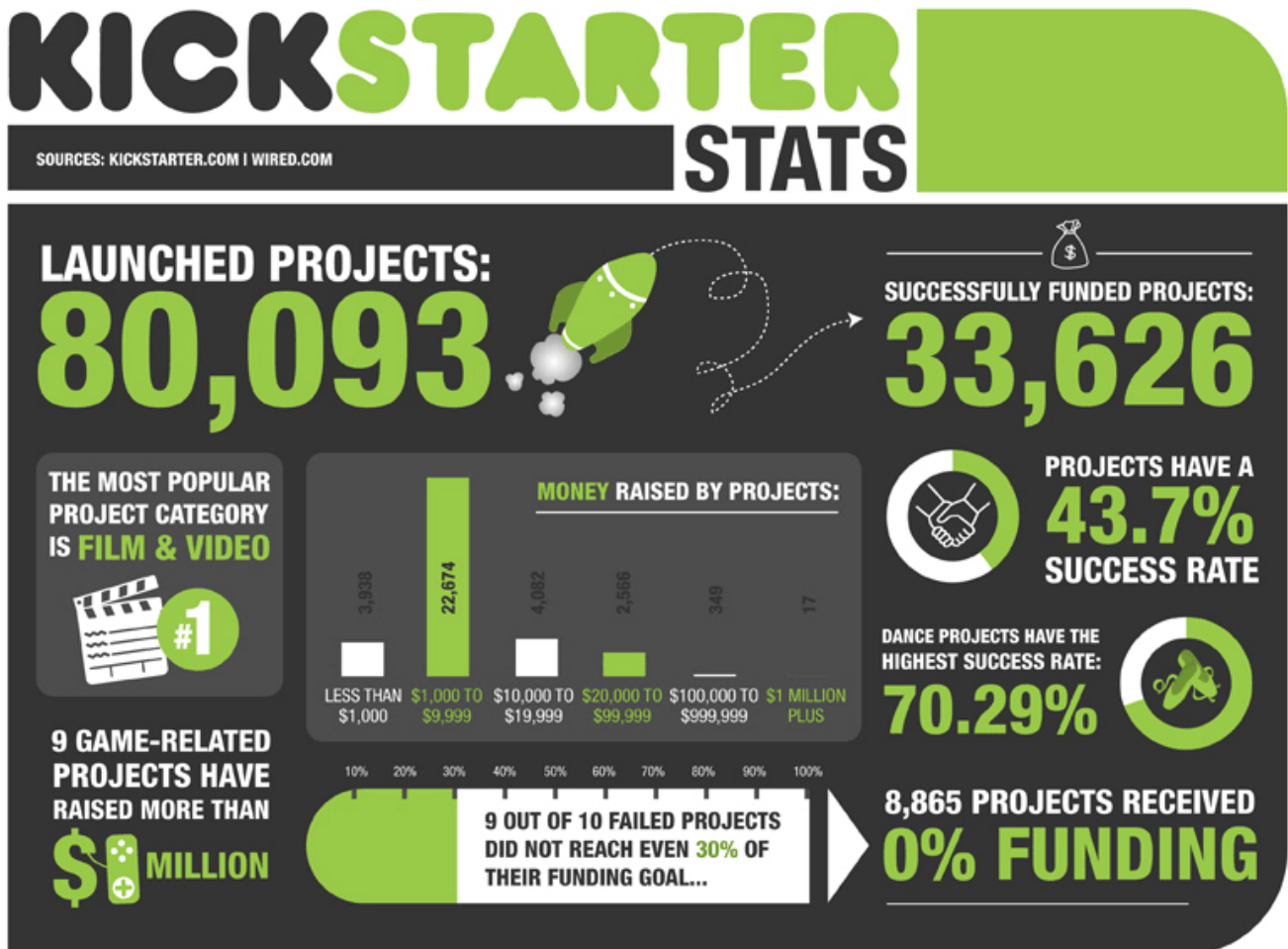
THIS PROJECT WILL BE FUNDED ON
THURSDAY MAY 31, 11:59PM EDT.

BACK THIS PROJECT
\$1 MINIMUM PLEDGE



2. Rewards: *(continued)*

Some statistics from 2012 for the leading rewards-based portal www.kickstarter.com...



Funded in September 2012

Bought by Facebook for \$2B in April 2014

"Backers" got zero upside

+ **Plus:** GREAT for businesses... free money, new customers & brand evangelists

- **Minus:** Terrible if people consider themselves investors (even emotionally)

2. Rewards: *(continued)***KICKSTARTER****The Stats: 2012**

Total pledged:

\$319,786,629

+221% from 2011

Pageviews

709 million

+279% from 2011

Total collected:

\$274,391,721

+238% from 2011

Unique visitors

86 million

+252% from 2011

Total backers

2,241,475

+134% from 2011

KICKSTARTER**The Stats: 2013**

Total pledged:

\$769 million

Total Backers

4.71 million

Total launched projects:

112,347

Successful Dollars

\$660 million

Total pledges

\$10.66 million

Unsuccessful Dollars

\$86 million

Successfully funded projects

47,942**Kickstarter Stats: 2013**

This page is updated at least once a day with the raw data behind Kickstarter. Metrics include funding success rates, dollars pledged, and trends of successfully and unsuccessfully funded projects. Statistics are available for the site overall as well as each of the 13 project categories.

Category	Launched Projects	Total Dollars	Successful Dollars	Unsuccessful Dollars	Live Dollars	Live Projects	Success Rate
All	70,290	\$349M	\$296M	\$36M	\$17M	3,462	43.89%
Film & Video	19,959	\$86.92M	\$72.41M	\$12.60M	\$1.90M	734	39.41%
Games	2,942	\$58.14M	\$49.18M	\$3.49M	\$5.47M	244	33.88%
Music	16,519	\$52.49M	\$46.76M	\$4.25M	\$1.48M	768	54.24%
Design	2,463	\$51.52M	\$44.35M	\$4.38M	\$2.79M	162	36.38%
Technology	1,395	\$22.42M	\$18.81M	\$1.82M	\$1.80M	79	30.78%
Publishing	7,702	\$17.01M	\$13.41M	\$2.72M	\$879.38K	487	31.25%
Art	6,491	\$15.76M	\$13.23M	\$2.03M	\$495.70K	326	48.40%
Food	2,226	\$11.41M	\$9.24M	\$1.79M	\$371.71K	139	40.78%
Theatre	3,567	\$10.88M	\$9.67M	\$833.84K	\$380.72K	129	64.21%
Comics	1,726	\$9.34M	\$8.15M	\$613.39K	\$574.73K	122	45.64%
Photography	2,331	\$5.38M	\$4.45M	\$777.71K	\$155.43K	97	37.65%
Fashion	1,977	\$5.31M	\$4.15M	\$817.83K	\$341.36K	140	27.44%
Dance	992	\$2.72M	\$2.44M	\$176.49K	\$101.87K	35	69.91%

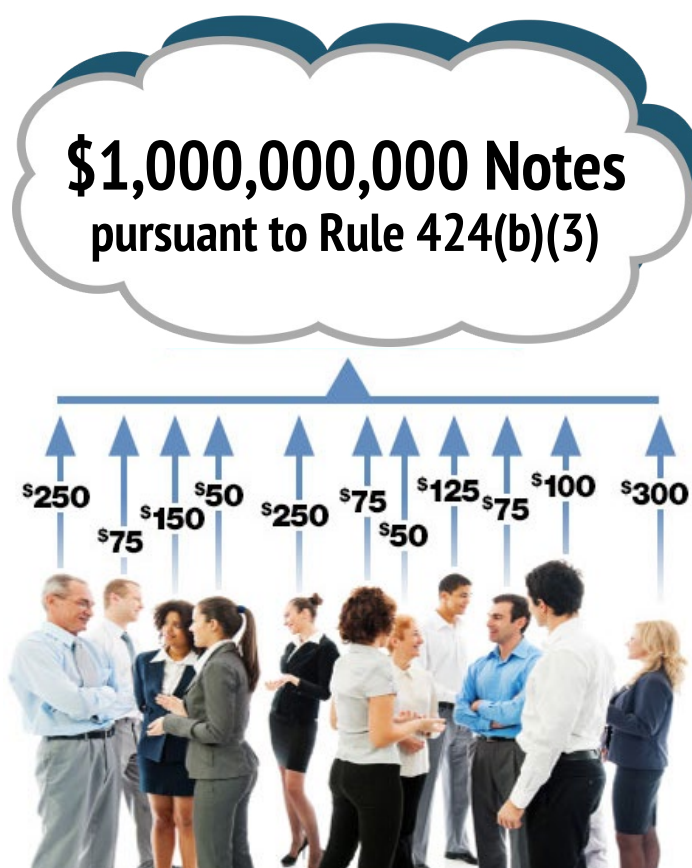


Note that business related funding represents a small fraction of rewards crowdfunding.

3. P2P Lending: Peer-to-Peer (P2P) lending is a concept where, on the face of it, people can lend money to people and businesses that need it. The reality, however, is quite different. The leading players in this space, [Lendingclub](#) and [Prosper](#), have made an arduous trek through the federal and state securities and banking minefields to arrive at a legal way to operate their platforms. Due to complex laws people are not really lending directly to people or companies but, instead, to a securitized pool which in turn lends money to the intended person or company. And the borrowers are liable to the lending entity (the fund or the bank) and not directly to the individuals participating. Yes, it's convoluted, but given the overwhelming need and the vacuum of capital alternatives it's been incredibly popular.

How It Looks – People make loans directly to people...

How It Really Works – People buy into a securitized pool which may *(or may not)* make loans to people...



From LendingClub.com...

Filed Pursuant to Rule 424(b)(3). This is a public offering of up to \$1,000,000,000 in principal amount of Member Payment Dependent Notes issued by LendingClub. We refer to our Member Payment Dependent Notes as the "Notes." We will issue the Notes in series. Each series will correspond to a single consumer loan originated through our platform to one of our borrower members. In this prospectus, we refer to these consumer loans as "member loans," and we refer to the member loan funded with the proceeds we receive from a particular series of Notes as the "corresponding member loan" or "CM Loan" for the series.

Through our online platform, we allow qualified borrower members to obtain unsecured consumer loans with interest rates that they find attractive. **We also provide LendingClub investors with the opportunity to indirectly fund specific member loans.**

3. Peer-To-Peer: *(continued)*

Case Study: LendingClub

- Business loans up to \$100,000
- Interest rates from 6% - 30%
- “Origination Fees” from 1% to 6% of the loan amount
- Loans must be personally guaranteed
- Misc fees for paying by check, late payments, etc



LendingClub is not a bank, there is no depositor insurance. The company lends money that is provided by people who invest in the “Member Payment Dependent Notes” as issued by LendingClub. This is a private market response to the regulatory and structural problems associated with bank loans. And, as the “Notes” are a public instrument, even unaccredited investors can participate with no limitations.

Statistics (as of April 2014):

Average loan size: \$13,913

Loan term: 3 years

Loans funded: over \$4 billion

Growth rate: over \$791 million in loans funded just in Q1 alone, at an average interest rate of 14.60% (plus fees)

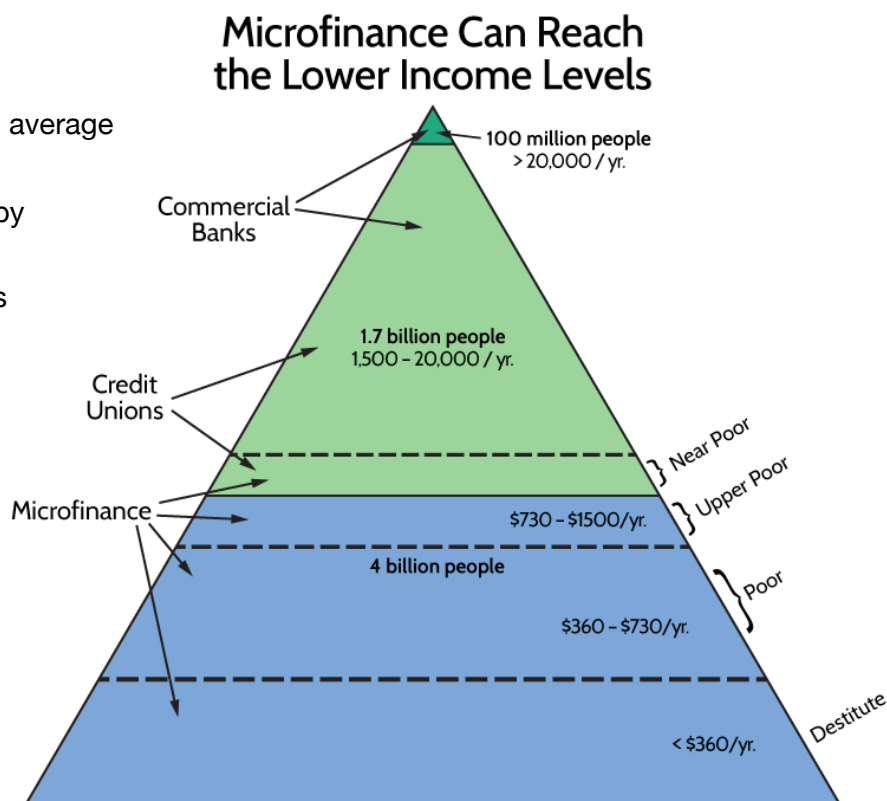
Risk: of \$2.6B in loans outstanding, approx. 3.5% was bad debt

Case Study: Kiva



“Microlender”, providing businesses with average loan size of \$417.

- Not legal in USA, as loans are made by people directly to people
- Funded almost entirely by US citizens (1.2M total “Kiva lenders”)
- \$550 million sent offshore to businesses in third-world countries (because it is not allowed in the USA)
- 98.93% repayment rate



Sources: Visa International, World Bank, C.K. Pralahad

4. Securities Crowdfunding: The ability (and right) to get equity or debt for your investment in a private (non-public) business; the USA lags behind the rest of the world...but will soon lead it. Our culture celebrates entrepreneurship and small business, and people are eager to help them for a wide variety of reasons (niche attachment, desire to help their local community, and of course a desire for potentially higher returns than the stock market, bonds or banks provide). How large is this market? In 2012 there was over \$1 trillion invested in 506 offerings. With the advent of crowdfunding that number is set to skyrocket.



FAQ: International Securities-based CF

➔ Several countries are way ahead of the USA in allowing businesses to raise money from the crowds (aka general public). These include Australia, the UK and Italy. Interestingly, contrary to the expectations of the naysayers (with their anti-small-business agendas), there has been practically zero fraud in international equity/debt crowdfunding.

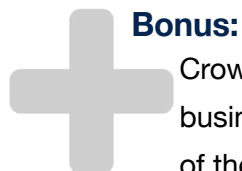
How It Works –

People buy debt or equity in a company...



Debt & Equity:

In a securities crowdfunding businesses can list their debt or equity offerings on a funding portal and showcase it to millions of people (who are now the new “crowd” of potential investors). The online deal includes the securities offered, along with various required disclosures, and of course a description of the company, a video pitch, and any additional perks or rewards for investors. As soon as the SEC and FINRA issue final rules, businesses will be able to launch securities based crowdfunding campaigns; and until then they can raise funds via the 506(c) rules already in place.



Bonus:

Crowdfunding also works to build a loyal and enthusiastic base of customers, business partners and media contacts who have a vested interest in the success of the business!



Add Deal Notes [for your eyes only]

Gen Kai International Karate Studios

Offering Memorandum Dated: <auto>
Cleveland, OH 44110 Broker: <x>%
<title>: Steve Smith Lead Broker: <x>%
Deal: \$10,000 in Debt with Revenue Participation Success Fee: <x>%
Stage: Start-Up <minority type>
Jobs: 8 Investor Rating: ★★★★★
Website: <autofill>

\$2500

raised of \$10,000 goal

deal is open
45 days left

avg. rating:
★★★★★

People Rate This Deal:

5 Stars: ★★★★★ [14]
4 Stars: ★★★★★ [18]
3 Stars: ★★★★★ [04]
2 Stars: ★★★★★ [09]
1 Stars: ★★★★★ [01]
Avg. Rating: ★★★★★ [46]

Expected number of jobs created: 8

INVEST NOW!

\$25 Friend of the Studio
All investment benefits plus special mention in our student newsletter

\$100 Benefactor
All of the above, plus a "Just Chop It!" Gen Kai t-shirt.

\$250 Founder
All of the above, plus your name inscribed on the Dojo Founders Wall.

\$500 Buddha
All of the above, plus a donation of 4 group sessions in your name to the Hopkins Children's Shelter.

\$10000 Black Belt Supporter
Everything above, plus all black belt titles shall be in your name (e.g. the Marshall Black Belt).

[edit](#)

invest in this deal

Company

Updates & Blog (xx)

Comments (xx)

Investors (xx)

About Us

Company Info

Due Diligence

About Us: [edit](#)

Gen Kai Karate Studio will serve the Cleveland community, teaching self defense & building self esteem in students. We have secured great space in a high traffic strip mall, and need help purchasing the mats and other equipment.

Vestibulum in metus vestibulum vestibulum, pharetra pellentesque nec, leo donec. At velit egestas nulla sit eget, cras tincidunt dui praesent dolor nibh, nulla turpis erat justo interdum, ac tristique, fusce felis. Elit integer est vel dui elit voluptatem, arcu erat arcu, pede suscipit vitae, nibh est venenatis tincidunt etiam, eget neque lorem.



quicklink: <http://url>

[Promote Deal](#)

Photos & Documents



The Deal [edit](#)

\$10,000 in Debt with Revenue Participation (\$XXX minimum investment / \$XXX share price)

The \$10,000 we need will be paid back in monthly installments over 36 months, at 7% Interest. Payments will begin 6 months after the close of this offer, in order to give us time to get the business started, students enrolled and memberships sold.

Furthermore, we are giving preferred stock in the business which is entitled to 5% of the Adjusted gross revenue (meaning revenue, less credit card fees and facility rental) starting one year after the close of this offer and for a period of 48 months. Also, all investors will get a Gen Kai official dojo t-shirt, and for people who invest over \$500 we will donate 4 group sessions in your name to the Hopkins Children's Shelter.

History:

- Started out as the “Entrepreneurs’ Access to Capital Act” in the House of Representatives in late 2011.
- Became the “Jumpstart Our Business Startups Act” in the Senate in early 2012 with the stated goal *“To increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies.”*
- Signed into law on April 5, 2012 by President Obama and reported with (appropriate) media excitement.
- This has the power to change everything. Businesses desperate for capital will now be able to reach out to the general public for help, and investors can get equity or debt instead of just product samples or a donation write-off. This...the democratization of capital...has the power to massively disrupt Wall Street and create an explosion of jobs and business finance.
- How badly is this needed?
 - ✓ *There are 28 million businesses with less than 500 employees and lack of capital is a critical problem.*
 - ✓ *Small businesses account for 64% of all net new jobs in the United States.*
 - ✓ *Venture capitalists invest in 2 deals per 1,000 reviewed... and only about 1 in 1,000 get an introduction in the first place, meaning they fund about 2 deals for every 1,000,000 businesses that need capital.*
 - ✓ *Capital formation in the public and private markets has been crushed due to oppressive securities laws and regulations, and the practical elimination of broker compensation.*



Specifics:

The JOBS Act amends provisions of the '33 Act, including those created by other Acts (e.g. Sarbanes-Oxley, Dodd-Frank) with the following components:

Title I – Reopening American Capital Markets To Emerging Growth Companies

Makes it easier for “small” companies to go public by reducing burdens on communications, reporting, accounting and compliance. Defines an “emerging growth company” as a business with less than \$1 billion in annual revenue.

Note: requires the SEC to conduct a study on the negative effects of decimalization (discussed later)

Title II – Access to Capital For Job Creators

Modifies existing Rule 506 Regulation D of the Securities Act of '33 in order to remove the ban on general solicitation and make it easier for businesses to raise capital from accredited investors.

Title III – Crowdfunding

Amends Section 4 of the Securities Act of '33 to create a new exemption under which private companies can raise up to \$1 million in capital annually from investors, whether accredited or not, by using the internet. *(discussed in detail later)*

Title IV – Small Company Capital Formation

Commonly referred to as “Reg A+” this modifies Reg A restrictions to make it easier for companies to use it as a form of public offering of securities up to \$50M per year (up from the current Reg A limit of \$5M). It also includes the ability to solicit interest prior to filing a registration statement.

Note: it requires the Comptroller General (not the SEC) to conduct a study on the impact of state Blue Sky laws on Reg A offerings.

Title V – Private Company Flexibility and Growth

Amends the '34 Act such that Section 12(g) registration is not required until the company has over 2,000 investors (or more than 500 unaccredited investors)



Safe Harbor: Equity acquired as part of an ESOP (Employee Stock Option Plan) or under 4(a)(6) offerings are not counted in the totals.

Title VI – Capital Expansion

Modifies the shareholder limits for banks and bank holding companies (similar but not identical to Title V).

Title VII – Outreach On Changes To The Law

Directs the SEC to provide online information and conduct informational outreach to small and medium sized businesses (“SMEs”), women-owned businesses, veteran-owned businesses and minority-owned businesses regarding changes brought about by the JOBS Act.

Resources:

[Jumpstart Our Business Startups \(JOBS\) Act](#) (on the web: www.sec.gov)

[H.R. 3606 – Jumpstart Our Business Startups Act](#) (actual text)

This certification course is for Titles II and III of the JOBS Act

Terminology:

For purposes of common nomenclature, we call Title II “*crowdfunding for rich people*”, and Title III “*crowdfunding for everyone*”. Though from a strictly legal/regulatory definition only Title III is “crowdfunding”.

And in a regulated world rules need numbers. So to that end, the translations for JOBS Act = '33 Act are...

✓ JOBS Act Title II = *506(c) exemption from the registration provisions of the Securities Act of 1933*

✓ JOBS Act Title III = *4(a)(6) exemption from the registration provisions of the Securities Act of 1933*

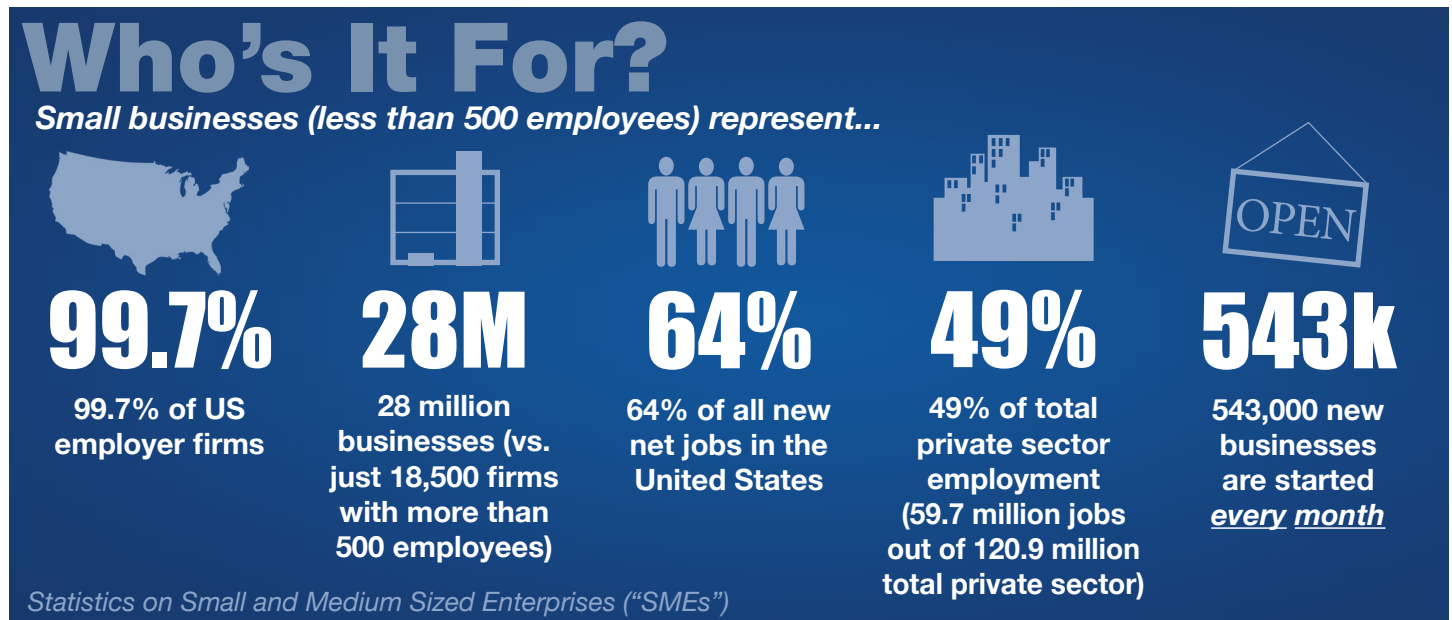
Timing of Rules:

The JOBS Act was signed into law on April 5th, 2012.

Title II 506(c) had a Congressionally mandated date, specified in the Act, that the SEC was required to issue rules no later than July 5th 2012. This proved impossible due to the complexity of securities regulations, and thus the rules became effective on September 23rd, 2013. And there are still additional proposed rules regarding pre-file requirements for Form D (*saying businesses who want to conduct an offering under 506(c) have to file a Form D 15 days prior to initiating a capital raise... vs the current rules which say you only file a Form D if you successfully raise capital and then within 15 days subsequent to selling securities*) and a new Rule 510T which would require every Facebook like, every Twitter tweet, every sign in the lobby of a business and literally anything else that talks about (“solicits”) the capital raise to be pre-filed with the SEC first.

Title III 4(a)(6) crowdfunding had a max date set by Congress of December 31st 2012. This is even more complex and, as such, the SEC issued proposed rules on November 3rd, 2013, with a public and industry comment period through February 3rd, 2014. After the comment period ended the SEC began the process to craft final rules, which can take anywhere from 3 to 12 months. The rules become effective 60 days after publication in the Federal Register.

But, in the words of late night tv, “that’s not all!” – even when the SEC does publish the final rules, FINRA has indicated they will want to craft additional rules and perhaps require a “CMA” (Continuing Membership Application, required whenever a broker-dealer wants to engage in a line of business that FINRA deems to be “new”). CMAs take anywhere from 60 to 180 days to complete. If this happens, and if the SEC issues final rules mid-2014, then that could mean late 2014 to early 2015 before anyone will be able to raise money via 4(a)(6) crowdfunding.



FAQ: Government employs 21.6 million while Agriculture represents 2.2 million jobs

[Small Business Association FAQ: September 2012](#) (on the web: .pdf)

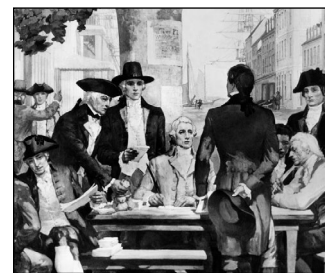
[SBA.gov: United States Small Business Facts](#) (on the web: .pdf)

Prior to 1933

The stock market was unregulated at the federal level, with few controls or oversight, which in part led to the Great Depression.

Wall Street, in the beginning

From the 1600s to the 1800s groups of people routinely met at “de Waal Straat” (Dutch) to trade slaves and fund pirate (“privateer”) voyages. Given its start, this wasn’t exactly a foundation for establishing solid controls, processes and procedures.



The Buttonwood Agreement created the first securities “regulation” in 1792.

Buttonwood Agreement

The first “regulation” of securities transactions was an agreement amongst competitors who met on May 17, 1792. The agreement was signed by 24 stockbrokers meeting outside under a buttonwood tree to establish rules for the buying and selling of stocks and bonds. The organization drafted its constitution on March 8, 1817, and named itself the “New York Stock & Exchange Board”. In 1863, this name was shortened to its modern form, “New York Stock Exchange”. It was a form of industry collusion that, in brief, had two provisions: 1) the brokers were to deal only with each other, thereby eliminating competition, and 2) the commissions were to be at least 0.25%. It reads as follows: “We the subscribers, brokers for the purchase and sale of public stock, do hereby solemnly promise and pledge ourselves to each other, that we will not buy or sell from this day for any person whatsoever, any kind of public stock, at a less rate than one quarter percent commission on the specie value and that we will give preference to each other in our negotiations.

Resources:

[NYSE Euronext: History](http://www.nyx.com) (on the web: www.nyx.com)

[The Buttonwood Agreement](http://wikipedia.org) (on the web: [wikipedia](http://wikipedia.org))

Market crashes of 1819, 1837, 1857, 1873, 1893, 1907 and 1929

The Great Depression of the 1930s was not the first such event in our financial history. It followed a long series of recessions and depressions which afflicted the American economy throughout the 19th century. Crop failures, drops in cotton prices, reckless railroad speculation, and sudden plunges in the stock market all came together at various times to send the American economy into chaos. The effects were often brutal, with millions of Americans losing jobs, and railroads, banks, and thousands of businesses going under. It wasn’t until the stock market crash of 1929, and the profound impact it had on global financial markets, causing massive, widespread unemployment, that the federal government finally took steps to regulate the securities industry.

Resources:

[Financial Panics of the 19th Century](http://wikipedia.org) (on the web: [wikipedia](http://wikipedia.org))

[List of Economic Crises](http://wikipedia.org) (on the web: [wikipedia](http://wikipedia.org))

1933 – Congress passes the Securities Act of 1933

In a nutshell, the Act superseded the patchwork of individual states securities laws with a comprehensive Federal framework. It is based upon a “philosophy of disclosure”, meaning that the goal of the law is to require issuers to fully disclose all material information that a reasonable person would require in order to make up his or her mind about the potential investment.

The Act requires that any offer or sale of securities using the means and instrumentalities of interstate com-

merce be registered, *unless an exemption from registration exists under the law*. “Means and instrumentalities of interstate commerce” is extremely broad, and it is virtually impossible to avoid the operation of this statute by attempting to offer or sell a security without using an “instrumentality” of interstate commerce (e.g. telephone, internet, mail).



Resale Safe Harbor: Rule 144A provides a safe harbor from the registration requirements of the Securities Act of 1933 for certain private (*as opposed to public*) resales of restricted securities to qualified buyers.

Fear: It is important to note that this legislation was crafted during the Great Depression, a time of fear and panic. It was well intended; parts of it were much needed and parts of it were a knee-jerk, overly protective reaction to extraordinary events.

Resources: [Securities Act of 1933](#) (on the web: wikipedia)

[Securities Act of 1933](#) (on the web: www.sec.gov - actual text)

1934 – The Securities Exchange Act of '34,

The Securities Exchange Act of '34 created the Securities and Exchange Commission. The first commissioner was Joe Kennedy, who made a fortune that to this day still funds the Kennedy family's social and political ambitions, by taking advantage of the lack of controls during the Crash of '29. As the biggest beneficiary (or “abuser”, “genius”, “scoundrel”, “opportunist” or other word of your choice) of those lack of controls he was perfectly positioned as to what rules to craft to prevent others from doing what he did (a little like how today the CIA and NSA hire the elite hackers that the FBI catches).

Resources: [Securities Exchange Act of 1934](#) (on the web: wikipedia)

[Securities Exchange Act of 1934](#) (on the web: www.sec.gov - actual text)

[431 Days: Joseph P. Kennedy and the Creation of the SEC \(1934-35\)](#) (on the web: www.sechistorical.org)



1938 – The Maloney Act

The 1938 Maloney Act authorized the creation of SROs (self-regulatory organizations), national securities associations which would supervise the conduct of their members subject to the oversight of the SEC. This amendment led to the creation of the National Association of Securities Dealers (“NASD”), which is the original self-regulatory organization for the securities industry.

Resources: [Self-regulatory organization](#) (on the web: wikipedia)

1940 – The Investment Advisors Act

This is what RIAs, PE firms, hedge funds, venture capitalists and others operate under. They are also subject to numerous state laws and requirements. It holds that certain persons and entities should be regulated as their advice, counsel, publications, writings, analyses, and reports customarily relate to the purchase and sale of securities and in such volume as substantially to affect interstate commerce, national securities exchanges, and other securities markets.

Resources: [Investment Advisers Act of 1940](#) (on the web: wikipedia)

[Investment Advisers Act of 1940](#) (on the web: www.sec.gov - actual text)

1998 - 2002 – Rules on Decimalization, Compensation, Research and Trading

Rules on decimalization, compensation, research and trading massively changed how much brokers could earn supporting public stocks. As with so many ill-conceived government actions, a series of rules were born out of extraordinary events surrounding over-the-counter “pink sheet” (aka “penny”) stocks and the abuses happening in that segment of the market (e.g. Wolf of Wall Street), and from the “dot-com bubble” of the late 1990s. The new decimalization rules crushed the spread between the bid and ask prices, which is where market-makers earned their fees (which supported research personnel, sales reps and others related to maintaining a viable market for public SMEs), and thus had the result of removing the incentive for brokers to write research, make markets, and sell stocks. This had a dramatic, damaging impact on capital formation. Small to mid-cap public companies to this day continue to languish and be ignored by investors since the only people allowed by law to help them, brokers, are disincentivized to participate in the process.

Resources:

[Hearing on Reducing Barriers to Capital Formation, June 12, 2013](#) (.pdf on the web: financialservices.house.gov)

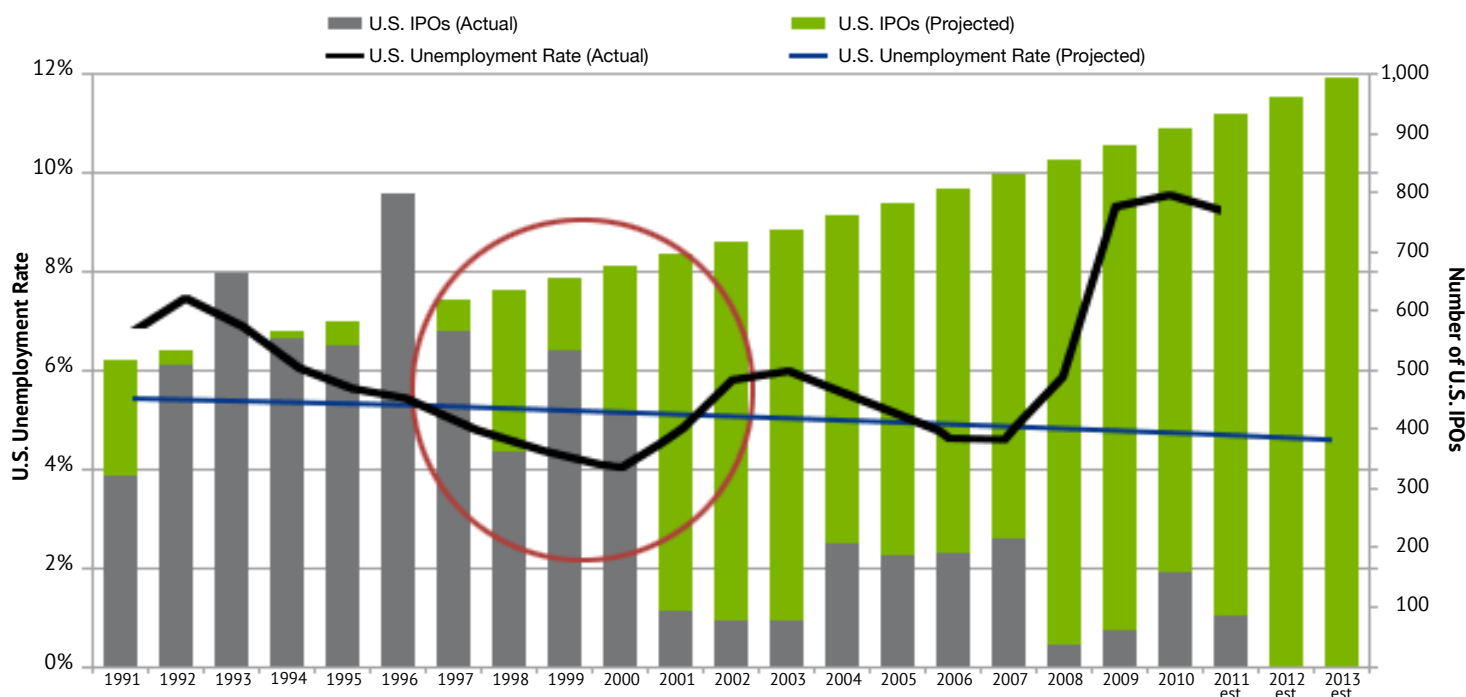
[Capital Market Series, September 2012](#) (.pdf on the web: www.sec.gov)

[Report to Congress on Decimalization, 07/20/12](#) (.pdf on the web: www.sec.gov)

[Amendments to the Corporate Financing Rule](#) (.pdf on the web: www.finra.org)

[Rule 2711. Research Analysts and Research Reports](#) (.pdf on the web: www.finra.org)

[SR-FINRA-2012-045](#) (on the web: www.finra.org)



The 'U.S. IPOs (Projected)' estimate assumes 520 IPOs per year starting in 1991 with a 3% compound annual growth rate equivalent to the U.S. GDP growth rate. A simple linear regression model was created using historical data to predict the 'U.S. Unemployment Rate (Projected)' based on this number of projected IPOs.

Sources: Grant Thornton LLP, Capital Markets Advisory Partners, Dealogic and U.S. Department of Labor | Data includes corporate IPOs as of 5/30/11, excluding funds, REITs, SPACs and LPs | © Capital Markets Advisory Partners, LLC



A Ray of Hope:

Title I of the JOBS Act requires the SEC to conduct a study on the effect of decimalization on public securities. However it did not mandate any changes to be made and thus, corrections are likely to be slow in coming (if at all).

2002 – Sarbanes-Oxley, the Public Company Accounting Reform and Investor Protection Act

Perhaps the single most harmful piece of reactionary legislation ever passed. In response to the scandals involving Enron, Tyco, Worldcom and other public companies, Congress passed legislation that set new or enhanced standards for all U.S. public company boards, management and public accounting firms. Some of the rules made a lot of sense, such as requiring that executive management personally certify the financial statements of their company and setting greater penalties for fraud.

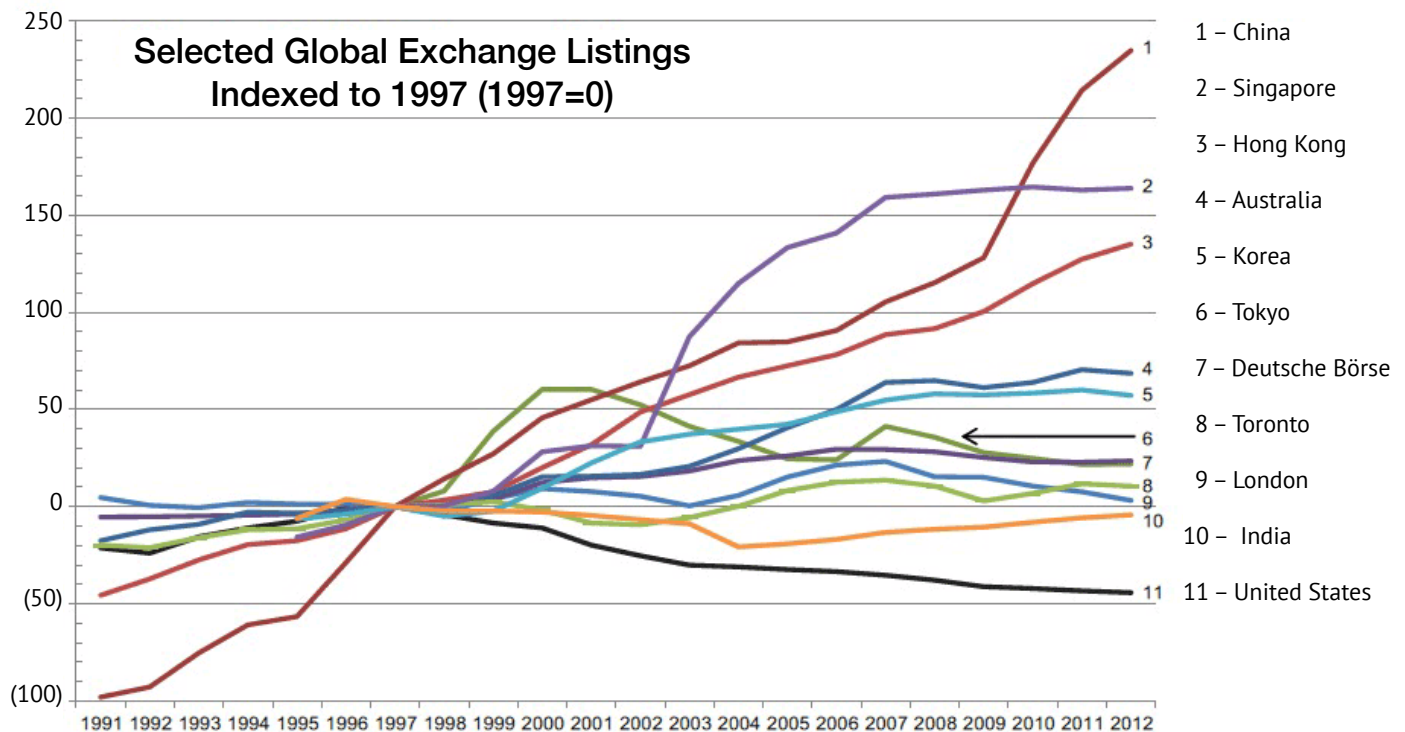
However other aspects of the Act increased compliance costs to the point where only the richest companies are now able to go public. The fallout has been devastating to capital formation for SMEs. A 2012 Wall St. Journal editorial stated, “One reason the U.S. economy isn’t creating enough jobs is that it’s not creating enough employers...for the third year in a row the world’s leading exchange for new stock offerings was located not in New York, but in Hong Kong...given that the U.S. is still home to the world’s largest economy, there’s no reason it shouldn’t have the most vibrant equity markets—unless regulation is holding back the creation of new public companies. On that score it’s getting harder for backers of the Sarbanes-Oxley accounting law to explain away each disappointing year since its enactment as some kind of temporary or unrelated setback.”

Resources:

[Sarbanes-Oxley Act : Compliance Costs](#) (on the web: wikipedia)

[Public Law 107-204, July 30, 2002 \(Sarbanes-Oxley Act of 2002\)](#) (.pdf the web: www.sec.gov - actual text)

Since peaking in 1997, U.S. listings have declined by over 44%



Sources: Weild & Co., World Federation of Exchanges and the global stock exchanges
 China includes Shanghai S.E. + Shenzhen S.E. India includes National S.E. + Bombay S.E.
 Based on the number of listed companies at year-end, excluding funds, as of Dec. 2012

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Grant Thornton
 An instinct for growth™

2007

The NASD merges with the enforcement arm of the NYSE to form a new entity regulating the brokerage industry, “FINRA” (Financial Industry Regulatory Authority).

**2010 – Dodd–Frank Wall Street Reform and Consumer Protection Act**

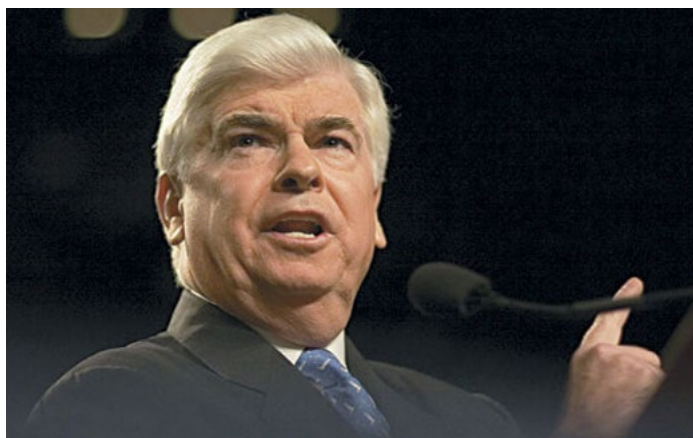
Another example of reactionary legislation that will haunt capital formation for decades to come. Passed as a response to the 2008-2011 housing crises and resulting recession, it brought the most significant changes to financial regulation in the United States since the regulatory reform that followed the Great Depression. It made changes in the American financial regulatory environment that affect all federal financial regulatory agencies and almost every part of the nation’s financial services industry. It was, to quote President Obama, a “sweeping overhaul of the United States financial regulatory system, a transformation on a scale not seen since the reforms that followed the Great Depression.”

The most immediate and profound effect of the Act on the economy was in the rules related to lending, “Title XIV, Mortgage Reform and Anti-Predatory Lending Act” which greatly reduced mortgage compensation and established national underwriting standards for loans; with the result being that it became nearly impossible for most people and businesses to get bank loans. We will continue to witness years of future rulemaking under various provisions of the Act, including “Subtitle A, Increasing Investor Protection” which without question will make it increasingly difficult for brokers to do their job and help small business capital formation.

Resources: [Dodd–Frank Wall Street Reform and Consumer Protection Act](#) (on the web: wikipedia)

2012, April

The JOBS Act is signed into law by President Obama.



“No one will know until this is actually in place how it works.”

Sen. Christopher Dodd (D., Conn.) said to reporters after finalizing the Dodd-Frank Act.

([National Review: Punting On Financial Reform, 7/22/2010](#))

“Crowdfunding is the democratization of capital, it may have taken 80 years to get here but it will quickly change the world of business finance.”

How Regulators Think:

Regulators view their role primarily as creation of, and the supervision, enforcement and compliance with, rules (usually through the lens of “investor protection”). It is critical for you to understand... and accept... that regulators focus on rules. As such, this is NOT a place where, to paraphrase an old adage, *you can take action now and ask forgiveness later*. The hardest thing for people who are not in the securities industry to internalize is that you must first, before any action is taken that is not clearly permitted under the rules, get either a **no action letter** or **safe harbor** from the staff at the SEC.

If you violate the rules, no matter how impractical, irrational or antiquated you feel they might be, it will almost assuredly result in actions which can be fines, suspensions, forced rescission of offerings, and even blacklisting from being associated with any securities offerings in any capacity (even as a shareholder, officer or adviser to a company). The rules are the rules, work within them at all times.

**Here's an example:**

per Rule 15c3-3 a broker holding a customer's money must hold it in a separate bank account from the brokers' general operating account.

- 1. That makes sense.*
- 2. However, if the customer wants their money back, the broker cannot send it to them.*

➡ **No, that isn't a typo. And yes, that makes no sense.**

The broker is required to send the customer an equivalent amount of money from the brokers own operating account, and then the next day can fill out a form and perform a “customer reserve account calculation”, after which it can refund itself from the customer account (since that customer no longer has a credit balance on the books and thus the special customer account has an “excess” balance).

*Yes, this is the 21st century and transactions can be easily accounted for using modern software. And Yes, everyone in the universe agrees that it makes sense that a broker should simply be able to send the customer their money back. **But they can't, it's the rule.** It doesn't matter that it's impractical and antiquated. It's the rule.*

State Securities Departments —

Every state in the Union has its securities overlords. They have their own rules, and often their own agendas; which are, surprisingly, often anti-small business and anti-small investor and always disguised as “investor protection”. E.g. Nevada adds rules and regulations above and beyond federal requirements for venture capital firms that states like California and New York don't, thus almost no venture capitalists have offices in that state. And Ohio is very restrictive on P2P lending, thus very little capital formation occurs there with this mechanism.

Further adding to the problem is that states generally do not cooperate to form cross-border mechanisms for capital formation, despite numerous attempts by well-meaning individuals and groups. Some states allow

“Fortunately, Federal laws eliminate the states’ control over most business finance conducted under the Securities Act of ’33.”

various forms of private fundraising, including localized crowdfunding, provided that in-state businesses are funded only from in-state investors and that special state rules and regulations are complied with. Plus, investors acquired via in-state crowdfunding are not exempt from federal securities rules and thus will be counted towards the 2,000-shareholder trigger for registration under the ’34 Act. Obviously these create a nearly impossible scenario for businesses who need capital. Hence the need for Federal laws and regulations which preempt the control or oversight of the individual states.

Fortunately, Federal laws eliminate the states’ control over most business finance conducted under the Securities Act of ’33. However that doesn’t mean they are completely out of the loop. All states have [“Blue Sky” laws](#) and require securities brokers to be licensed, which is accomplished via a “Series 63” securities license and a U-4

application to every state (which then reviews the applicant to determine if they are allowed to handle securities transaction on behalf of residents of that state). And all states have requirements for reporting various types of securities transactions conducted via Federal rules and exemptions; e.g. in California when a company raises funds via a 506 offering, if any investors are California residents then the company has to file a Form D with the state and pay applicable fees within 15 days of the date the securities were sold. Generally the company’s broker or lawyer will handle these filings for them.



Blue Skies Ahead...

A blue sky law is a state law in the United States that regulates the offering and sale of securities.

What's a "security"?

A security is a contract issued in exchange for some form of consideration (money, services, products, copyrights, intellectual property rights, compensation for employment, and other things of value) which grant holders specific rights in a business. The contract contains an expectancy of monetary remuneration based upon the efforts of others (not the investor) and may be tradable (meaning it can be sold or transferred to others), and is therefore different than a donation, employment agreement, non-monetary reward, or purchase of goods or services. In the United States all tradable contracts issued by businesses which are any form of either equity or debt (or other similar rights) are deemed to be securities and fall under the regulation of the Securities Act of '33. Ownership of securities may be represented by physical certificates or, more commonly in the 21st century, evidenced by a statement of confirmation that the ownership is maintained in book-entry form by the issuer or its designated agent(s).

What's not a "security"?

Employment agreements, copyrights, physical goods, services, donations and other things which do not represent an obligation of an organization in the form of equity or debt.

Debt vs. equity... what's the difference?

Debt is a loan.

Equity is an ownership interest in the entity.

Common terms for debt: loan, bond, note

Common terms for equity: stock, units, partnership interest

Types of securities (most typical):

✱ 'Common'

A security that represents general ownership in a corporation, without any special or unique rights associated with other classes of ownership, if any. Holders of common stock (or, in the case of limited liability companies, "LLCs", the term is "units") exercise control by electing a board of directors and voting on corporate policy. Common stockholders are on the bottom of the priority ladder for ownership structure. In the event of liquidation, common shareholders have rights to a company's assets only after bondholders, preferred shareholders and all debts have been paid in full.

✱ 'Preferred'

A class of ownership in a corporation that usually has special or unique rights that are unique to the class. A company may have several different types of preferred stock, each with its unique rights and



privileges. Preferred stock often has preferential payout rights in the event of a merger or liquidation, and may even have a dividend or fixed minimum rate of return which must be paid before distributions to common or other classes of stockholders. Other features common to preferred stock, especially when held by professional investors, are rights to Board seats, special voting (or veto) rights, drag-along rights, anti-dilution rights in the event of down rounds, and rights of first refusal on any future sales of company equity by either the business or existing shareholders.

✿ 'Convertible Debt'

This is a loan of any type (senior, secured, subordinated, etc.) that has a feature enabling the debtholders to convert the note into a stated form of equity at a predetermined ratio. The conversion may be at the noteholders' option or it may be a mandatory event based upon some agreed upon trigger (e.g. filing for an IPO, a sale or merger, etc.).



✿ 'Senior Debt'

A loan with a high preference on repayment. Whether a bond (note) or a traditional bank loan, senior debt will be repaid first in the event of a liquidation or other company event.

✿ 'Secured Debt'

The highest protection for investors, this is a loan that is in some way secured by certain assets of the company. In the event of default creditors would have the ability to foreclose on the stated security, which might be inventory, intellectual property, assets, leases, customer contracts, etc. After that they would continue to have the rights of other debtholders in line with the type of debt (senior, subordinated, etc.). The lender should "perfect" the security in the loan by filing a UCC-1.

✿ 'Subordinated Debt'

An unsecured loan that ranks below all other obligations of the company. Subordinated debt can often count towards capital of the borrower as it is practically without protection. All obligations of the company, including employee wages, vendor payables, and other loans will be repaid before subordinated debt.

✿ 'Option'

A contract that represents a right to acquire or sell the described securities of a company. Options typically have some agreed upon vesting period (e.g. vesting monthly for three years) of the class of equity they are issued for, at a fixed conversion price, and may have additional rights such as accelerated vesting in the event of a merger. They also typically have an expiration date in the event they are not executed and converted to the form of equity described in the contract.

✿ 'Warrant'

A warrant is similar to an option except that it generally has no vesting period and can be executed by the holder at any time. The warrant contract enables the holder to acquire the amount and type of equity in a company at a set price or for the consideration stated (which may be non-monetary). Like options, warrants typically have an expiration date.

✿ 'Revenue (or Profit) Sharing'

Revenue or profit sharing can be a right in either a debt or equity security that provides investors with a right to a percentage of the company's gross revenues (or profits) for a predetermined period of time. A basic illustration might look like this: Investors buy \$1M in senior debt from ABC Company, which also contains a right to 5% of the gross revenue of the business, paid monthly, for 3 consecutive years starting after the \$1M note has been repaid in full. After the 3rd year that particular right in the security expires. This can help a company lower its stated cost of capital and provide investors with an attractive risk-weighted upside if the business is successful.

Revenue participation instruments have existed for thousands of years, the most common form of which are royalties (a proven security in the oil and gas, media and entertainment, real estate, and pharmaceutical industries in particular).

Profit participation instruments are rarely used anymore except in venture capital funds and SPVs (special purpose investment vehicles). This is, in part, due to infamous abuses by Hollywood studios and other organizations in their accounting practices. Investors in private businesses are, in general, smart enough to avoid situations where they are at the mercy of self-serving corporate accounting which can effectively limit or even eliminate their anticipated returns. And businesses are reticent to promise profit sharing as it can expose them to criticism (and backseat driving) from investors and potential liability for actions which while viewed as reasonable by any business person could be taken far out of context by a smart tort attorney and a hostile jury.

✿ 'Redeemable Securities'

Are rights of a security, as part of any equity or debt instrument containing the right, to be "put" (forcibly sold or exchanged for the stated redemption item) to or "called" by a company by or from the holder pursuant to the contractual terms of the right contained in the security acquired by the holder. Similar to an "option" put or call, except here the investor actually owns the securities, not just a contractual right.

200 Series: Industry Participants

Issuers

CF201

An “issuer” is a business that is raising capital by selling securities (debt or equity) of the company; issuing securities in exchange for some form of investment. For crowdfunding, an issuer is...

- Any industry
- Must be organized and in good standing as either an LLC, a C-corp, an S-corp, an LLP, or other entity.



FAQ: Why can't this be a sole-proprietorship?

➔ Because a person can't sell a security in themselves under the Securities Act of '33.

- Not just start-ups, there are over 28 million existing small businesses and “lack of capital” is the #2 reason for failure (“inexperienced team” is #1, poor sales is down at #10). But this isn't just about keeping them from failing, as millions of businesses are not in danger of that...the problem is that they don't have the capital to grow and create more jobs.
- Selling not just “equity”, but literally ANY form of security; including debt, preferred stock, convertible debt, warrants, options, etc.

First, let's be realistic — does this business even have a prayer of getting funded? It's time for an honest look at them with the VRT framework:

1. **Value Proposition:** is their product or service of interest to people? And within a reasonable timeframe? Who will buy from them, why, and when? Oh, and “why” again?
2. **Revenue Model:** how will they make money? Are the assumptions realistic? Does their value-proposition hit enough people in the market to make this business profitable and sustainable?
3. **Team:** the #1 reason for business failure is “team” (“lack of capital” is #2, “low sales” is #10). A desire and willingness to work hard is NOT ENOUGH. You couldn't open a tax service business unless you have passed the CPA exam and obtained professional licenses regardless of how hard you would otherwise work. You couldn't open a gas station without knowing how to deal with EPA regulations, how to contract with wholesale suppliers, how to deal with various state agencies and tax entities, and much more. The team matters, period. And they'd better have both the desire to work hard AND the foundation in, and passion for, the industry and business they are getting into.

So, does the business have a great value proposition, solid revenue model and awesome team?

✓ **Yes.** Fantastic, let's keep going! ✗ **No?** Then someone needs to have a serious conversation with them regarding their likelihood of success.

Define “investor”

An investor is a person (“person” meaning either an individual or an entity) who allocates capital with the expectation of a financial return.

Reasons people invest

Returns — a desire for returns on capital that have a chance to exceed public market averages.

Control/Participation — feeling (or even knowing) they can have some direct impact on a company’s success, whether as a customer, an evangelist, business partner, etc. This is especially true given the general sentiment that small investors in large public companies have no voice, no impact and just don’t really matter.

Passion — they personally know the business or the people in it, or are emotionally vested in the industry, the niche, the mission or any other aspect of the issuer.

Guidance is needed to help investors look beyond their emotions to analyze the company’s VRT and disclosures!

Accredited vs. unaccredited

Unaccredited Limitations

Unaccredited investors may participate in 4(a)(6) offerings as discussed in detail later in CF301. In a nutshell, they must go through an education process on the portal and are limited in how much they can invest annually based upon their income or net worth. They cannot invest in 506(c) offerings.

506(c) Accredited Investor Verification

Only accredited investors may participate in 506(c) offerings. Furthermore, the rules require that an issuer have a “reasonable” basis for believing that an investor really is accredited. Generally the portal will do this for the issuer via a number of ways that meet the SEC’s “reasonability” standards, including but not limited to;

Confirmation from Licensed Professionals – a lawyer, accountant, broker or registered investment advisor can confirm that a person is accredited (and issuers may rely on such confirmation). This is typically the easiest method as it permits professionals who have a trusted relationship with an investor to provide confirmation without any invasive documentation.



Public Records – The issuer or portal can ascertain that the investor is reasonably likely to be accredited based upon finding references in the public record (e.g. information on the investor’s employment, or a biography that speaks of their investment activity, etc.).

“Bite Size” – Per the “Principles-based method of verification” in the rules, if an investor commits a high amount of funding or it can be seen from their other investment activity that there is a high “likelihood that purchaser satisfies the definition of accredited investor such that, absent any facts that indicate that the purchaser is not an accredited investor, it may be reasonable for the issuer to take fewer steps to verify or, in certain cases, no additional steps to verify accredited investor status other than to ask them to confirm that their cash investment is not being financed by a third party.”

Full Doc – The most invasive method of confirmation is to have the investor provide tax returns, bank statements, or other documents evidencing their income or net worth in meeting the standards.



What is an “accredited investor”?

Per the SEC’s rules, an accredited investor is a person (whether an individual or an entity) that meets at least one of the following criteria:

- ✓ Has an individual net worth, or joint net worth with their spouse that exceeds \$1 million (including any IRAs, 401Ks and other retirement accounts, but excluding the net value of their primary residence); or,
- ✓ Is an individual with income of over \$200,000 in each of the last two years, or joint income with their spouse exceeding \$300,000 in those years, and they reasonably expect at least the same this year; or,
- ✓ Is a bank, insurance company, pension fund, or other registered investment company with assets exceeding \$5 million; or,
- ✓ Is a corporation, partnership, or charitable organization with at least \$5 million in assets; or,
- ✓ Is a business in which all the equity owners are accredited investors; or,
- ✓ Is an employee benefit plan, within the meaning of the Employee Retirement Income Security Act, if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of \$5 million; or,
- ✓ Is a trust with assets in excess of \$5 million, not specifically formed to acquire the securities offered, whose purchases a sophisticated investor makes.



Safe Harbor: This is not a requirement that must be met with absolute certainty. The SEC holds that the “reasonable belief” standard in the definition of accredited investor in Rule 501 of Regulation D is unchanged by the new amendments to Rule 506. In this regard, as long as an issuer, either directly or via those acting on its behalf, takes reasonable steps to verify that a purchaser is accredited and has a reasonable belief that the purchaser is accredited, the issuer would not lose its ability to rely on Rule 506(c) if it is later discovered that the purchaser was not in fact an accredited investor.

International/foreign investors

Accepting money from non-US citizens, entities is permitted in both 506(c) and 4(a)(6) offerings. *To be safe, keep to the same standards and limits just as if the investor were US-based.*

The investing process:

1. Review offering memorandum.
2. Review crowd-vetting (if any).
3. Conduct your own due-diligence.
4. Read and acknowledge the risk disclosures.
5. Attest you are capable of sustaining any losses without issue.
6. Understand & accept “book entry” ownership.
7. Read & sign the subscription agreement.
8. Send funds to escrow.

Post-Close:

- ★ **Help the business now that you’re an investor** (customer, evangelist, partner, mentor, etc.). Remember, helping the business helps yourself *as an investor*.
- ★ **What to expect from the business** – you have the right to periodic reports and delivery of what was promised by the security. It would also be reasonable to expect the managers of the business to keep you and other investors informed and up-to-date.
- ★ **What NOT to expect** – **a lot of handholding**. If there were a lot of investors then it simply won’t be possible for each one to have a personal relationship with management, so nobody should take that personally.



What Is and Isn't Fraud?

Fraud is a concern people have about crowdfunding, and appropriately so. It should be a concern people have with just about everything in life, whether using an ATM machine (which might have a scanner attached), handing a credit card to a waiter, or keeping your computer safe from malware.

The most common types of securities fraud in private, non-public companies include misrepresentation, failure to disclose ("omissions"), insider benefits abuse, over-selling equity (i.e. "The Producers"), and manipulating company assets to the detriment of investors. This would include any self-dealing by executives and directors of use/abuse of company assets (including capital, employees, customers, business relationships, intellectual property, etc.) to the benefit of select persons and relationships other than investors.

In an offering of securities, fraud is the misstatement or omission of a material fact, or making any statement that is misleading or a misrepresentation of fact. A statement is material if it would be important to a reasonable person making an investment decision. Additionally, the statement or omission must be either "reckless" or made with the intent to deceive, manipulate or defraud.

It is NOT, however, a business failure where management made a genuine effort to achieve success and deliver on its promises to investors.

The majority of securities fraud cases prosecuted in the United States involve Section 10b and Rule 10b-5 of the Securities Act of '34. This is the general provision that prohibits any person from using fraud in connection with the purchase or sale of any security. Reasonable mistakes of fact, made without the necessary intent, are generally not prosecuted under Rule 10b-5.

However, there are numerous state securities (and criminal) laws that can also factor in and lead to local prosecution. Plus there are countless forms of civil liability that can serve to protect investors and provide them with mechanisms to seek justice if a company or its management has mislead them or abused their rights.



Surprise!

You might expect crowdfunding to be riddled with fraudulent postings, similar to the early days of online auction sites. Remarkably, you would be mistaken. While the occasional case of fraud does inevitably and intermittently pop up, international securities and US rewards crowdfunding platforms have a remarkably successful record of squashing them—sometimes only hours after they've been launched. Even Kiva, with over \$500,000,000 of US investors' money lent to small businesses in third-world countries, has a historic repayment rate of 98.97%.


The transparency that the internet brings has become a common component in our daily decision making process. Using the feedback we get from sites like yelp and ratings from the community have also become a common way in which we further analyze our decisions. This is called the wisdom of the crowd, aka "crowd vetting", and it plays a big role in the transparency and credibility of the crowdfund investing market place.

What Else is Not Fraud?

MISTAKES: In their offering, businesses have to post financials, a business description, and various disclosures. Everyone makes mistakes, and if it's unintentional then they need to just own it and take corrective action (which could be as extreme as rescinding and refunding an offering). If it wasn't premeditated or reckless, and the cause was a genuine mistake and not criminal intent, then it may not be fraud. That's not to say it doesn't incur potential liability for the business owners, as their representations to investors have to be accurate and truthful.

IT DIDN'T WORK OUT: Many businesses make it, some don't. If people invest in a company and the owners work hard but just can't get it profitable, then investors will obviously lose some or all of the money they put into it. This happens, and it isn't fraud. Sometimes "shit happens" and things don't work out. It's sad for the investors, but think of the people who put their time, energy, emotion and resources into running the business, it's likely far worse for them...everyone is in this together.

INVESTORS EXCEEDING THEIR INVESTMENT LIMITS: The government allows people (all people, regardless of whether they are rich or not) to play lotteries, visit casinos, shop at stores and otherwise spend money in an unrestricted way. If you gamble your entire paycheck, the government does not stop you from doing so, nor does it hold the state lottery commission responsible. In these things they allow for personal accountability. However, if someone isn't rich and wants to, say, help some local businesses in their community by investing in them, the government has decided that this is something people shouldn't do very much of. Thus they put severe limits on what unaccredited investors can invest in 4(a)(6) offerings. So their "at risk" money in crowd-funding private companies is going to be fairly small even if they invest 100% of what they're allowed.

 **Safe Harbor:** In case investors misrepresent their income or net worth in order to invest more than they would otherwise be allowed in 4(a)(6) offerings, the SEC has proposed a Safe Harbor so that the burden of these statements is on the investor and not on either the issuer or the portal.

“With all these safeguards in place, the overwhelming majority of offerings are very real businesses that need help to get the capital they need to grow and create jobs.”

Fraud Deterrence & Detection

When it comes to securities fraud, and specifically to fraud potentially orchestrated on the FundAmerica platform, there are a large number of things being done to deter and detect it.

It goes without saying that scammers would love to use a platform to steal money, just as they want to use Craig's List, Ebay, or Charles Schwab. And there are many things that are being done about it. First, businesses may be charged a small fee for hosting an offering on the platform; not many scammers want to pay to try to run a con, let alone provide a real name and real address as required to run a credit card transaction.

Second, the hosting fee is a recurring monthly charge; thus if someone used a stolen credit card, it would likely be caught in the next billing cycle, which is usually well before any money is released from escrow. Third, the platform doesn't host the credit card data on its servers (the merchant bank holds that data). Fourth, the platform checks IP addresses, as well as proxies, and disallows people outside the USA from posting a deal. Fifth, a LOT of company information and disclosures are required before any deal can be seen or invested in; making this a huge hassle for anyone looking to run a con.

And all that is just “**fraud deterrence**”. While it is as easy as possible for legitimate businesses to use the platform, it can be a real challenge for con artists to do so.

And for those that do anyway? Well that's where “**fraud detection**” comes in. First, Patriot Act background checks are run on the business and on key people associated with it. Second, all investor money is held in escrow until the deal is funded, and at success it can only be wired to a bank in the USA and only in the exact name of the business. Third, all brokers in the selling syndicate have to review the due diligence material, putting a lot more professional eyeballs on a deal. Fourth is “the crowd”; by letting all users comment and rate deals, it will generate quite a bit of vetting from people with a vested (or even just curious) interest in finding fraud and other inaccuracies in an offering. When a fraud is detected deal is suspended, investors are refunded from escrow and the company is reported to authorities.

SUMMARY: Will fraud occur? Yes, probably. It happens in the stock market (think Madoff, Zzzzzz Best, Enron, Tyco, et al), so it'll happen in crowdfunding too. But the thing is, it won't happen very often as the industry will do a LOT to deter and detect it. With all these safeguards in place the overwhelming majority of offerings are very real businesses that need help to get the capital they need to grow and create jobs. So investors and industry professionals shouldn't let an over-exaggerated fear of an incredibly rare situation overwhelm their passion to help get companies funded and drive the American economic engine to new heights.

A large blue number '98.97%' is displayed. Below it, the text 'Kiva historic repayment rate' is written in a bold, dark grey font. A horizontal grey bar is positioned below the text.

Kiva historic repayment rate

A large blue number '0%' is displayed. To its right, the text 'fraud on international platforms' is written in a bold, dark grey font.

* all numbers as of Q1 2014

There are many professionals who are passionate about helping businesses raise money and/or investors who get them funded via Title II and III exemptions. These include lawyers, accountants, bankers, brokers, marketers, PR firms, mentors, incubators, and other third-party service providers.

Who can help with, and charge for what –

Unregistered persons (not brokers)...

*Unregistered persons
(not brokers)...*

CAN:

- ✓ Charge for professional, non-investment services
- ✓ Provide deal marketing services & activities
- ✓ Be paid from escrow at the closing of the offering
- ✓ Invest in or receive a piece of the company
- ✓ Have creative price models, incl back-end participation

*Unregistered persons
(not brokers)...*

CAN'T:

- ✗ May not negotiate terms for or on behalf of 3rd parties
- ✗ May not provide investment advice to individuals
- ✗ No compensation tied directly to \$ amount of the fundraiser
- ✗ No compensation tied to the success of the fundraiser
- ✗ Sell securities to investors

Registered persons (brokers & RIAs)...

*Registered persons
(brokers & RIAs)...*

CAN:

- ✓ Charge fees for investment advice
- ✓ Charge fees based upon size & success of fundraiser
- ✓ Sell securities to investors
- ✓ Negotiate terms with all parties

*Registered persons
(brokers & RIAs)...*

CAN'T:

- ✗ Receive warrants or any piece of the company (Title III)
- ✗ Invest or participate in the fundraiser
- ✗ Charge for other services in any way related to the offering
(note: actually they might be able to, but FINRA may count such fees towards underwriting compensation and extend their rules to this “related” business of the broker)

Professional Service Fees

Only SEC registered, FINRA member firms and persons can receive ANY compensation tied directly to the success of an offering. And they may only share that compensation with registered persons. Thus, no one except brokers can receive any “success” compensation. THERE ARE NO EXCEPTIONS TO THIS.

So what can certified crowdfunding professionals charge? Pretty much anything, so long as it isn't tied to the amount or success of an offering. This includes:

- ✓ service fees
- ✓ hourly rates
- ✓ fixed project rates
- ✓ options and warrants
- ✓ subscription fees
- ✓ advertising fees
- ✓ back-end participation agreements
- ✓ and other charges that are customary to the type of service provider you are.

Can I help a company put their offering together even though I don't have a securities license?

- ➡ **Yes!** Per SEC guidance issued in March of 2013, “The SEC staff does not believe that the Act applies to persons whose activities are limited to advising issuers concerning the structuring of their securities offerings (although such advice may technically be about securities).”

Resources: [Regulation of Investment Advisers by the U.S. Securities and Exchange Commission](#) 2.A. 3.c.

The main thing is that you do NOT receive any compensation tied to the amount or success of the offering. Only brokers can do that, and it's a hard (not gray) line used in determining whether you are acting as a broker.

The other big thing you CANNOT do, unless you are certified as such, is provide investment advice directly to individuals. Telling someone that they should invest entails a level of securities industry sophistication and knowledge of the customer (“KYC”) that under our securities laws can only be done in a registered capacity (either as a broker or RIA). So although you can help promote an offering generally to prospective investors, you cannot specifically say that it is appropriate for any particular person to invest.

What guarantees can professionals make...

Only those consistent with your professional capacity. E.g. an accountant can certify an audit, a lawyer can write an opinion, and a PR firm can state what they will accomplish as part of their agreement.

However, all Title II and Title III fundraising is “best efforts” so no person, registered or not, can guaranty or make promises regarding the success of the fundraiser. Nor can any person make any guaranties regarding the future prospects or success of the business or the future value of any securities.

Brokers who act as intermediaries, aka “funding portals”, and/or who are assisting with an offering as the “Lead Broker” or as a member of the “selling syndicate”, have a number of responsibilities dictated by regulators. These include...

KYC (“Know Your Customer”) – brokers are required to ask very specific questions to ascertain how reasonable or appropriate an investment strategy is for an investor. These rules and requirements vary by type of security; e.g. mutual funds require certain information, options trading requires other information, and offering private securities does as well. Brokers must, to some degree, know their customer and obtain that customer's experience and risk tolerances prior to allowing them to make investments.

Risk Tolerance – as part of the KYC process, brokers must gauge the level of risk an investor is willing to assume in making decisions per their goals and objectives. For private securities, investors are required to understand and attest that they accept the high level of risk and that they can bear a loss of principal and promised returns.

Selling Syndicates – brokers only get paid when a deal gets funded. Any other fees they receive may help offset some of the costs of assisting with an offering, but no matter what, a Broker-Dealer (BD) will be in the red unless and until the offering is successful. Often a BD will invite other brokerage firms, and their reps, to help sell the deal (and get a share of the potential success fees), thus forming a syndicate of BDs working together to get a business funded.

Patriot Act – Legislation passed in 2001 that requires, as applied to crowdfunding, that all investors and issuers be periodically screened against federal and regulatory databases.

“Crowd Vetting” – the comments, research and collective “wisdom of the crowd” on a 4(a)(6) private offering that is publicly and generally solicited. Brokers must ensure their platform contains tools and features so users (the “crowd”) can vet the deals on it.

AML (“Anti-Money Laundering”) – there are numerous rules that require brokers and others engaged in financial businesses to integrate systems into their platforms and conduct AML checks and processes.

Due Diligence – all brokers involved in an offering, whether as lead or as part of the selling syndicate, have a duty to conduct “reasonable due diligence as is appropriate for the offering.” Reasonability standards in due diligence requirements are one of the biggest things allowing brokers to become involved again in small offerings. Previously there was no way a BD could economically service a small issuer, as rules and standards required them to fly teams of people to visit businesses, conduct analysis of financials and overall industry of the issuer, and many other expensive, resource intensive activities. With a lighter due diligence burden BDs can now assist small issuers with their platforms. However, they still need to perform some diligence, which may include things like verifying the issuer is incorporated and in good standing, running officers, directors and major shareholders of the issuer through an SEC “bad actors” database, etc. Each BD sets its own standards.

Accredited investor confirmation – all investors participating in a 506(c) offering must be reasonably verified as accredited pursuant to SEC guidelines. Generally brokers handle this on behalf of the issuers, and issuers are

entitled to rely on this to meet the “reasonability” test.

Unaccredited investor education and cap compliance – all portals are required to ensure investors in 4(a)(6) offerings have gone through a basic educational process before they commit to their first deal. Furthermore, portals must keep track of investors’ annual maximum-investment limitations (caps) and ensure they do not exceed them on their platform.



Safe Harbor: investors are individually responsible for ensuring they do not exceed their legal caps on all platforms combined...the portal is not liable for that.

Archiving all records related to all transactions – rules require brokers to retain all records related to securities sales, as well as KYC, AML, exceptions and other data, for various periods of time.

Brokers Do Not: They do NOT have a responsibility to spend more time, energy and resources than is reasonable for the offering. Liability for fraud, for business failure, and other problems is between the issuer and their investor(s); the broker is generally not liable for problems.

Arbitration — in the event of any dispute between any party and a FINRA broker, it is mandatory that it be resolved via binding arbitration. Arbitrators are FINRA members (peers, not regulators or staff).

Broker-Dealers vs Registered Funding Portal?

Both BDs and Registered Funding Portals (RP) are SEC registered, FINRA member firms. However, whereas forms of BDs have been around for over 100 years, RPs are a new category of securities intermediary that were created pursuant to the JOBS Act.



What's the difference?...

RP: Essentially an RP is a “BD-light” in that it is a registered entity and can receive compensation tied to the success of a crowdfunded offering. It is also subject to FINRA oversight and periodic audits. However, an RP cannot engage in any activities other than 4(a)(6) offerings, meaning they cannot help a company with a concurrent 506(c) or other type of offering. Nor can they assist with investment advice, management of investor funds, or any other services that a typical BD can provide. They are not SIPC insured, do not carry any minimum net-capital requirements, and have no professional licensing requirements for their employees; all of which are standard for a BD.

Service Levels: On the plus side, RPs, by means of their lighter requirements, may be able to offer 4(a)(6) services at less cost (or higher profit) than a BD. On the minus side, there can be issuer, investor, and service provider risk where such portals are operated by unregistered and untrained persons at firms with no capital standards and no SIPC insurance.

300 Series: Getting Ready to Crowdfund

Understanding 506(c) / 4(a)(6) Rules & Best Practices CF301

Common rules and best practices regardless of which exemption is used in raising funds:

- May raise capital via issuing any form of equity or debt securities;
- Company may be of any age, including a start-up;
- Company must have less than 2,000 shareholders (of which less than 500 are not accredited), not counting equity issued under an ESOP or via 4(a)(6) offerings if not a reporting entity;
- Disclose all material aspects of a business such that an investor can make a reasonably informed decision;
- A “formal document” (e.g. a business plan) is not required, however a “description of the business” is. This may take the form of a business plan, a VRT, a lean business model, etc.;
- Executive compensation;
- Intended use of funds;
- Discussion of pending, threatened, current or recent litigation or regulatory actions;
- A cap schedule listing all forms of equity outstanding or promised (including any options and warrants), and detailing by name all officers, directors and beneficial owners of 20% or more of the company’s equity;



FAQ: What’s a “beneficial owner”?

➔ This is someone who directly or indirectly (such as through a corporation or partnership) owns or who has rights to such ownership through options, warrants or any other contractual arrangement.

- Officers, directors and 20%+ beneficial equity owners must not be “bad actors” according to SEC regulations or any state in which securities are offered, and must be able to pass a background check as specified by the Patriot Act;
- Disclosure of all past capital raises historically, and specific details of recent capital events within the last 12 months for 4(a)(6) and within the last 6 months for 506;
- The method of valuation of the business for the current offer (if equity);
- All details of the securities being offered;
- Other information and details as requested by brokers or investors to aid them in reasonable due diligence of the company and the offering;
- Allow investors to rescind their commitment at any time up until securities are “sold” ([see page 43](#)). Conversely, the issuer can also rescind the commitment of any investor per the same terms;
- Resale limitations and disclosure that the securities are not registered under the Act of ’33 and may not be resold except as permitted by law;
- Provide investors with annual reports and updates.

Resources:

[Disqualification of Felons and Other “Bad Actors” from Rule 506 Offerings and Related Disclosure Requirements](#)

(.pdf on the web: www.sec.gov)

[Definition of Bad Actors](#) (on the web: www.crowdcheck.com)

[Regulatory Notice 10-22: Regulation D Offering](#) (.pdf on the web: www.finra.gov)

[Regulatory Notice 13-26: Private Placements of Securities](#) (.pdf on the web: www.finra.gov)

Unique rules

506(c) (Title II)

- File Form D with the SEC and each state in which investors reside (no exemptions, unlike 506b) within 15 days of each sale of securities (if incremental sales, otherwise within 15 days of binding to close);
- Company cannot be a “reporting entity” pursuant to Section 12 of the Act (i.e. a public company);
- No annual regulatory report filing requirements;
- For any amount of money (as little as \$25,000 or more than \$200M);
- May close in increments, with money released from escrow at each incremental “sale of securities”;
- Brokers may be compensated with cash and/or securities of the company;
- May unconditionally advertise the offering however they desire;
- May only be sold to accredited investors (unlike 506(b), which allows up to 35 unaccredited investors);
- Issuer must have “reasonable” confidence that investors really are accredited (unlike 506(b), in which investors simply state that they are accredited by filling out a form);
- No audits or CPA reviews required, investors may rely on statements by management;
- May be conducted directly and without broker assistance (self-service) – but highly discouraged if soliciting numerous investors due to state securities laws as discussed in section CF402;
- Ability to view offering memorandum can be limited in any manner desired (e.g. to specific persons or groups);
- May close in whole or in part at any time pursuant to the terms of the offering and subscription agreement;
- Issuer does not have to have a website;
- Equity investors do count towards the 2,000 shareholder registration trigger pursuant to the Act of '34.

Resources:

[Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings](#)

(.pdf on the web: www.sec.gov)

4(a)(6) Crowdfunding (Title III) –**❗ PROPOSED, rules are not yet final (expected June or July 2014)**

[Crowdfunding: Proposed rules](#) (.pdf on the web: www.sec.gov)

[Comment on Proposed Rule: Crowdfunding](#) (on the web: www.sec.gov)

- ❖ Company must be organized (incorporated) in the US and in good standing;
 - ❖ Raise up to a maximum of \$1 million in any 12 month period, regardless of whether done all at once or in multiple offerings, using this exemption (may raise more overall by combining with other exemptions such as 506(c));
 - ❖ Investors, regardless of whether accredited or unaccredited, are limited to strict investment caps ranging from a minimum threshold of \$2,000 up to a maximum of \$100,000 (all deals, all platforms combined):
 - i. The greater of \$2,000 or 5 percent of annual income or net worth on first \$100,000 (whichever is greater: income or net worth)
 - ii. 10% of annual income or net worth if either is above \$100,000 with a calculation cap at \$1M in income or net worth (thus a \$100,000 investment cap) – the proposed rules limit even sophisticated institutional investors to a maximum aggregate of \$100,000 per year across all deals on all portals combined, making it highly unlikely they will participate in offerings conducted under this exemption. So businesses will usually need to do a concurrent 506(c) offerings in order to attract accredited investors.
 - ❖ “All or none”, stated funding goal must be achieved for offer to close and funding released from escrow (no partial/incremental closes);
 - ❖ Financial statements for the most recent 24 months prepared in accordance with GAAP that are...
 - a. Offering size is \$100,000 or less – certified by the principal executive officer of the issuer to be true and complete in all material respects, and the most recent years tax return (if any, as it is recognized that startups won’t have any yet);
 - b. Offering size is more than \$100,000 but not more than \$500,000 – reviewed by a CPA who is independent of the issuer (with such review notes accompanying the financial statements);
 - c. Offering size is more than \$500,000 – audited financial statements.
- and include:
- a. Balance sheet
 - b. P&L
 - c. Cash flows
 - d. Changes to owners’ equity, and,
 - e. a “narrative” discussion by management of its financial condition

**Strategy**

To reduce accounting burden a company can run concurrent 506(c) and 4(a)(6) offerings, with the crowdfunding raise capped at either \$100,000 or \$500,000 (*and no oversubscription allowed, as that would trigger the requirement at the new level of funding*), and use 506(c) to raise the rest.

- ❖ Ability to view the offering memorandum can NOT be limited in any way and must be publicly accessible (not even requiring portal registration is allowed);

- ❖ File Form C with the SEC (no state filings required) at various points via XML:
 - i. **Form C (initial).** Prior to offering initiation
 - ii. **Form C-A.** Mid-offering changes that are “material”
 - iii. **Form C-U.** Updates are required five days after any of the following milestones:
 - a. commitments for 50% of the deal are received;
 - b. commitments for the full deal are received;
 - c. subscriptions in excess of the initial offering amount will be accepted; or,
 - d. the offering closes.
 - iv. **Form C-AR.** Once an issuer completes a crowdfunded offering, it becomes subject to limited ongoing filing requirements. Annually, within 120 days of the end of the issuer’s fiscal year, the issuer must prepare and file an annual report on Form C-AR. The annual report should update information included in the Form C.
 - v. **Form C-TR.** The annual Form C-AR reporting obligation continues indefinitely unless one of the following events occurs:
 - a. the issuer becomes an SEC reporting company;
 - b. all securities sold in crowdfunded offerings are redeemed or repurchased by a third party; or,
 - c. the issuer liquidates or dissolves.

This would carry forward to any mergers or acquisitions for so long as the 4(a)(6) investors remain on the cap schedule of any surviving entity.
- ❖ Prove the company’s ability to manage their cap schedule (investors) and maintain compliance with investor communication rules;
- ❖ Brokers may not invest in nor receive any securities in the company as compensation;
- ❖ Advertisements of the offering are limited to “notices” and must direct interested parties to the full offering on the portal;
- ❖ Portals must conduct an educational program to investors to ensure they are aware of and accept the risks of investing in the securities of private companies (including answering specific questions);
- ❖ May ONLY be conducted on a funding portal (no self-service offerings allowed and no offline offerings allowed);
- ❖ Must be online and open for a minimum of 21 days, even if it reaches the funding goal earlier, after which it can close ahead of the stated date provided at least 5 business days’ notice is given to investors;
- ❖ Investors and issuers can rescind an investment commitment at any time until the sale of securities;
- ❖ Issuer must have a website;
- ❖ Must provide public updates periodically during the offering;
- ❖ Offering must have a deadline, may not be for an indefinite period of time;
- ❖ Investor updates and reports must be done via email and through the web, including postings to the company website or social media sites;
- ❖ Syndication (multiple BDs and/or RPs helping sell the securities) is allowed, but using multiple portals to conduct simultaneous 4(a)(6) offerings is not allowed;
- ❖ Disclose (specific requirement) offerings conducted within the past 3 years – including a date of the offering, the securities exemption relied upon, the type of securities offered, the amount of securities sold, and the use of proceeds;

- ❖ Discuss how (if an equity offering) the company/securities were valued. This does NOT require a formal or expensive valuation process (nor does it prohibit one), and can simply be “as negotiated with investors such was agreeable to the market” or something similar;
- ❖ Can pay people to promote the company and the offering, but if such persons promote on the portal’s platform directly then such persons must disclose, in every instance of such promotion, that they are associated with the issuer;
- ❖ Officers, directors and related persons CAN purchase securities in the offering;
- ❖ Cannot arbitrarily remove comments or ratings posted by users that it disagrees with or doesn’t like;
- ❖ Material changes to offering put investors into a pending state, which they must reconfirm within 5 business days or their participation will be cancelled and refunded from escrow;
- ❖ Investors may not resell or transfer their securities for the first year of ownership except to accredited investors, to family members, as part of an estate or trust, or as part of an offering that is registered with the SEC;
- ❖ Excluded from using 4(a)(6) are foreign companies, reporting entities subject to the Act of ’34, and companies operating pursuant to the Investment Company Act of ’40 (unlike 506, which permits venture capital funds, hedge funds, PE firms, etc.);
- ❖ Investors in securities originally issued under 4(a)(6) are not ever counted towards the shareholder thresholds of Section 12 of the Act of ’34 (which could otherwise force a company to go public and be subject to not just the reporting requirements, but also the requirements of Sarbane’s Oxley, Dodd-Frank, et al).



Safe Harbor: Future resales, gifts, or other secondary distributions of ownership do not affect this exemption.



FAQ: We hear the terms “Concurrent” and “Integrated” used by many people in the securities world. What’s the difference?

- ➡ **“Concurrent”** – the ability to conduct a 4(a)(6) offering and another offering via a different exemption at the same time. They do not have to be similar (though they can be, and likely should be in order to avoid problems with an offering to unaccredited investors). The only issue the SEC has here is that steps be taken to ensure that an offering conducted via an exemption that does not allow for general solicitation (e.g. 506(b)) is not, in effect, marketed, even if indirectly, by a 4(a)(6) or other offering which allows for public solicitation.
- ➡ **“Integrated”** – a regulatory term meaning that the offerings, though being conducted under different exemptions, “must be treated as one offering”; thus a \$100K 4(a)(6) and a \$750K 506b/c would be viewed as an \$850K 4(a)(6) since the 2 offerings, if viewed by the SEC as “integrated” would be treated as one offering and not two. This was something we definitely did NOT want the rules to require and worked hard to avoid. Thankfully the proposed rules state that 4(a)(6) offerings are not considered integrated with other offerings, even if conducted concurrently.

Resource: *(law firm summary)*

[Standing Out From The Crowd: A Closer Look at FINRA’s and SEC’s Proposed Crowdfunding Rules](#) (.pdf on the web)

**FAQ: What is the “securities sold date”?**

➡ This is one of THE most misunderstood concepts in the securities industry.

First, understand the difference between a “commitment” and an “indication of interest”...

The term “commitment” is very different than an “indication of interest” but it is NOT the “securities sold date” – in a commitment the investor has signed the subscription agreement and, in all likelihood, sent funds to escrow. They are more than “interested”, they are “committed” even though they do NOT yet own the securities.

This is further clarified on *page 165 of the proposed Title III rules* where it states that a commitment is not the same thing as a sale of securities: “(2) this information be made publicly available on the intermediary’s platform for a minimum of 21 days before any securities are sold in the offering, during which time the intermediary may accept investment commitments;”

So what, then, is the “securities sold date”?

The SEC defines “the date of first sale (of securities) is the date on which the first investor is irrevocably contractually committed to invest, which, depending on the terms and conditions of the contract could be (but not necessarily is) the date on which the Issuer receives the investor’s subscription agreement or check.” *(parenthesis and bolding added)*

see also: [Instructions for Submitting Notice](http://www.sec.gov) (on the web: www.sec.gov)

Thus, an investor signing a subscription agreement and sending funds to escrow is committing to the offering. But it can be rescinded at any time by either the investor or the issuer, up until either as defined in the subscription agreement in a 506(c) offering, or 48 hours prior to close in a 4(a)(6) offering, at which time it become irrevocable, is deemed to be a sale of securities, and thus starts the 15 day clock for filing a Form D/Form C.





The passage of the JOBS Act and the legalization of debt and equity crowdfunding is an exciting, disruptive and investor equalizing force that opens capital markets for companies of all sizes. The community is opening its arms and wallets to give your business the funds you need to thrive and grow, and investors a chance to profit accordingly. To be in compliance with regulations and best practices, and to give your campaign the best chance of success there is quite a bit of preparation to do before launching on a portal.

Crafting a “deal” takes a combination of art and science. There are numerous disclosures that must be made in order for investors (and brokers) to have enough information pursuant to regulatory guidelines and best practices, and a multitude of ways to craft the campaign to attract investors and gain momentum. **Yet for most business owners the offering memorandum can be as intimidating as it is necessary... which is why they need professional advisers trained in securities-crowdfunding.**

- The “**what**” is straightforward, for which we use the FundAmerica standard.
- The “**how**” is the tricky part, as you need to balance the required elements with the presentation so as to be attractive to investors, partners, media and others.

Preparing to Raise Funds in a Regulated World...

I. Getting Ready – The Deal

What securities should a business (“issuer”) offer investors? Debt? Equity? What terms? The answer, of course, is whatever is best suited for the business while at the same time acceptable to investors. This can be a tricky balance even for the most experienced brokers, venture capitalists, and professional advisers. Every business is unique, and management should rely solely on the advice of their professional, licensed advisers in determining which securities, and what specific rights thereof, should be sold. With that said (*disclaimed*), there are some specific things we suggest you consider and discuss with your team:

When considering the type of deal structure for a crowdfunding campaign, our opinion is:

EQUITY VS. DEBT

Equity is rarely the right choice for a small business... *Why is that?*

EQUITY: When a business gives equity in exchange for investment...



- Balance sheet is not weighed down with debt obligations
- May be easier to obtain bank loans, factoring or lease financing in the future
- No need to worry about fixed promised returns or maturity dates





- Determining and supporting a valuation is difficult
- Minority shareholder rights may prove impossible to handle
- Corporate governance issues are complicated, especially when the corporate charter or membership agreement needs to be changed
- Tax issues – some states require all (equity) members to sign a tax return committing to file personal returns in that state, which could prove practically impossible
- Tax issues – filing K-1's for investors
- Tax issues – may cause significant issues with employee stock options and any stock grants or warrants
- Equity owners may incur corporate liability and become involved in litigation, forcing them to prove “passive” nature in court which may be difficult if they are partners, employees or even active evangelists online
- Banks may require all members of a company to sign bank account or loan documents, something which may be impossible in a private company with a large number of shareholders/members
- Is an uncertain exit strategy and time horizon for investors
- Equity owners are forever part of the company

DEBT: Is almost always the right choice for a small business.



- Can be paid off (“retired”) and be done with
- Provides better investor protection from litigation
- Provides better investor protection regarding exit strategy
- Provides better investor protection with a claim on assets superior to equity holders
- May eliminate problems with valuation and stock-related tax issues
- Allows management greater control over company direction and governance



- Balance sheet overhang may hinder ability to borrow (*may not be an issue if debt is subordinated*)
- Does not in itself give investors the right to participate in equity upside (*may be fixed by issuing convertible debt*)
- Tax issues – filing 1099-I's for investors
- Tax issues – when interest is payable at maturity, investors still have to pay tax annually on the accrued interest. **Benefit:** *the company gets an expense deduction.*



FAQ: Debt?

➡ This is contrary to general wisdom where people often say “debt kills.” And they are right... if and when it's too much debt or depending upon the terms. But you probably already tried to get a bank loan (and were turned down), which means you are open to debt and thus it is a moot issue. The trick now is to figure out what's right for the business and for potential investors.

example structure:

So what's an example of a crowdfunding offering securities-type? It depends upon the type of business. In our opinion (*again, always rely solely on advice of your professional advisers*)...

“Enterprise Value” – is an equity building business. This is a company that is of a type that might reasonably be able to go public or be purchased for a large amount (as seen from similar industry competitors) if it is successful. Investors are swinging for the fences with this one and this is typically THE highest risk.

Deal Type: Subordinated Convertible Debt

Deal Terms:

- ✓ 7 year maturity
- ✓ 25% interest (*rationale is that you are telling people they will get at least a 25% annualized return on their investment*)
- ✓ Principal & interest accrue until maturity
- ✓ Preference over all equity, subordinated to other debt
- ✓ Converts to equity in certain events

Conversion:

- a. in an equity funding event (including an IPO) of \$5M or more, all accrued debt converts to the same class of equity as the new investor(s) at a 25% discount to the price being paid.
- b. in a sale, merger or liquidation event involving 50% or more of the company's assets, value or equity then the accrued value of the note is converted into equity at a price equal to 75% of any equity previously sold to any insider or professional investor closest to the time when the debt was originally sold, with the notes so converted forming a preference (meaning that the debt investors receive their accrued value back as first-money-out, and then participate with all other equity holders in the remaining amount according to their ownership percentages).

Summary: This gives investors the best upside opportunity, along with some protection for their investment, while at the same time minimizing the problems for the management team.

“Cash Flow” – is a business that is focused on revenue and profits, but is unlikely to have a large “multiple” shareholder liquidity event. **THIS IS 99% OF ALL BUSINESSES!**

Deal Type: Debt with Revenue Participation

Deal Terms:

- ✓ 3 or 4 year term
- ✓ 8% interest
- ✓ Principal & interest amortized and paid monthly or quarterly
- ✓ Preference over all equity and most debt
- ✓ Revenue kicker;
 - a. 5% revenue participation for 3 years starting after the debt is fully retired (this is the real upside for investors, and helps keep initial borrowing costs low), *or*,
 - b. 75% of the increase in value of assets (e.g. a real estate deal).

Conversion: There is no conversion, and the investors exit strategy is straightforward

Summary: Investors have the protection of their debt security, understand their exit strategy, and are betting that the company will use the funding to grow the business in order to both repay the debt AND provide upside via revenue participation. The company gives up no equity and eventually has the investors off its books.

Debt works for a doctor's office, a restaurant, a real estate project, an oil & gas venture, a film project, etc. Businesses in just about every industry and niche may be able to build thriving, profitable companies that are creating jobs and doing good things for their customers, suppliers, partners, employees and investors... but aren't likely to go public or get bought for a big number. These can still be a solid investment – maybe not a high-tech style “home run”, but a nice risk weighted return nevertheless. Risk is still high, as is the case for all small businesses.

And what about “perks”?

Investors love non-financial perks (*e.g. product samples, t-shirts, Twitter shouts, factory/site tours, etc.*) as part of what they get as part of their investment! If you provide some engaging perks note that there is always the chance that they may trigger tax issues, check with your accountant.

example perks for a martial arts dojo

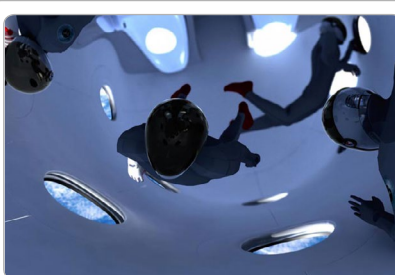


Gen Kai Karate Studio

Gen Kai Karate Studio will serve the greater Cleveland community, teaching self defense & building self esteem in students.

- \$25 Friend of the Studio**
All investment benefits plus special mention in our student newsletter.
- \$100 Benefactor**
All of the above, plus a "Just Chop It!" Gen Kai t-shirt.
- \$250 Founder**
All of the above, plus your name inscribed on the *Founders Wall*.
- \$2500 Buddha**
All of the above, plus a donation of 4 group sessions in your name to the Hopkins Children's Shelter.
- \$5000 Honorary Black Belt**
Everything above, plus all black belt titles shall be in your name (e.g. the Marshall Black Belt).

example perks for gamers



Cyberdine Virtua Gaming

We're building a state-of-the-art virtual game space. The "pod" will allow gamers from all over the world to interact with each other via the hub. This is the next generation of gaming, and we're building it now!

- \$50 Fan**
Badass Cyberdine Virtua Gaming logo stickers (set of 4).
- \$200 Sim**
News from the Future monthly updates, and the Badass Cyberdine Virtua Gaming logo stickers (set of 4).
- \$500 Player**
DIY specs for the demo Virtua Glove (non-functional but stylish) prototype, CVG *News from the Future* monthly updates, and the Badass Cyberdine Virtua Gaming logo stickers (set of 4), plus you're added to the Grand Prize Giveaway.
- \$5000 Futurist**
The demo glove, a CVG logo hoodie, *News from the Future*...

example perks for a bakery



Golden Brown: A Bake Shop

Using molecular gastronomy, Golden Brown Bakeries has developed a revolutionary new cake pop, and sales are thru the roof... we need to expand!

- \$25 Honey**
Our thanks takes the form of three loaves of our amazing fresh-baked bread (any kind!), and a cake pop to see you to your car.
- \$100 Sugar**
Reap the rewards of giving with three loaves of fresh-baked bread, one coffee cake, and a baker's dozen (13) cake pops.
- \$250 Cookie**
Five loaves of fresh bread, one coffee cake, a baker's dozen (13) cake pops and a specialty 9" cake.
- \$1000 Master Baker**
Everybody wants a piece of the pie! You get EVERYTHING above, plus...



FAQ: 506(c) or 4(a)(6)?

- ➡ It's the issuers option, though highly likely that they will want to conduct “concurrent” 506(c) and 4(a)(6) offerings in order to reach out to both institutional and unaccredited investors.

II. Getting Ready – Marketing

Lack of preparation here is the number one reason why many crowdfunding campaigns fail. You need to take the time to get ready, before you launch your crowdfunding campaign, and give yourself the best chance of success at getting funded.



First Impressions:

Remember that your online deal listing is the way of introducing your business to the crowd...and first impressions count! If it's not complete or accurate and doesn't make a good impression you will not only lose possible fans, followers, customers and evangelists, but your chances of getting investors to step up and fund you will dramatically decrease. Ensuring you present your company and your offer in a way that is engaging and easy to understand will go a long way in helping you achieve your funding goals.

Business Description:

Honestly, and as succinctly as possible, describe your business (whether in a business plan, VRT or Lean Business Model) so that investors can grasp what you do, your value proposition, your revenue model and your team.

Pitch Video:

Has been proven, time and again, to be THE most effective way to emotionally engage people who view your deal. Talk about your business, your team, your products and services, and what you plan to do with the funding. Don't hype up the investment or make claims you can't factually support or promises you can't keep.

Social & Professional Network:

Is your network ready? Historical data from rewards-based crowdfunding has shown in order for your project to be a success you must raise at least 30% from your own network, and that takes time and preparation. To be successful, it is critical that your online and offline networks are ready to go. Get your own contacts ready, as well as those of your employees, your customers, your vendors, your business partners, and everyone else with a vested interest in the success of your company.

Marketing Plan:

How do you plan on marketing your offering to investors? How will you gain the quick early adopters you need to overcome inertia and build momentum? Are you planning on emailing your customers? Engaging brokers? Buying Google AdWords? Running a Super Bowl commercial? Whatever it is, make sure it is ready to go as soon as the portal pushes your offer live on the platform! See [Section CF404](#) for ideas and examples.

III. Getting Ready – Accounting

Creating a set of financials that comply with regulations is a lot of work. Are your historical records accurate? Are they easy to understand? Are your projections reasonable or are you being too optimistic and running the risk of losing potential investors, who may view them as unrealistic? Have you included all potential revenue and expense components in your model to be sure you can afford the costs associated with the investment? How will you be using the funds? Creating financial state-



ments that do not misrepresent your overall potential is a delicate balance of knowledge, experience and keen understanding of your operations. Get it wrong and there can be repercussions, so have your accountant roll up his sleeves and help you get this done.

Special Requirements for 4(a)(6) Offerings

Offerings conducted using 4(a)(6) crowdfunding exemptions have specific requirements which are **NOT** required in 506(c) offerings. The requirement is that the offering disclosures must include 24 months (most recent) of financial statements prepared in accordance with GAAP that are...

- a. Offering size is \$100,000 or less – certified by the principal executive officer of the issuer to be true and complete in all material respects, AND the most recent year's tax return (if any);
- b. Offering size is more than \$100,000 but not more than \$500,000 – reviewed by a CPA who is independent of the issuer (with such review notes accompanying the financial statements);
- c. Offering size is more than \$500,000 – audited financial statements.

IV. Getting Ready – Legal

Get Incorporated

In order to raise funds on a portal your business must be incorporated in a way that gives you the ability to issue the securities you are promising. Sadly some companies will waste time and money doing this incorrectly and then having to reincorporate, delaying their ability to raise capital.

Do Some Housekeeping

Ensure your corporate records are all in order (minutes of shareholder meetings, business licenses, permits, trademarks, etc). The portal may need them as part of their due diligence.

Have an Attorney Review your Risk Disclosures and Investor Subscription Agreement

The “Risk Disclosures” and “Investor Subscription Agreement” are boilerplate from the platform and **MUST BE EDITED FOR THE ISSUER AND THE SPECIFIC OFFERING!** The subscription agreement is the contract between the investor and the company, and the risk disclosures (combined with the elements of the offering memorandum) are to cover the business as much as possible in the event of unforeseen, or even reasonably anticipated, problems. It is **STRONGLY** recommended that the company have an attorney edit these documents.

Create your Capitalization Schedule

This is your list of equity issued, including options and warrants, organized by type of securities (e.g. common, preferred A, preferred B, etc). The cap schedule can be in summary form, listing the types of securities and only specifically disclosing the names of inside executive shareholders (officers and directors) and those people or entities with 20% or more “beneficial ownership”. All other shareholders can be grouped as “Other” on the cap schedule and not listed by name. And yes, this is part of the offering memorandum and therefore public.

Be Ready for Background Checks

Will all the officers, directors and 20%+ beneficial owners on your cap schedule pass background checks related to securities fraud, securities disciplinary issues, and Patriot Act checks? This isn’t a detailed invasion of privacy, just a check to make sure there aren’t any “bad actors” or AML issues as required by regulators.



FAQ: Are the results of the background checks publicly displayed?

- ➡ No. This information isn’t displayed publicly and is only displayed to and used by brokers for the required background checks and in their due diligence on the offering. You must list all officers and directors of the company, as well as all people or entities who directly or indirectly own or have rights to 20% or more of the equity (calculated as of the current time, not post-offering).

Creating The Offering Memorandum

This is where the disclosures are made, where the marketing strategy starts, and where people access the subscription agreement to invest in your company. Key elements here are the company image and short description, which form the “cover” for the deal on both the portal and for all sites that pull data from it, and of course the optional-but-highly-recommended video. This, from a marketing perspective, is the most important part of the process and has to tell the story, engage people emotionally as well as logically, and work well for SEO (search engine optimization).

It is a blend of required disclosures, best practices and marketing elements. Some elements are for public display (e.g. incorporation type, year founded, etc.) and some are not public but for use by the portal in its due diligence (e.g. company tax ID). Many optional entries allow the issuer to “raise their flag” in order improve SEO and attract investors who share their passion or mission, be it minority, cultural, religious, or labor. And because the JOBS Act was enacted on the premise of creating job growth, the offering memo asks how many jobs will be created and/or saved if the offering is successful.



Key Tool: Permissions Management

This is where the issuer can authorize their lawyer, accountant, CFO, broker and others to help craft the offering memorandum. **NOTE** that this gives those users complete control over the offering, and visibility into every aspect (including investor vesting), so the issuer may want to consider removing permissions once someone has completed their part of the process.

Here is what the online template looks like on the FundAmerica platform (and on all private-label licensees). It may appear daunting, and even intimidating, at first look, but it’s really not. It simply helps issuers and their advisers step through the disclosures and marketing options in order to get their offering organized and online as quickly as possible.

“...the legalization of debt and equity based crowdfunding is a very exciting proposition. The community is opening its arms and wallets to give your business the funds you need to thrive and grow...”

Offering Memorandum Template: **About Your Business** *(click any sample screen to view the entire memorandum online)*



Create a Deal.

status: deal is being drafted

This is your online Offering Memorandum and Due Diligence Questionnaire



[FAQ: Offering Memorandum](#)

About Your Business	General Info	Required Docs	Deal Details	Legal Docs	Disclosures	Background Checks
---------------------	--------------	---------------	--------------	------------	-------------	-------------------

1. About Your Business

your deal graphic
dimensions: 500x500 pixels

Business Name

Website

Offering Memorandum Template: **General Information**

About Your Business	General Info	Required Docs	Deal Details	Legal Docs	Disclosures	Background Checks
---------------------	--------------	---------------	--------------	------------	-------------	-------------------

2. General Information

Type of Business ☐ not incorporated* [?](#) ☐ LLC ☐ S-CORP ☐ C-CORP ☐ LLP

Organized in United States

Year Founded

Company Tax ID

Offering Memorandum Template: **Required Documents**

About Your Business	General Info	Required Docs	Deal Details	Legal Docs	Disclosures	Background Checks
---------------------	--------------	---------------	--------------	------------	-------------	-------------------

3. Required Documents



VRT or Business Plan or Lean Business Model and Financial Projections/Forecast [upload](#)

Tax Returns [upload](#)

☐ we are a new business and haven't filed tax returns yet (allowed)

Company Financial Statements (most recent 24 months) [\(read requirements\)](#) [upload](#)

(click any sample screen to view the entire memorandum online)

Offering Memorandum Template: Deal Details

About Your Business	General Info	Required Docs	Deal Details	Legal Docs	Disclosures	Background Checks
---------------------	--------------	---------------	---------------------	------------	-------------	-------------------

4. Deal Details

Amount of Investment Sought

\$.00

Allow Over-Subscription

☐ no ☐ yes % of deal total

e.g. 20% oversubscription on a \$100,000 deal would allow for up to \$20,000 additional funding on the same terms and rights.

Offering Memorandum Template: Legal Documentation

About Your Business	General Info	Required Docs	Deal Details	Legal Docs	Disclosures	Background Checks
---------------------	--------------	---------------	--------------	-------------------	-------------	-------------------

5. Legal Documentation

Risk Disclosures

(note: this is your legal disclosure to investors. This boilerplate should be reviewed and edited by your attorney.)

Source

B **I** **U** **S** **x₂** **x²**

Format Font Size A A

Offering Memorandum Template: Disclosures

About Your Business	General Info	Required Docs	Deal Details	Legal Docs	Disclosures	Background Checks
---------------------	--------------	---------------	--------------	------------	--------------------	-------------------

6. Disclosures

Revenue Last Month

\$.00

Revenue Last 12 Months

\$.00

Profits/Losses Last Month

\$.00

Profits/Losses Last 12 Months

\$.00

Offering Memorandum Template: Background Checks

About Your Business	General Info	Required Docs	Deal Details	Legal Docs	Disclosures	Background Checks
---------------------	--------------	---------------	--------------	------------	-------------	--------------------------

7. Patriot Act and SEC Background Checks

(you must list every director, every officer and every shareholder who owns or has rights to 20% or more)

Background Check

Origin

☐ US Individual ☐ US Entity ☐ Foreign Individual ☐ Foreign Entity

Executive (real name)

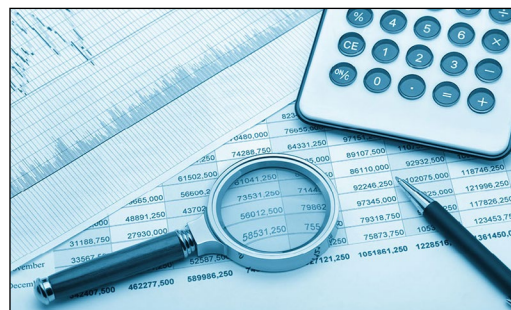
Chief Executive's Name (if an entity)

FundAmerica Profile (optional)

[\(click any sample screen to view the entire memorandum online\)](#)

Why so much disclosure?

The devil is in the details. You need to have a solid, well researched, clear and detailed plan of what you're doing and where you're going with your business. No one will invest in an effort lacking transparency. Investors want to know where their money is going, how it will be used, and when they will get it back. The rules require that your business description, financial statements and other disclosure items be forthright, organized and easily available to prospective investors and the crowd in general. And if a company representative "makes an untrue statement of a material fact or omits to disclose a material fact," they will be held liable.



The disclosures combine rules with best practices to help ensure that investors have enough detail about the company to make a "reasonable and informed" investment decision, so the portal and syndicate brokers have enough information to perform due diligence, and so the issuer can protect itself in the event things don't work out as planned. Some of this is uncomfortable for issuers, such as discussion of compensation or financials, but the consequences of not adequately disclosing these things to investors far outweighs the discomfort of the disclosure.



FAQ: Is an "offering memorandum" the same thing as a "private placement memorandum (aka PPM)"??

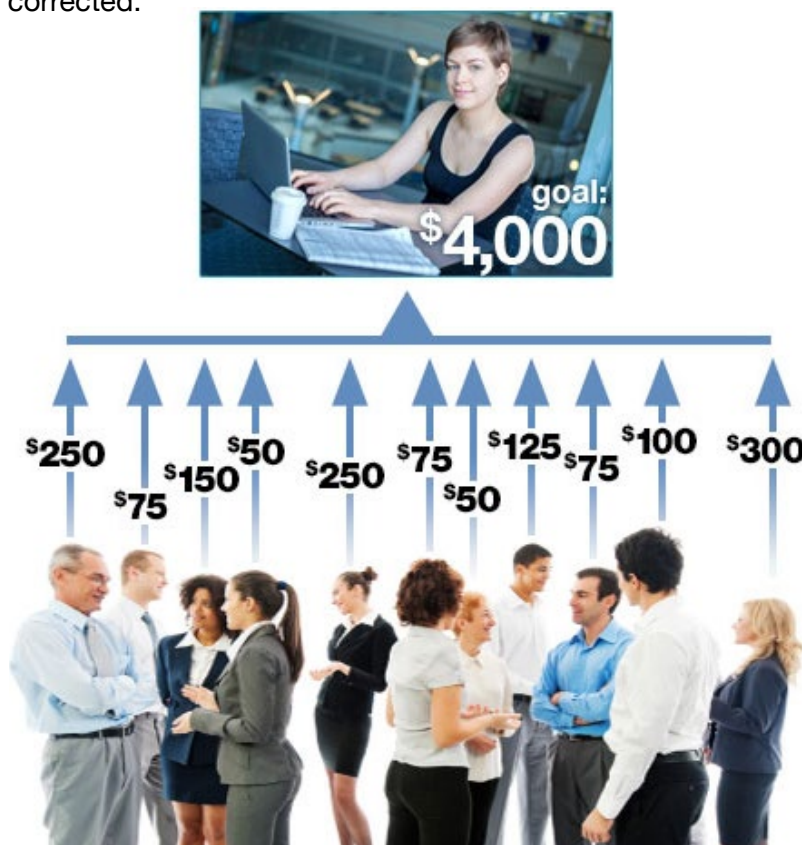
- ➡ Not quite. FINRA has historically held that a PPM is a paper document which must be numbered, and each person receiving a PPM, such person evidencing a preexisting relationship with the issuer, shall be recorded in a ledger detailing what number PPM was provided to what known person. An offering memorandum contains more disclosures and information than an old-style PPM, and as it is accessible via the internet and used in conjunction with a 506(c) or 4(a)(6) offering it does not need to be printed on paper or numbered with a ledger to record who it was distributed to or proof of a preexisting relationship. With the easy accessibility and wide distribution an offering memorandum affords exponentially greater investor protection since more eyes (people) viewing a deal are far more likely to uncover irregularities, or even fraud, than an old-style limited PPM distribution model.

Prepare: Don't Let Your Crowdfunding Campaign Fail Before You Even Launch!

Ready to raise capital? Let's summarize...

- ✓ **The Rules** – are you up to speed on the various 506(c) and 4(a)(6) rules?
- ✓ **The Deal** – is it well written and something that will interest investors?
- ✓ **The Exit Strategy** – does it provide clarity on how investors can reasonably expect to get their money back?
- ✓ **The Company Description** – this is the “Dating Profile”, think “Match.com for companies and investors”, and how to make the business as attractive as possible so it can get that first date (company description, video, photo album, niches, etc.)
- ✓ **The Perks** – are there some nice extras that the company is offering investors?
- ✓ **Disclosures** – do they accurately, honestly, and forthrightly present everything that is both required and is reasonably needed for investors to make an informed decision?
- ✓ **Risk Disclosures & Subscription Agreement** – has an attorney reviewed and edited these so they are appropriate both for investors in this deal AND to cover the company in the event things don't work out as planned?
- ✓ **Marketing Plan** – is everything queued up so when your campaign goes live you are ready to rock and quickly overcome inertia and have a successful offering?
- ✓ **Offering Memorandum** – is it completed, ready for due diligence and something investors will love?

Ready? Then click “Post!” and the offering will go into the portal's due diligence queue. Once that's done it will either be pushed live so the company can begin fundraising, or returned to draft-mode with comments about what needs to be corrected.



400 Series: Raising Capital

Going Live

CF401

Okay, it's ready to rock! Well, not quite...

The broker is now required to perform due diligence that's appropriate for the deal and the amount of money being raised. If everything checks out then the deal is pushed live onto the platform and is available for promotion and investment — **do NOT publicly solicit investors until this is done!**

How does escrow work?

At this time the funding portal will establish an escrow account pursuant to SEC Rule 15c2-4. As people subscribe to the offering their money will be placed into a unique escrow account for the deal. Note that this is NOT the issuers' money. Once securities are sold then the escrow agent will promptly send funds. Until then the funds are not the issuers and no lien, encumbrance or promise can be placed on them.

What's "subscribe"?

Investors are not buying securities until the securities are considered "sold". So ahead of that they are confirming their interest by "subscribing" to the offering and sending funds to be held in escrow. Since the securities are not sold (or owned) yet, any subscription can be cancelled at any time up until the securities sold date (see page 43); either by the investor or the issuer.

FundAmerica Create a Deal Browse Deals How It Works Find Your Deal sign up

Deal Name	Description	Location	Deal Type	Amount Raised	Time Left	Avg. Rating
FanMail Virtual	FanMail builds and maintains custom email services for brand name entities looking to resell to their fans and customers.	Hollywood, CA	Preferred Equity, Debt	\$100,000 raised of \$755,000	45 days left	★★★★☆ (234)
The Xtreme Games	GameMaster develops action video games in support of its partners.	Denver, CO	Deal, Warrants	\$530,000 raised of \$755,000	18 days left	★★★★★ (846)
Gen Kai Karate Studio	Gen Kai Karate Studio will serve the Cleveland community, teaching self defense & building self esteem in students.	Cleveland, OH	Warrants, Debt	\$10,000 raised of \$30,000	2 days left	★★★★★ (2649)
Brighter Tomorrow Energy	Brighter Tomorrow Energy is creating a pilot program to get their customers completely off the power grid.	Dallas, TX	Preferred Equity, Warrants	\$400,000 raised of \$400,000	0 days left	★★★★★ (11762)
Ut Tempus Ligula	Purus a lacus ut tempus ligula. Libero sollicitudin ante consectetur vestibulum integer vitae dui justo praesent maec.					
Vehicula Ultrices	Urna a fames purus sed natoque erat, vehicula ultrices nec, velit vehicula, fringilla condimentum faucibus in eros.					
Vestibulum Integer	Libero sollicitudin ante consecter vestibulum integer, ullamcorper donec nunc, vivamus vel elit cond orbi, dui venis.					
Libera Ligula Duis	Turpis nam ullamcorper, libero ligula dui, scelerisque aliquam eu orci, bibendum sit pul morbi sed cur.					

*NOTE: All graphics above are fictional and do not represent actual offerings.

Steps to Success – here are the pre, during and post activities for crowdfunding...

1. Get Ready, then post an attractive offer that investors will love

(along with all the required disclosures, of course)

Preparation is key in order to have a quick launch and drive towards success, as we just covered in section [CF302](#).

2. Build an army of evangelists who are passionate about the success of your campaign (and your business)

It's social. Get people emotionally engaged, both offline and online. Excite them with more than just the deal and disclosures, get them to buy into your mission, your products and services, and your team. They will help spread the work – an energized crowd can make amazing things happen.

3. Stay engaged and upbeat

Nothing takes the air out of a campaign faster than someone the crowd perceives as detached or nonchalant. It's your business and they expect you to care...passionately. Show that to them!

4. Don't get discouraged by funding plateaus

It happens, even with a quick launch. The daily investor counts may have been going up steadily, but suddenly there's a lull. This is common, so keep you chin up and continue the marketing strategies. Reach out to investors who may be on the fence and get them to commit. Reach out to your crowd of evangelists with some new tidbits about the company and implore them to help bring in the money. Chances are things will pick up again shortly.

5. Don't let comments posted by a few negative people keep you up at night

Some comments are constructive criticism, while others are idiotic. Regardless, don't personalize either. And don't engage in debate with irrational users, avoid people looking to create drama (remember that it takes two to argue) as you'll just feed their behavior and make a mess of your deals comment board. Be positive, respond to critiques with information and – if warranted – make changes to your offering. Keep in the front of your mind that people are taking the time to read and comment, so they are likely interested and just waiting for a reason to become a passionate evangelist and/or an investor in your company! The portal will likely give you the ability to report abusive postings and even block certain users.

6. Remember to keep running your business

The fundraising campaign is important, and so is the health and vitality of your business. So put in the extra hours to make sure your company continues to do what it does. And communicate often with the key employees who are pulling extra duty while you're out raising money, they need it.

7. Try different marketing techniques for your campaign

Your marketing plan may have been great, and may get the job done completely. Even so, try other things such as different social networks, blogs or comment posts on different websites catering to your industry, or special promotions for customers. You might just accelerate your fundraising, and no matter what will likely gain new customers, business partners and brand evangelists.

8. Keep investors and evangelists informed with frequent updates about both the offering AND the business

Write status updates on the portal deal posting...frequently. Talk about how the deal is coming along, give shout-outs to key people, and celebrate recent wins for your business which are unrelated to the



deal (but very important for investors and potential investors). Also consider periodic video updates to make it really personal.

9. Close the deal and get your funding!

Success! Fantastic, work with the portal to close the offering and get your money released from escrow.

10. Thank **EVERYONE** who helped with your successful campaign, not just the investors

Naturally you want to send all the investors a nice thank you...and welcome...email. Remember also to reach out to those who didn't invest but nevertheless were instrumental in enthusiastically getting the word out.

11. Stay organized with Investor Relationship Management (IRM) software

If you have more than, say, five investors you'll find it almost impossible to manage them with Excel, Outlook and iContact. Not only is the vesting information hard to keep track of that way, but so are ownership changes, redemptions, annual reporting requirements, and periodic email communications. You don't need an expensive registered transfer agent, but you do need an IRM solution like CapSchedule.com to manage things.

12. Keep communication flowing to your investors, and to those who helped you raise the funds

Sure, you have an annual obligation to send financials. Keep in mind that these people trusted you with their money and they want to see you succeed. So send frequent updates, not just those required annually, to keep them informed of new things at the company and to maintain their enthusiasm. You might need them again someday, and in fact you can probably use them even now in helping promote your brand – *it's your "crowd", leverage it!*



There are a million ways to do something wrong, so how can you tell when it's right? Securities-crowdfunding is too new to have a lot of precedents for us to work with (*it will be great to update this section of the textbook in the near future*). So we will instead look to rewards-crowdfunding for examples of what works...and what doesn't.

Success: If you look at the “[Most Funded](#)” campaigns on [Kickstarter](#), you will see a number of common elements. Let's walk through a successful deal and see how it came together...

The Micro ([click here to see the entire campaign](#)):

KICKSTARTER Discover Start Search projects

The Micro: The First Truly Consumer 3D Printer
by M3D LLC

Home Updates **3** Backers **8,325** Comments **1,148** Bethesda, MD Technology

Updates are key for backers to see that you care

Wow, amazing user engagement

Informative, fun (not boring) video

8,325 backers
\$2,361,097
pledged of \$50,000 goal
25 days to go

Back This Project
\$1 minimum pledge

This project will be funded on Wed, May 7 2014 5:45 AM PDT.

Share 28,950 Tweet Embed Remind me

The first truly consumer 3D printer should be incredibly intuitive, easy to own, and seamless by design.

...And That's Why We Made The Micro

It is the most affordable 3D printer that can be used right out of the box. Perfect for beginners and experts alike, just plug in the printer, download or create models, hit print, and watch your custom creations form right before your eyes.

The Micro is Designed For Everyone

Bring your ideas to life, turn them into businesses, educate, learn, personalize products.

Clearly this is a company

They are part of the community

Linked to social media to aid in marketing

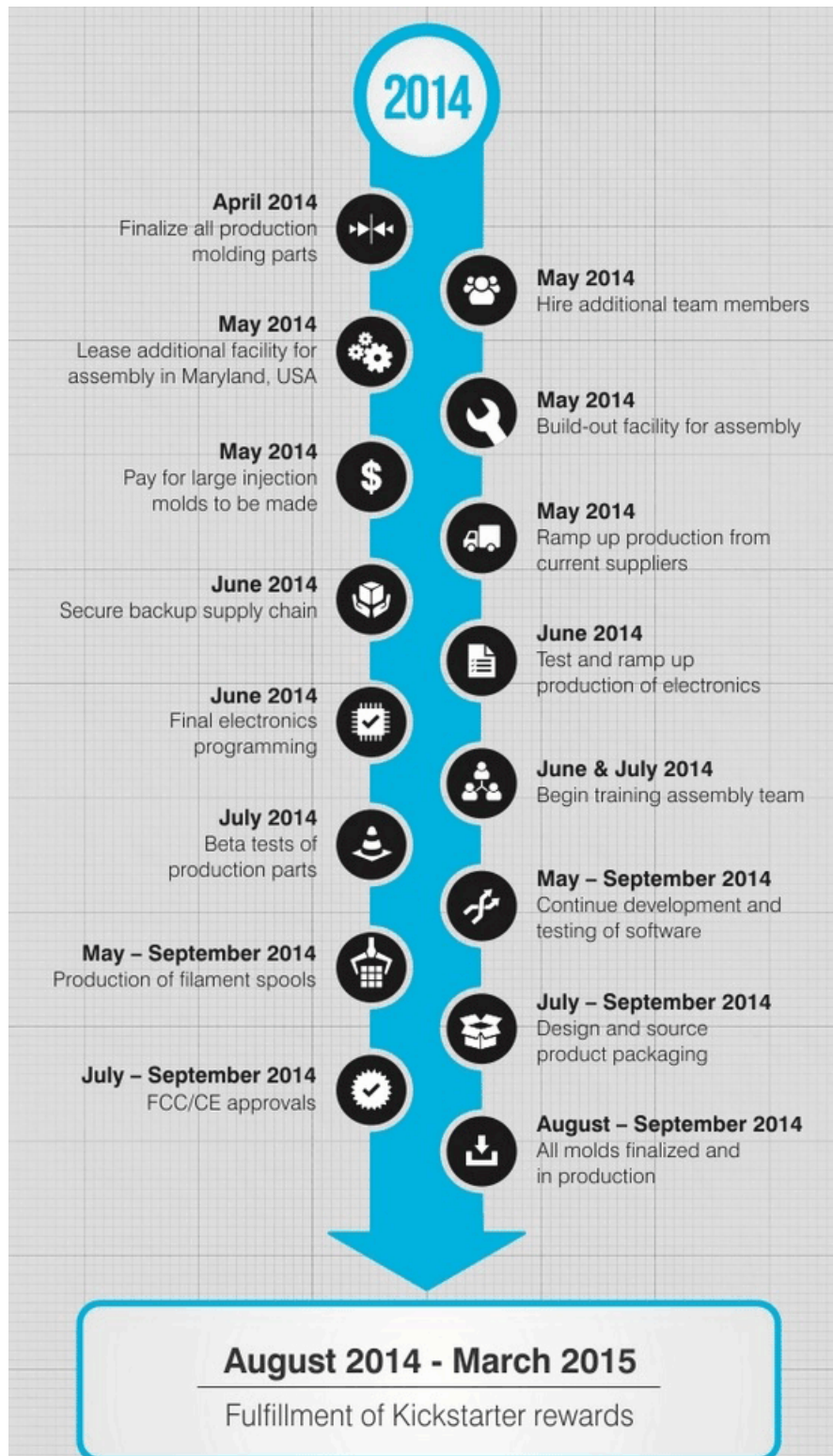
Good ".com" business web address

Great value proposition, easy for users to grasp and embrace

The company was active and engaged with the Kickstarter community. They previously backed other campaigns to establish themselves as part of the fabric of the group. And in posting their campaign they created a great video, wrote a strong and succinct value proposition, had a LOT of information and graphics in their “description” section, linked the project to Facebook, and presented themselves as what they are – a company looking for capital. Their company website was also tied into the campaign and linked back to the Kickstarter project, thus reinforcing credibility, helping marketing and aiding SEO.

Company Goals

A business plan is always good to have, but Micro took things a step further and created a graphic that they included in their company description. This gave prospective backers a quick and easy visual on how they planned to build the business and what their targets were.




Perks (Rewards)

On a rewards-based platform, backers cannot receive equity or debt for the funds they give a business. They can only get perks. On a securities-based platform backers (investors) can get equity or debt AND perks.

If perks are included in the deal, make sure they are interesting to the targeted investors. On the Micro campaign they included a number of rewards at different levels, some of which weren't picked up at all and some of which completely sold out, all of which combined to greatly, and quickly, exceed their funding goals.

Pledge \$25 or more

 **147 backers**
Limited (103 left of 250)

Enthusiasts: Support the idea of ultra-affordable 3D Printing! You will receive an M3D t-Shirt showing the five colors of The Micro and a mural of enthusiast backers' names. Shipping not included.

Estimated delivery: Jul 2014

Pledge \$199 or more

 **250 backers All gone!**

Super Early Bird Adopter: For those who get in quick and want the best deal! Get The Micro 3D Printer at a very limited special price and help kick off our launch. Also get a special "early adopter" badge with your order. Includes 1 filament spool. Shipping not included.

Estimated delivery: Jul 2014

Pledge \$249 or more

 **500 backers All gone!**

Early Bird Adopter: Get The Micro 3D Printer at a very limited special price and help kick off our launch! Comes with 1 filament spool. Shipping not included.

Estimated delivery: Feb 2015

Pledge \$299 or more

 **2500 backers All gone!**

Get The Micro! A Micro 3D Printer from the first full batch of production! Comes with 1 filament spool. Shipping not incl.

Estimated delivery: Jan 2015

Pledge \$299 or more

 **2500 backers All gone!**

Get The Micro! A Micro 3D Printer from the first full batch of production! Comes with 1 filament spool. Shipping not incl.

Estimated delivery: Dec 2014

Pledge \$299 or more

 **2500 backers All gone!**

Get The Micro! A Micro 3D Printer from the first full batch of production! Comes with 1 filament spool. Shipping not incl.

Estimated delivery: Nov 2014


Pledge \$299 or more

 **1168 backers**
Limited (1332 left of 2500)

Get The Micro! A Micro 3D Printer from a full batch of production in February (after early backers). Comes with 1 filament spool. Shipping not included.

Estimated delivery: Feb 2015

Pledge \$599 or more

 **143 backers**
Limited (357 left of 500)

Very Early Beta Adopter! You get the Micro 3D Printer from the second pre-production batch. Reward includes 3 filament spools, your name laser engraved on the printer, you will be included on our exclusive Beta feedback panel, we'll listen to your input, and send you exclusive updates. Shipping not included.

Estimated delivery: Oct 2015

Pledge \$899 or more

 **34 backers**
Limited (66 left of 100)

Superstar Backers! You not only get the earliest Micro 3D Printer from the first pre-production batch but also 5 filament spools, your name engraved on the printer and you will be included on our exclusive Beta feedback panel. We'll listen to your input, and send you exclusive updates! Shipping not incl.

Estimated delivery: Aug 2014

Pledge \$2000 or more

 **3 backers**
Limited (97 left of 100)

Signed Special! You will not only get The Micro, 5 filament rolls, but we'll also include a print of the original sketch design, signed by the team. Shipping not incl.

Estimated delivery: Aug 2014

Pledge \$5000 or more

 **1 backer**
Limited (4 left of 5)

Branded Special! We know you love our printer, but so does your office. We will make sure your printer is branded especially for your desk by allowing you to pick completely custom colors. Comes with 5 filament rolls. Shipping not included.

Estimated delivery: Aug 2014

Pledge \$10,000 or more


 **0 backers**
Limited (2 left of 2)

Big Spender! You will get one of our printers (laser signed by the team!) with 5 filament rolls, but also meet the team and have a tour of our offices to see where The Micro began. All this and a wonderful meal at our favourite restaurant. Flights are not included, but a great conversation is!

Estimated delivery: Aug 2014

Comments & Management Involvement


People commenting on a deal are music to a crowdfunding's ears. ***They are engaged!*** The team at Micro did a great job at responding to comments, both individually and in general. As you can see it wasn't just the main profile who took the time to engage with prospective backers, it was a true team effort.



Daniel Baxendale about 1 hour ago
@Oliver


The problem is if you want to change the spool between print jobs, this is going to be a pretty common use case. You might want to print one thing in white ABS and then another in clear PLA. It's not like a regular printer where you only refill it when the ink runs out. If you change the material (spool) you're going to have to weigh the spool and re-enter the weight every time. The software could be set up to store profiles for each spool and you could give your spools labels that correspond to the software profiles. But if you forget to switch profiles when you switch spools it's going to mess everything up and you'd have to start your book keeping all over. The end result is it's still the user that's doing most of the book keeping rather than the software. It's just messy. Better to just use the simpler solution of spot checking your spool before beginning a print. You should be able to eyeball that you have enough left when the spool is half full or above and below that you can just measure.

Either way you do it though user error is still going to be a big factor, it's not something the software can properly compensate for without a cartridge system. And I'd rather have the mild inconvenience of having to keep an eye on the filament levels than have to pay a premium for proprietary cartridges.




Oliver Pfeiffer about 1 hour ago

Why not letting the user simply weigh the spool (filament including the roll) and let him enter the total weight within the printer software. Certainly this has to be done each time the user is replacing the spool, but it just took 5 seconds to weight the spool and enter the total weight within the printer software. Afterwards the software can maintain an consumption display showing (approximately) whether the current model can be printed with the remaining filament or not. Since M3D knows the exact weight of their naked rolls, it should be possible to give a rough estimation for the current model.




Daniel Baxendale about 1 hour ago
@Roland

Only if you get them in 1.75mm diameter. M3D have said it will work with 1.75mm PLA or ABS filaments.




Karsten Topp about 2 hours ago

read: non cubic voxels, my bad




Karsten Topp about 2 hours ago

Obviously, a finer nozzle will only have benefits if the x/y/z resolution is fine enough to make use of it. Otherwise you will have different x/y/z resolutions and non-square voxels have been a royal PITA for some software...



Roland about 2 hours ago


Would these filaments work with the Micro?
<http://www.faberdashery.co.uk/products-page/>
Also +1 for a smaller nozzle for more detailed table-top miniatures.





Reggie Fourmyle about 2 hours ago


Could we see more detailed images of the printed objects up close? Also, more videos of the printer printing would be really nice to see. It's a very exciting printer, and I'm trying to suggest it to friends, but a lot of people are very skeptical about it


Team members are jumping on to help respond to comments (*hence the personal profile here, vs. the company profile on the next page.*)


M3D LLC about 6 hours ago
 **@Daniel Walthall** Thanks for the suggestion! Send it over to us by email.


M3D LLC about 6 hours ago
 **@Andre Prager** The images are sufficiently high rez to see a lot of detail, but we'll be providing others in the futures. Thanks for your feedback. Our production units will have phenomenal repeatability using Micro Motion Technology, I assure you.


M3D LLC about 6 hours ago
 **@Dylan Taylor** Thanks for your support and kind words!


M3D LLC about 6 hours ago
 **@Frederick Tremblay Fassler** Thanks for the feedback!

M3D LLC about 6 hours ago
 **@Asterix** Small nozzles will improve resolution for tiny figurines and such.
@Bee The Z-axis is very accurate and our technology can be used to account for any z-axis errors. These are optimizations we will be working on in fact! Smaller nozzles allows you to put smaller features closer together. Many printers come standard with nozzles the same size as ours and the resolution you can achieve is fantastic for the vast majority of applications. If you want to print tiny things with small features close to each other (much less than the nozzle diameter), the tiny nozzle will help. I like the suggestion on the guide. When using very small nozzles, it's best to use the highest quality material you can buy to ensure it behaves the way it should. Our filaments are made in the USA for this reason. Smaller nozzles will take longer to print, but if you're printing tiny things it won't matter so much.

M3D LLC about 6 hours ago
 **@Maxim Kalenkov @Anders Oster @Karsten Topp @Vasvari Tibor**
 Thanks for the feedback! Working on the small nozzle details now.

M3D LLC about 6 hours ago
 **@Michael O'Donnell** Thanks for the feedback. We agree. We originally thought to optimize it this way and was difficult to nail down exact details and laws that apply, but we will do whatever it takes to optimize shipping costs for our international backers. It is very important to us that our international backers are happy. With our additional staff, we'll be able to focus more attention on this optimization and have just brought someone on to work out the details.

M3D LLC about 6 hours ago
 **@Peter VandenBempt** Thanks for the feedback! Yes, we'll definitely make smaller nozzles available as an add-on. We are working on getting it sourced and will provide an update with details once we have them.

M3D LLC about 6 hours ago
 **@Mark Van Vegge!** There are no plastic parts on the micro that can break through usage. They are so strong, you couldn't break them if you tried! Believe me... we've tried. ;) We once considered including an image of us standing on the printer. You can always tinker with the printer to turn it into something else, like a

Taking the time to respond to individual users, as designated by the "@" sign and the screen name or the person who commented.

This may be a cluster of responses, but it's important that the company took the time to do so after an especially busy night of postings.

This is how to comment and thank several users at the same time.

Company Updates

Micro did a fantastic job of posting enthusiastic-yet-humble updates for their backers. No self-aggrandizing here, as you can see in the 2nd paragraph where they wrote *“You’ve shown the world that we are ready...”* and *“we want you to know that you are our first priority...”*. They even included images in their updates. This particular update was so well received by users that they took the time to “like” it 129 times and thus helped promote it further on Facebook. Do the same and watch what happens.

Update #2

Apr 8 2014

You Backed Us - One Million in 25 Hours!!

16 comments 129 likes

So much has happened since we launched the campaign yesterday. It's hard to believe that only 30 hours have gone by. Yesterday was the most fast-paced campaign any of us could have ever imagined. A team of 6 of us were each behind a computer from 8 AM EST and worked 14 hours straight to address the flurry of positive questions, comments, and inquiries, before leaving for the night to recoup.

Thanks to your support, The Micro has received so much attention. You've shown the world that we are ready for a new consumer product category. Although we get a lot of inquiries about The Micro from outside of the campaign, we want you to know that you are our first priority and we'll be giving you our full attention. We're going to continue to respond to your comments, private messages, and social media posts in the order we received them, and we'll be caught up very soon.

We also want you to know that we are committed to maintaining delivery schedules. We always planned to eventually go into high-volume production. The additional pledges help us meet our production goals. In addition, assembling in the U.S. guarantees quality and control of operations.

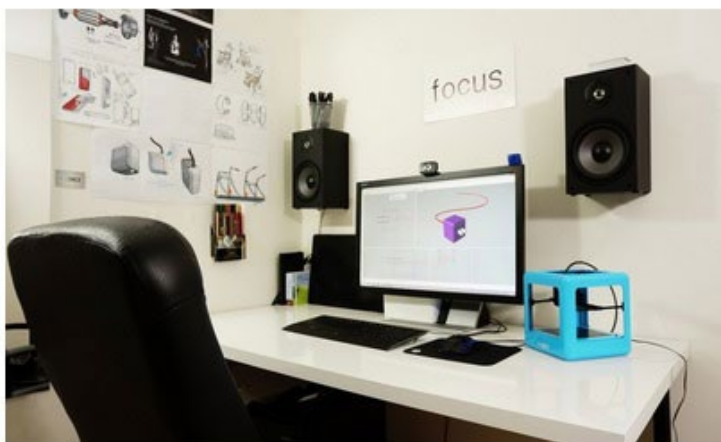
One of the best ways for us to ensure that we deliver on time is by staying with the design we presented to you. We're thrilled to get started and we have many more exciting updates for you in the coming days.

Thanks again from The M3D Team.

The crowd is helping market the deal!

Update is positive and deferential to the backers

No ego trips here, it's about the team



Result – They got what they put in... the community was enthusiastic and funded them with \$1 million in just 25 hours!

Fail: We've seen what happens when someone does it right. Of course, you can do everything right and still not reach your funding goals... but you need to at least do as much as you can to give your business the best shot at raising the capital you need. What's it look like when it wasn't done right at the outset?

Holistic Hounds (click here to see the entire campaign)

The image shows a crowdfunding page for 'Holistic Hounds | Natural Products for Pets' by Michele Cervantez. The page has a green header with the title and author. Below the header, there are navigation links: Home, Updates (0), Backers (2), and Comments (0). The main content area features a large image of a dog's head in a circular frame with the text 'Holistic Hounds Simple. Natural. Healthy.' and a background of a green field and blue sky. To the right of the image, it says '2 backers', '\$35.00 pledged of \$2,500 goal', and '0 seconds to go'. Below the image, there are social media sharing options (Facebook, Twitter, Embed) and a section titled 'About Holistic Hounds...' with a personal story. On the right side, there is a section for the project creator, Michele Cervantez, with a photo, name, location, and a 'Contact me' link. Below this, it says 'First created: 0 backed', 'Has not connected Facebook', and 'holistichounds.net'. At the bottom right, there is a section for 'Pledge \$10 or more' with '0 backers' and a description of the reward: 'A heart felt thank you and a picture of your dog on your website under the "Our Friends" page (currently under development)'. The estimated delivery date is 'Apr 2014'.

Annotations on the page:

- Zero updates? Wow. (points to Updates 0)
- No user engagement (points to Comments 0)
- No video = no emotional engagement (points to the main image)
- Is this a business or a person? Confusing to users (points to the project creator's name)
- Not at all part of the community (points to the project creator's photo)
- Amazing (points to the project creator's photo)
- Not horrible, but not really a business domain (points to holistichounds.net)
- A personal story is NOT a value proposition (points to the 'About Holistic Hounds...' section)

Result – If the business owner didn't take the time to be part of the community and even do some basic things, then the crowd will perceive you as detached and disinterested, or at the very least disorganized and uncommitted, and will treat you just as you are treating them.

Crowdfunding has a high failure rate for those who have the perception “if you post it they will come”.

The truth is that the issuer must help drive traffic to their offering, especially at the beginning. The changes in 80 year old securities laws means businesses can now use the full arsenal of marketing tools to let people know about their need for capital.

The better the planning (and execution) the less stress and the less sleepless nights, when instead of counting sheep the issuer is counting all of their Facebook friends, Twitter followers, LinkedIn connections, em-

ployees, customers, business partners and friends who haven't contributed yet. Companies are strongly encouraged to plan their campaign well in advance, with ideas, relationships and marketing material ready before they hit the 'launch' button. When well run, Crowdfunding campaigns can seem effortless, almost magical to those watching from afar, but the reality is that it takes a lot of time and hard work to become an overnight success.



Rules & Best Practices on Promoting Your Offering:

506(c)-D offerings can be advertised however you want, so long as such promotion is not in itself an offer to sell securities (*which should be done via the offering memorandum and subscription agreement*).

4(a)(6) offerings are slightly more limited than their 506(c) brethren. The main thing is that marketing be limited to “notices” which must direct investors to the full offering memorandum on the portal. Specifically the rules allow notices that advertise the offering:

1. a statement that the issuer is conducting an offering, the name of the intermediary (portal) through which the offering is being conducted and a link directing the potential investor to the intermediary's platform;
2. the terms of the offering; and,
3. factual information about the legal identity and business of the issuer, limited to the name of the issuer of the security, the address, phone number, and website of the issuer, the e-mail address of a representative of the issuer, and a brief description of the business of the issuer.



Safe Harbor: *The proposed rules do not restrict an issuer's ability to communicate other information that does not refer to the offering, such as their regular business marketing activities.*

Marketing Strategies

You want the broadest reach you can get, accessing as many potential investors as you can in order to get your deal sold and funded. This includes...

Social Media – posting on your Twitter, Facebook, blog and other sites to engage friends and followers.

Tips:

- ❖ increase the number of Facebook friends, Twitter followers and LinkedIn connections.
- ❖ start teasing with notices and postings about your company to get the network ready for when you call out for capital
- ❖ keep Tweets short, awesome punches that people cannot resist clicking on and re-tweeting.
- ❖ on Facebook you can write longer messages, but don't go more than one or two sentences (you have plenty of copy for them to read on your offering page).
- ❖ never underestimate the power of a good picture on Facebook.
- ❖ ask for help with referrals, people may not be able to invest themselves but if they are excited about your company or mission then get them to evangelize for you, e.g. "Help me spread the word: LINK HERE" "Know anyone who might like this investment? LINK HERE", Who can help me find the next backer? LINK HERE"
- ❖ use tools like Hootsuite or TweetDeck to schedule tweets ahead of time.

Website – display something on your company website.

Email – leverage your lists of customers, business partners and other people who have opted-in (no spamming).

PR – write a press release and engage professionals to help get media coverage of your offering.

Advertising – perhaps an advertisement makes sense, either general (e.g. a Google AdWords buy) or specific (e.g. an ad in an industry publication).

Angel Networks – reach out to local and national angel organizations.

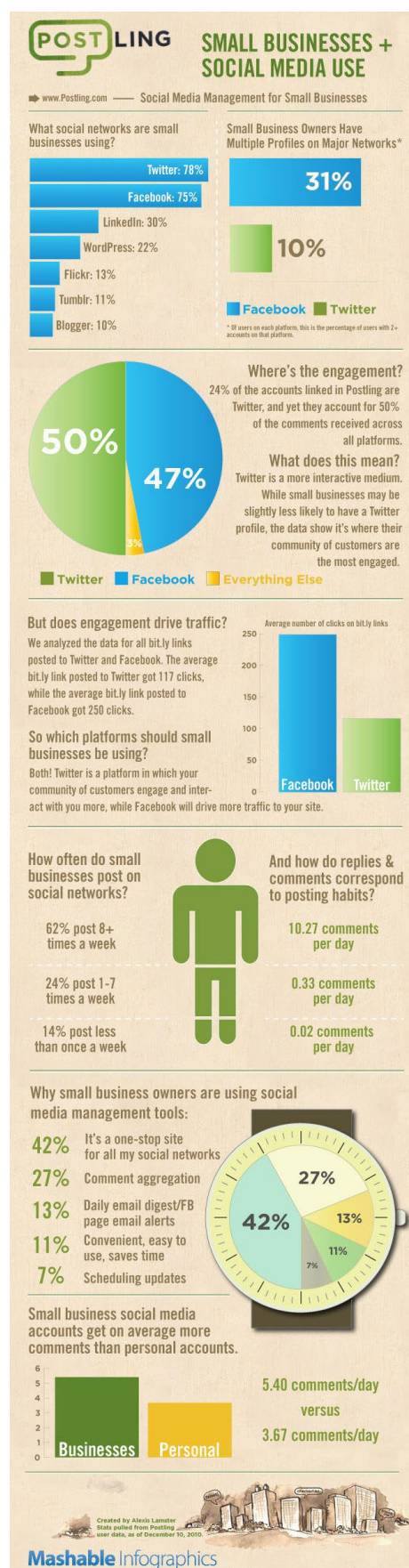
Investor Conferences – such as FundingPost or StartupWeekend.

Employees – their jobs just might depend upon the business getting funded, so have them help spread the word.

Signage – if you have a brick & mortar business, then place a sign for customers to see and ask questions.

Promoters – anyone employed by or professionally associated with you, whether for compensation or not, must disclose their relationship with you as a "promoter" in conjunction with any and all postings they make on the portal regarding your offering. But they do not have to disclose this when making postings off the portal (e.g. sending a Tweet, writing a blog, sending an email, etc.).

Brokers – they earn their living by helping businesses like yours get funded.



Importance of Social Capital:

Why do you need to use social media, have a large email list, make connections with angel groups, involve your employees and customers, and establish relationships with brokers in order for your offering to succeed? Because if a tree falls in the woods and no one is there to hear it...you get the picture. And statistics show that 80% of all rewards-based crowdfunding dollars come from one degree of separation. So you can have the most perfectly written description and video, the most amazing offer and exit strategy, and best business plan ever written, but if you don't have a way to get noticed then it won't matter. You won't raise the money you need. So make building social capital a significant part of your marketing strategy for your fundraiser.

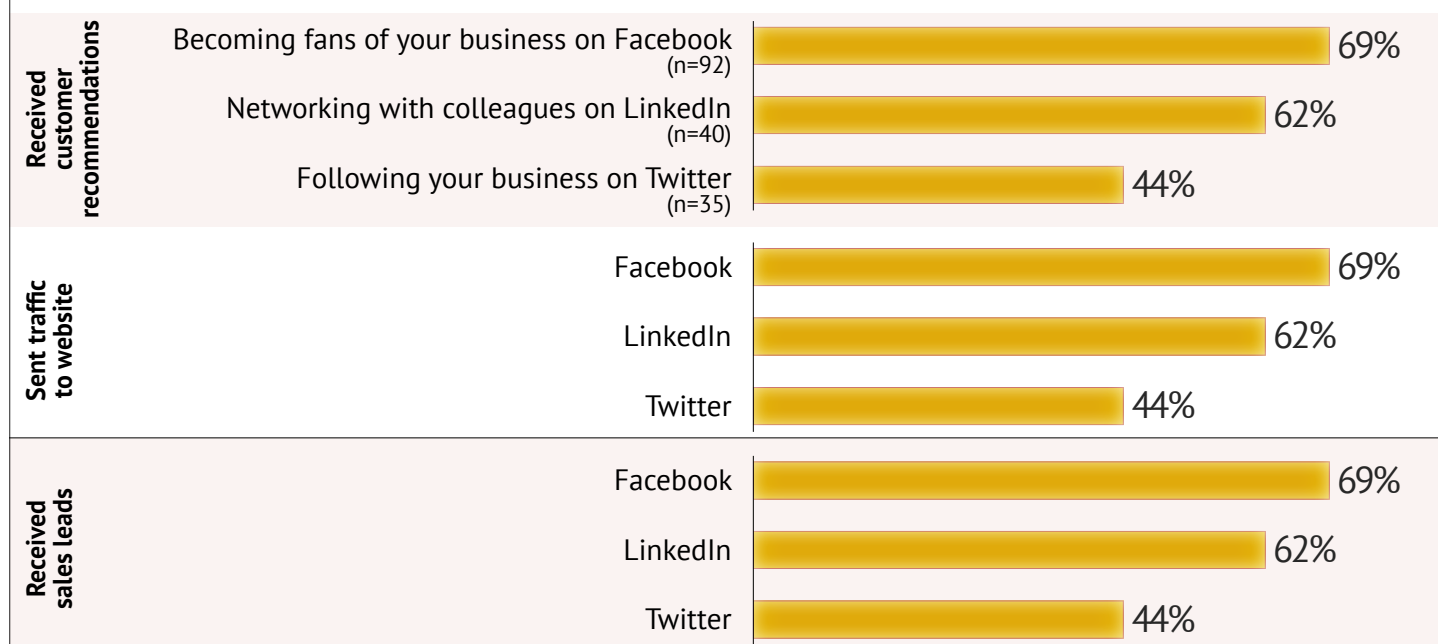
The key to effective social media is hooking people quickly with something interesting, and then following through and delivering.

Before you launch you need to have your armies of supporters primed and ready to create immediate momentum... and investment. Appreciate the people who help you by sharing the love and thanking them online and in person (as practical). Encourage people to participate in any way they feel comfortable. Remind them (and yourself) that there are many ways to contribute. Spreading the word can be just as powerful and important as contributing money.

The most successful crowdfunders use social media every day, or engage the help of those who do. Some expertise is needed to know what is and isn't appropriate to say in online forums, and what protocols are expected are critical to success in building a "crowd". It takes a lot of work to build...and keep...followers, friends and connections who may become investors, customers, brand evangelists and/or business partners.

Activities Achieved through Social Media Sites

– Among business owners who use/may use social media –



source: Network Solutions, University of Maryland Smith School of Business

SEO

Search Engine Optimization (“SEO”) is ensuring that your website and everything you do online, from Tweets to blogs to press releases, is done in a way that’s optimal for Google (and Bing) to find you, to include you in their database, and to properly AND PROMINENTLY list you in search results both directly (people searching for you) and indirectly (people searching for things related to you, such as industry information or about products or services). This has become a specialized skill and you will likely need someone to assist you to ensure your business is found by people as they search for various things, including both your offering and your business in general.



Social Credibility

What happens when someone Googles you? If results come up for your offering or website then your SEO is great. But “social credibility” is more than that. People are more likely to be comfortable using your services... and investing in you...if other people have talked about you. This includes mentions on blogs, in magazine articles, on Wikipedia, on LinkedIn, and on ratings sites like Yelp. So take steps to get your company and/or your name out there where people can validate (and trust) you thanks to third-party mentions.

Initial Investors & Celebrities

A reality that restaurateurs’ know all too well is that their dining rooms will often remain empty until they aren’t empty. People tend to go where people already are. Thus, getting that first person in the door (overcoming inertia) is always the toughest part of the day. Once people are there, then the more likely it is that other people will come. And if you have a celebrity in the mix, then even more people will be comfortable that it’s a credible and acceptable place to be. This is why many businesses post images (and even issue press releases) of celebrities visiting their establishments or being seen with their products. So work hard to get those first customers (oops, “investors”) in the door. And if you can get a “celebrity” to join in (meaning not just media personalities, but anyone that the crowd finds credible and may follow, which could include leading business leaders, politicians, professional investors, prominent members of religious or minority communities, etc.) then you are that much more likely to accelerate towards your funding goal.

Status Updates & Communication:

Give your crowd a consistent stream of engaging information. Talk about your progress, remind them that you’re still working hard and need their help, talk about any changes in your business, etc. And be prompt in answering questions from prospective investors about your business, your management teams’ ability to execute on what you’re proposing, and anything else they ask. Show that you care and respect them enough to keep them in the loop and be responsive. This not only keeps your backers happy but might encourage them to get their friends to back you too.



FAQ: Do I really need help from others with social media and to market my offering?

- You have a 70% greater chance of raising the money if you have 4 or more people working with you on your campaign.

Summary:

The bottom line is that you are going to have to cast a very wide net to raise capital. Most people, especially in the current economy, are going to think long and hard before they invest their money in your business and you're going to need a lot of people to crowd together to get your company funded. And remember that you are in a competition with thousands of other campaigns who are also trying to raise money, so you have to have every element of your campaign dialed in, including the title, description, video, offer and exit strategy. You're going to need to count on your initial social network to spread the word and invest the first portion of the total funds needed. Some statistics from rewards-based and international crowdfunding portals show*;

A. **Tipping Point:** Upon reaching 30% in funding, campaigns have nearly a 90% rate of success.

B. **Momentum:** *With immediate (within 7 days of launch) commitments...*



* Securities-based crowdfunding is too new to generate any statistics, so it is not known if or how these numbers from rewards-based crowdfunding apply to 4(a)(6) or 506(c) offerings.

NOTE: An issuer must continuously review and update their offering memorandum to ensure it is accurate and not misleading about the company, its business model, its prospects, its financials, its customers, its partners, the members of its team, etc. In addition, any marketing claims (e.g. "the company is an industry leader") should be supportable with reliable third-party data.

What you absolutely, positively can never say:



- ✗ Guarantees of future performance of the company or the securities;
- ✗ "Puffing up" of claims that cannot be substantiated (e.g. "this is the best in the world!");
- ✗ Suggesting that the investment is good or suited for any particular individual (unless you are an appropriately licensed securities broker or RIA); and,
- ✗ That anything is "approved" by the SEC (it may be "reviewed", but they do not approve anything, ever.)

Timing & Probability of Success?

There is no set answer on this, and per securities laws nobody is allowed to make guaranties or promises in this regard (it is a “best efforts” underwriting, not “firm commitment”).

A number of factors contribute to the success of a fundraising...

- ✓ Quality of marketing materials (*description, logos, graphics, video, etc.*)
- ✓ Deal terms (*equity, debt, interest rate, revenue participation, etc.*)
- ✓ Exit strategy for investors (*how realistic and believable is it*)
- ✓ Industry and/or niche (*if something investors are passionate about*)
- ✓ Deal marketing (*media coverage, social media reach, evangelists, etc.*)
- ✓ Lead investors (*celebrity endorsement, venture-capital commitment, etc.*)
- ✓ Traction (*in general, an offering doesn't start gaining momentum until at least 30% is committed*)
- ✓ Momentum (*how much is committed right out of the gate*)
- ✓ Product/service (*how interesting it is to investors and do they understand who your customers are*)
- ✓ Company momentum (*ongoing businesses obviously have things going for them that startups don't*)



Extra Credit: To use a broker or not? *Broker Alternatives...*

4(a)(6) Offerings – There are no alternatives. These offerings must be conducted using a portal operated by an SEC registered, FINRA member firm (*either a broker-dealer portal or a registered non-broker portal*).

506(c) Offerings – These offerings can be done directly (*self-service*), without having to be on a professionally operated portal. However, there are serious risks that have to be considered when circumventing the traditional broker role.

Brokers:

- ✓ Help creating the offering (*deal type, sales strategy, etc.*)
- ✓ Help with compliance (*filing forms, performing due diligence*)
- ✓ Enhance investor protection (*confirming diligence, enabling crowd vetting*)
- ✓ Enhance issuer protection (*investor KYC, verifying accreditation, sending confirmations*)
- ✓ Are motivated to get the deal sold (*forming syndicates, compensating sales reps*)



Now that it's live, how do the issuer and their authorized persons manage it?

Status Updates:

Write frequent updates on the company and the offering. All are emailed to investors and seen by everyone looking at the deal.

Investors:

All investors, along with vesting info, appear on the investor's tab. Note the status of each showing...



Confirmed – the investor signed the subscription agreement and their funds have been received by escrow.



Awaiting Funds – the investor signed the subscription agreement but funds have not yet been received.



Pending – the investor signed the subscription agreement prior to material changes being made to the offering, which reverted their status to a pending state, and they have yet to reconfirm their participation (and will be refunded from escrow if not reconfirmed within 5 business days from the time of such material change).



Invested – the securities have been sold and the investor's commitment is irrevocable.



Cancelled – the investor's commitment was cancelled and they were refunded from escrow.



Rescinding an investor:

There are numerous reasons you may want to deny someone from investing in your company. They may be the only investor from a particular state, and you want to avoid the costs of filing a Form D just for them. They may have a reputation that you feel would be detrimental to your company or brand. They may be annoying you with constant phone calls. Or whatever else. Until the securities sold date you can rescind the participation of any investor you want, for any reason. This is not a democracy, this is your company, and you don't have to accept anyone you don't want. Likewise, investors can rescind their participation any time they want until securities sold date ([see page 43](#)), so be sure to communicate with them and keep them happy.



Escrow Balances:

When your offering goes live the broker will establish an escrow account at an FDIC insured bank, as required by SEC rules. You can see the activity in your deal's escrow account by reviewing your online ledger.



Emailing Investors:

Use the tool provided by the portal to email your investors in bulk or by status.

Can you edit or change an offering memorandum once the deal is live?

Yes! There may be times when you need to edit your offering memorandum.

Perhaps you forgot to add some disclosures. Or maybe something significant has happened since you first started the fundraising. Or maybe a big investor has negotiated some changes to the terms (which must then be made available to all investors).

- a. Just click “edit” and make your changes
- b. Declare whether these are “material” or “minor” changes
 - **S-24 Principal review process** — all changes are subject to broker review regardless of what you say in the editing process

If “Material”:

1. All confirmed investors are changed to “pending” status. The system sends an email notification encouraging them to review the deal and reconfirm their participation.
2. Form C-U needs to be filed within 5 business days if a 4(a)(6) offering.
3. All edits are posted publicly to your offering memorandum.



Post-close

The offering memorandum is locked and may no longer be edited. Nor may it be deleted as it is now considered part of the public record.

Post-Deal: Successfully funded? Congratulations! Now...

Funding Process — Funds will be removed from escrow, broker fees deducted, other applicable fees deducted, and net proceeds remitted to the company.



FAQ: Can my professional fees be remitted to me from escrow?

- ➔ Yes! The issuer can instruct the broker or escrow agent that a certain portion of the proceeds are to be sent to you in order to pay for the services you provided (so long as those services were charged in accordance with your standard fees and not tied to the amount or success of the offering). Escrow may try to accommodate you, but is not under any obligation (or liability) to do so as you are not a direct party to the escrow agreement.

Cap Schedule — Maintain and manage your investors cap schedule, ensure you track and maintain a record of all changes (especially secondary transactions) – this is required by SEC regulations that you demonstrate the ability to do this!

- **“Book-entry”**: unless you stated otherwise, the portal will advise investors that their ownership of the securities you issue is book-entry and that they will not be receiving formal, physical certificates.
- **“Transfer Agent”**: generally small businesses act as their own transfer agent and manage any changes to investors’ ownership directly. Registered Transfer Agents are expensive and usually used only by public companies.



Tool: Historically small businesses managed their cap schedules with a combination of Excel spreadsheets and a contact management system. Obviously that becomes impossibly unwieldy for a crowdfunded company, which is why the SEC included a regulation requiring assurance of a business’ ability to maintain their Cap Schedule. *We recommend using the SaaS, cloud-based IRM (Investor Relationship Management) service www.CapSchedule.com.*



Investor Communication — Communicate with investors both immediately and regularly via email and blog updates, and send required annual reports per regulations.



Tip: It is strongly suggested that more frequent updates go out to investors...remember that they trusted you with their money, so management should show them the respect they deserve.

Regulatory Compliance — Form D's for 506(c) and Form C's for 4(a)(6) need to be filed with the SEC and any required states. It's VERY important to consider the costs, as it may make the difference between you accepting an investor from a particular state or rescinding their participation. Furthermore, although the exact requirements are still unclear, the SEC and possibly states may require businesses to file annual forms and financials. *Do NOT be lackadaisical about this!*

Resales (aka "Secondary Transactions") – Securities in 506(c) and 4(a)(6) offerings are first subject to any restrictions placed upon them by the issuer (e.g. a right of first refusal), and second they are subject to securities regulations. Generally speaking, investors can sell their interests to accredited investors at any time. Unaccredited investors are prohibited from purchasing 506(c) securities, and are generally prohibited from selling securities they bought in a 4(a)(6) offering (except to accredited investors) for the first year of ownership. It is widely assumed that a secondary market will evolve for private securities (e.g. SecondMarket.com is an early mover in this space) and perhaps even a private or an alternative trading system, depending upon further rule changes in various federal and state securities regulations (most notably Reg ATS). Of course no securities can be traded on an exchange or, if 506(c), sold to unaccredited investors unless and until such time as the securities are registered under the Securities Act of '34.

Expired or Cancelled:

We're sorry the deal wasn't successful...at least you don't have to file any more reports. And hopefully you've gotten some exposure, gained some new customers, and perhaps even met business partners as part of the process.

- Escrow will be cancelled and funds returned to investors (100% of their investment, no fees can be charged to them);
- No success fees will be charged to the company (the deal wasn't successful, so the brokers didn't earn their money);
- Miscellaneous service fees (e.g. deal hosting, escrow set-up, etc) are incurred and non-refundable;
- Fees paid to professional service providers (e.g. accountants, lawyers, marketing specialists, etc) are incurred and non-refundable.

Online Viewing:

Whether successful or not, the offering memorandum CANNOT be deleted from the system, and can no longer be edited. It stays as it is as an historical record. This is just as though a paper PPM was published and housed in a library.

Investor Relations...

They've trusted you with their money, and with that goes certain rights and expectations. These include...

- ✓ Random updates from company, may be direct or via Twitter, Facebook, LinkedIn, company blog, etc.
- ✓ Annual financials or other reports as specified by regulators
- ✓ K-1's if equity *(and if company is an LLC or S-Corp)*
- ✓ 1099-I's if debt
- ✓ All communication is generally via email, so investors **MUST** keep the company updated with any changes *(and should periodically check their spam folders)*
- ✓ The securities/investment they were promised
- ✓ The perks & rewards *(if any)* they were promised (and any applicable tax forms)
- ✓ No certificates unless "ceremonial" *(discussion of "book entry")*
- ✓ Right to communicate with the company
- ✓ Your commitment to work hard and make the company a success, not just for management but for the investors, customers, employees and everyone touched by the business.



Test!



You are now ready to take the certification exam. Passing with a score of at least 80% will confer the status as a “Crowdfunding College Certified Crowdfunding Professional”! You will be listed in the directory at www.CertifiedCrowdfundingProfessionals.com (you may opt out of being listed in the directory if you wish).

Being certified provides your customers and business partners with an increased level of confidence in your commitment to this sector of the finance industry, and to that end you are authorized to use the various CCFP logos and marks in your business. There is a nominal annual maintenance fee to stay in good standing and for ongoing updates to rules and regulations.

The certification exam is taken online, has a 3 hour time limit and consists of 125 multiple-choice questions covering the various sections of the curriculum. Thus some questions are on the JOBS Act, some on regulatory history, some on investors, lots on the rules and the offering memorandum, and some on what professionals can and can't do.

To take the test simply log on to CrowdfundingCollege.com and click the button to initiate the test. Note that all questions and answers are copyrighted and should not be shared or posted anywhere, in any way.

Appendix & Additional Resources

Offering Memo Template

<http://www.fundamericatechnologies.com/offering-memorandum-template/offering-memorandum.html>

JOBS Act

<https://s3.amazonaws.com/wac6web/docs/JOBSAct.html>

the full text of H.R. 3606 – Jumpstart Our Business Startups Act

Title II Rules

<http://www.sec.gov/rules/final/2013/33-9415.pdf>

(the full text of the Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings – .pdf on the web: www.sec.gov)

Title III Proposed Rules

<http://www.sec.gov/rules/proposed/2013/33-9470.pdf>

(the full text of the Proposed Rules – .pdf on the web: www.sec.gov)

Form D

<https://www.sec.gov/about/forms/formd.pdf>

(.pdf on the web: www.sec.gov)

Form C

(coming soon)

CFIRA Best Practices for Funding Portals

<http://www.cfira.org/?p=2167>



About the Author



Scott Purcell is a lifelong entrepreneur with extensive experience in both the securities and internet industries. In 1988 he founded a trust company that held fixed income instruments for institutional investors, which he grew to \$1 billion in assets and sold to a regional bank. Scott also started a bond-trading desk, a clearing firm for institutional investors and published a book "The Guide to Fixed Income Investing". In 1994 he founded Epoch Networks, one of the world's first ISP's, and raised over \$60 million in venture capital to build data centers and service wholesale and corporate customers. As an initial Board member of the Commercial Internet eXchange (CIX), he often represented the nascent industry before Congress and the FCC. In 1999 he founded OnAir Networks, raised over \$40 million in venture capital and built the first music storage, streaming and downloading services for Sony and Universal. During this time he was retained by the Recording Industry Association of America to advise them on internet technology issues and copyright matters, and to represent the industry before Congress. Between selling OnAir in 2001 and the birth of crowdfunding Scott kept himself busy by starting several ventures, including a search engine wholesale business, a family tree and journaling website, and a niche social network.

In 2011 Scott founded the securities based crowdfunding platform FundAmerica, which will operate pursuant to Title II and Title III of the JOBS Act. Recognizing the need for certain immediate ecosystem participants, he also founded CapSchedule.com, a software-as-a-service investor relationship management ("IRM") platform, Crowdfunding College, and Crowd Originals. He has been an active Board member of the Crowdfunding Intermediary Regulatory Association (CFIRA), a founding member of the Crowdfunding Professionals Association, and the author of the "Best Practices for Funding Portals", which sets forward best practices for operations, fraud detection and security. He is also the author of CFIRA's position on "Broker-Dealer and Registered Portal Regulatory Mechanics" and has been an active editor of numerous other industry positions. As the nascent crowdfunding industry takes shape, Scott brings considerable experience in both securities and internet technology.

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www.fundamerica.com
www.fundamericatechnologies.com
www.capschedule.com
www.crowdfundingcollege.com
www.crowdoriginals.com